Strengths and weaknesses of independent advisory fiscal institutions in the EU economic governance framework

External author:
Roel BEETSMA

Supporting EU economic governance scrutiny
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Abstract

National independent fiscal institutions (IFIs) are an important element in the EU fiscal governance landscape and can play a role in the envisaged fiscal-structural plans. To this end, minimum standards are needed. Even though an individual government may be reluctant to strengthen its IFI, it is in the collective interest to have a set of strong IFIs throughout the EU. This would need the support from the European Commission and the European Parliament, being the institutions that “internalise” fiscal policy externalities.

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LIST OF ABBREVIATIONS

AIReF Independent Authority for Fiscal Responsibility
CBR Council for Budget Responsibility
CFP Conselho das Finanças Públicas
CPB CPB Netherlands Bureau for Economic Policy Analysis
DSA Debt sustainability analysis
EC European Commission
EFB European Fiscal Board
EU European Union
GDP Gross domestic product
IFAC Irish Fiscal Advisory Council
IFI Independent advisory fiscal institution
MFAC Malta Fiscal Advisory Council
MoU Memorandum of Understanding
MS Member State
MTBF medium-term budgetary frameworks
OBR Office of Budget Responsibility
OECD Organisation for Economic Cooperation and Development
SCPs Stability and Convergence Plans
SGP Stability and Growth Pact
SIFI Scope Index of Fiscal Institutions
TSCG Treaty on Stability, Cooperation and Governance
UPB Ufficio Parlamentare di Bilancio
EXECUTIVE SUMMARY

On 9 November 2022 the European Commission presented a Communication on orientations for its long-awaited review of the economic governance framework. The Communication envisages a role for the independent advisory fiscal institutions (IFIs) in the proposed fiscal-structural plans. At the design stage, IFIs could assess the assumptions underlying the plans and their adequacy in terms of debt sustainability. The plans would take a more medium-term perspective than thus far. Ex-post IFIs could assess compliance of the budgetary outcomes with the agreed path of net primary expenditures and their assessment could serve as an input to the Commission and Council decisions. An important question is whether the IFIs would be up to this task.

Several databases give a perspective on mandates of the IFIs and what they actually do. Within the EU, they monitor compliance with numerical fiscal rules and they assess, endorse or even produce official macroeconomic forecasts. Fewer do budgetary forecasting and policy costing or long-run sustainability analysis. To be able to deliver on their mandates, IFIs would need to adhere to certain minimum requirements. This would a fortiori be the case when they receive a role in the fiscal-structural plans. Most common sticking points are limited resources that are moreover insufficiently secure, various impediments to factual independence, lack of timely access to the relevant information and weakly functioning comply-or-explain procedures in which the IFIs assessments are frequently ignored. Improvements can be made along various dimensions, such as first determining an appropriate no-policy-change scenario followed by an assessment of the macroeconomic projections under proposed policy measures, production of the official forecasts, extension of the mandate to endorsement or production of the official budgetary forecasts, expansion and concretisation of the comply-or-explain procedure, and enshrining these roles in EU and national law.

However, IFIs find themselves in a complicated position in the budgetary and economic governance landscape. It is hard to be “loved” by an institution whose work one is monitoring and potentially criticising. From an individual perspective, a government may prefer to ignore the IFI at the specific moment the IFI criticises its policies. However, societies and maybe even current governments themselves may be better off with an EU-wide system of strong EU IFIs than in the absence of such a system. The European Commission and the European Parliament take a pan-EU perspective, thereby internalising the cross-border externalities of national fiscal policies, and they may also be able to take a longer-term perspective in which the interests of future generations are internalised better than via current governments. Hence, these EU institutions have an important role in supporting a system of strong EU IFIs. IFIs do not have decision powers, nor do they have a role in allocative or distributive matters. They enhance budgetary transparency, and in this way they promote the efficient and proper deployment of collective resources, which is a goal that makes all societies at large better off. Finally, it is remarkable that precisely some highly-indebted Member States have brave and strong IFIs. All Member States concerned with fiscal policies in other countries should foster a strong IFI at home and live up to the spirit of the comply-or-explain concept, as this would implicitly bolster the position of IFIs in countries with less disciplined or otherwise less well-functioning fiscal policies.
1. INTRODUCTION

The EU fiscal governance landscape is quite complex. In the autumn of each year, governments construct the budget for the coming year, which becomes legally binding once the legislature accords it. As part of the European Semester the draft budget is submitted to the European Commission, which could in principle ask to revise it. Governments also make medium-term fiscal plans as part of the Stability and Convergence Plans (SCPs) that they submit to the Commission in the spring. Budgets are subject to the budgetary rules at the European Union (EU) level, the so-called Stability and Growth Pact (SGP), with the most important provisions being the reference value of 3% of GDP on the headline deficit and of 60% of GDP on the (gross) public debt. In addition, countries have adopted their own numerical fiscal rules, which can take on many different forms, such as budgetary balance rules, revenue rules, spending rules and debt rules. National fiscal rules can be more or less aligned with the EU fiscal rules. Finally, there is a key role for the national independent advisory fiscal institutions (IFIs) that are assigned a range of tasks, including to encourage compliance with the EU and national fiscal rules. Some of these institutions already existed before the eurozone debt crisis. However, most of them came into existence following new EU legislation, the so-called “Six-Pack” and “Two-Pack”, and the intergovernmental Fiscal Compact, in the aftermath of the crises.

The current EU governance framework suffers from three main interrelated problems: weak compliance, procyclicality and excessive complexity. Dissatisfaction with the functioning of the current rules, combined with the interlude provided by current severe economic downturn clause, has led to the recent European Commission’s (2022) Communication on orientations for a revision of the economic governance framework. The consensus is that a revision would need to focus on simplification (including fewer numerical rules), transparency and more on the medium run. However, a focus only on the SGP is not sufficient. It is very much the combination of the different elements that determines the strength of the governance framework. For example, there is an important complementarity between IFIs and national fiscal rules, as the former monitor obedience to the latter. A strong monitoring role in this regard will also strengthen the credibility of the EU rules with which the national rules tend to aligned to a substantial extent. The Commission Communication foresees a larger role for the IFIs in the revised governance framework. For example, they may be involved in the assessment of the new fiscal-structural plans and of the adherence to these plans. Therefore, an in-depth analysis of the strengths and weaknesses of the IFIs in the EU economic governance framework is warranted.

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1 This has once happened, after which negotiation between the Commission and the Member State concerned resulted in an acceptable adjustment of the budget.
2. THE CURRENT LANDSCAPE OF IFIS

2.1. Description and principles

According to the Public Governance Committee of the Organisation for Economic Cooperation and Development (OECD) (2014) “Independent fiscal institutions (commonly referred to as independent parliamentary budget offices or fiscal councils) are publicly funded, independent bodies under the statutory authority of the executive or the legislature which provide non-partisan oversight and analysis of, and in some cases advice on, fiscal policy and performance.” The OECD (2014) sets out 22 principles for IFIs under the following broad headings:

(1) *Local ownership:* local ownership is crucial for an IFI to be effective and manifests itself in commitment and consensus across the political spectrum towards the IFI. The design of the IFI would typically depend on local needs and institutional environment.

(2) *Independence and non-partisanship:* an IFI’s analysis should be done in absence of political influence and be devoid of a specific political perspective. Its leadership is selected on the basis of merit and competence and should be remunerated and preferably full-time appointed. Term length, number of terms, and criteria and a procedure for dismissal should be specified in legislation. The leadership should be completely free in hiring (through open competition) and dismissing staff.

(3) *Mandate:* should be set in higher-level legislation and clearly linked to the budget process. An IFI should be able to undertake and report analysis at its own initiative.

(4) *Resources:* must be commensurate with the mandate and be published.

(5) *Relationship with the legislature:* mechanisms should be in place ensuring sufficient accountability to the legislature. The various interactions with the latter should be clearly set in legislation. IFIs should have sufficient time to conduct analysis for parliamentary work.

(6) *Access to information:* IFIs should have complete and timely access to all relevant information, including methodologies and assumptions on which the budget is based.

(7) *Transparency:* credibility and independence are maximally served with full transparency in their work, the results of which should be made available to the public for free and published under the IFI’s own name. Release dates of publications should be formally set and coordinated with official government publications.

(8) *Communication:* effective communication channels need to be established with media and relevant stakeholders. The power of the IFI is the visibility of its high-quality analysis, as it has no formal instruments to correct fiscal policy.

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2 A bit more tangible with respect to its activities, Debrun et al. (2013) define an independent fiscal council as “a permanent agency with a statutory or executive mandate to assess publicly and independently from partisan influence government’s fiscal policies, plans and performance against macroeconomic objectives related to the long-term sustainability of public finances, short-medium-term macroeconomic stability, and other official objectives. In addition, a fiscal council can also: (i) contribute to the use of unbiased macroeconomic and budgetary forecasts in budget preparation, (ii) facilitate the implementation of fiscal policy rules, (iii) cost new policy initiatives, and (iv) identify sensible fiscal policy options, and possibly, formulate recommendations.”

3 There is no unique definition of the “effectiveness” of IFIs. Horvath (2017) constructs an indicator which encompasses the width of the mandate, financial and human resources, access to information, public awareness, government responses and the relationship with parliament. Beetsma and Debrun (2016) deploy a signal enhancing capacity index, which gauges the capacity of IFIs to inform the general public, based on the independence from politics, width of the mandate, ability to communicate to the public and ability to directly interact with actors in the budget process. Both indicators are measures based on what has been laid down on paper, rather than of what has been achieved in terms of outcomes.
(9) **External evaluation**: a mechanism for external evaluation of their work needs to be developed.

### 2.2. Legal embedment

With the exception of Poland, every EU Member State now has one or more institutions acting as an IFI. This development followed from legal initiatives at the EU or intergovernmental level, in particular the so-called “Six-Pack” of 2011, the Fiscal Compact of 2013 and the “Two-Pack” Regulation 473/2013. In addition, the amended EU Regulation 1466/97, which governs the SGP’s preventive arm, requires the SCPs to be based on the most likely (or a more prudent) macro-fiscal scenario and the macroeconomic and budgetary forecasts to be compared with the latest Commission forecasts “and, if appropriate, those of other independent bodies”. For an overview, see Jankovics and Sherwood, 2017, and Angerer and Valkama’s (2018) in-depth analysis for the European Parliament.

Part of the “Six-Pack” of 2011 is Council Directive 2011/85/EU. According to its Article 6.1 “… country-specific numerical fiscal rules shall contain specifications as to the following elements: … (b) the effective and timely monitoring of compliance with the rules, based on reliable and independent analysis carried out by independent bodies or bodies endowed with functional autonomy vis-à-vis the fiscal authorities of the Member States,” Article 6.2 deals with escape clauses and Article 9 contains provisions around the medium-term budgetary frameworks “Member States shall establish a credible, effective medium-term budgetary framework providing for the adoption of a fiscal planning horizon of at least 3 years, to ensure that national fiscal planning follows a multiannual fiscal planning perspective.” The Directive also requires Member States to ensure that fiscal planning is “based on the most likely macrofiscal scenario or on a more prudent scenario”. The medium-term perspective will likely become more important in view of the European Commission’s (2022) orientations, to be discussed later.

The inter-governmental Treaty on Stability, Cooperation and Governance (TSCG), Title III (the Fiscal Compact) introduces a structural balanced-budget rule with a national correction mechanism with a role for national IFIs to assess whether there are circumstances that warrant triggering the correction mechanism and whether correction is proceeding in line with the plan. The TSCG also contains a number of provisions to safeguard the independence of the monitoring institutions and introduces the comply-or-explain principle, by which governments either follow the advice of the monitoring institution or explain why depart from it.

Finally, the ‘Two-Pack’ Regulation 473/2013, which concerns only euro area Member States, provides the IFIs with a formal role in official forecasting and makes them responsible for monitoring compliance with all numerical fiscal rules in force in these Member States. IFIs should provide public assessments on the latter, including the activation of the correction mechanism in the case of a significant deviation from the Medium-Term Objective or the adjustment path towards it, potential exceptional circumstances, and how the correction is proceeding. The Two-Pack also requires draft budgets and national medium-term fiscal plans to be based on independently endorsed or produced macroeconomic forecasts.

### 2.3. Origin and governance

The landscape of IFIs is rather diverse. Prior to the above legislative changes, some Member States already had an IFI. Examples are the Netherlands with the CPB Netherlands Bureau for Economic Policy Analysis (CPB), Belgium with its Federal Planning Bureau, Denmark with its Economic Councils and Slovenia with its Institute of Macroeconomic Analysis. Twenty-five more IFIs came into existence in the period 2011-2017. A number of countries divide the tasks between two IFIs. For example, the
Netherlands has assigned the construction of macroeconomic projections to the CPB and the monitoring of fiscal rules to the Advisory Division of the Council of State, which was only established in 2013. Legal grounding can be in the form of a decree (e.g., in Sweden), ordinary law (most cases), organic law (in Spain, France and Portugal) or in constitutional law (in Estonia, Hungary, Italy, Lithuania and Slovakia). The legal anchoring is important and anchoring higher in the legal hierarchy is expected to provide more protection to the IFI, ceteris paribus. However, despite its fairly strong legal framework embedded in the Fiscal Responsibility Act of 2008, the Hungarian IFI saw its budget and mandate drastically curtailed by the government in 2010 (see Kopits and Romhanyi, 2013).

Terms of appointment of the board range from 3 years in Sweden to 9 years (e.g., Romania). The IFI can be a standalone entity, such as in the case of Spain, or it can be attached to another institution, such as the National Central Bank in the case of the Fiscal Advisory Council of Austria and the Parliament in the case of Italy’s Parliamentary Budget Office (Ufficio Parlamentare di Bilancio – UPB). The IFI can also be embedded in another institution, such as in the Dutch Council of State in which its Advisory Division is embedded. Embedded means being part of a larger institution, while attachment amounts to merely having organisational and financial links with a host institution, which could provide for stable funding, and access to (physical) resources. However, especially in case the IFI is embedded in a larger institution, provisions need to be in place to properly ring-fence it, to ensure its independence and dedication to its mission. A disadvantage of embedment in a larger institution is a potentially reduced visibility of the IFI and less opportunity to develop its own identity.

2.4. Mandates of IFIs and SIFI scores

The European Commission (2021) maintains a database on the IFIs within the EU. Alternative databases have been constructed by the IMF (2023) and the OECD (2023). Table 1, based on the European Commission (2021), lists the IFIs in the EU, together with their tasks and the so-called Scope Index of Fiscal Institutions (SIFI index) at the level of the country for the year 2021, the final year in the Commission’s database. The addition “at the level of the country” is relevant as there are several countries with two IFIs with tasks split between them. For these countries looking only at each individual IFI would give a misleading picture of the totality of tasks performed. The SIFI index at the level of the country measures the scope of all IFIs in a country combined.

National IFIs may have a number of tasks beyond those strictly mandated in the context of the abovementioned EU-level or intergovernmental agreements. The columns for the last three possible tasks “Long-run sustainability analysis”, “Active promotion of transparency” and “Normative recommendations” only indicate whether the country’s IFI(s) have activity in the field (value = 1) or not (value = 0). Activity in these fields is less frequent than for example “Monitoring compliance with numerical fiscal rules” or “Macroeconomic forecasting”. For the first three tasks the table allows some additional granularity. For example, when it comes to “Monitoring compliance with numerical fiscal rules”, the score is zero in the absence of any monitoring, 1 in case of either ex-ante or ex-post monitoring and 2 in case of both ex-ante and ex-post monitoring. The breakdown of the scores for the first three tasks is provided in Table 2 (which has been directly copy-pasted from European Commission, 2021). A higher score in these columns implies a larger scope. In addition, for the first three tasks, an IFI may earn bonus scores for certain subtasks, such as for the presence of a reconciliation procedure or having a mandate to conduct ex-post evaluations of forecasting accuracy in the case of macroeconomic forecasting.

We observe that all IFIs are engaged in the monitoring of compliance with the national numerical fiscal rules. Also, in line with the Two-Pack Regulation 473/2013, all euro area IFIs are in some way involved in macroeconomic forecasting, the majority either assessing the official macroeconomic forecasts.
underlying the budget or officially endorsing them. A minority produces the official forecasts for fiscal planning. Most IFIs are involved in assessing budgetary forecasts. Official endorsement or even production of the official budgetary forecasts is rare and is only observed for the Hellenic Fiscal Council and the Malta Fiscal Council. However, the IFI can also produce its own budgetary forecasts as a numerical benchmark to assess compliance of the government’s plans with fiscal rules (e.g., the Fiskalrat in Austria) or its forecast can be a reference point for planning as in the case of the Netherlands. Policy costing involves estimating the budgetary impact of measures envisaged by the government. This is labour-intensive work requiring detailed knowledge of the tax system, which can reasonably be performed only by the larger IFIs, such as the Dutch CPB and Italy’s UPB.

IFIs may be explicitly mandated to make normative recommendations, such as on the fiscal stance and the composition of fiscal measures. IFIs do not by definition feel at ease with having such responsibilities that could be seen as the preserve of the government. As discussed, one of the OECD principles was to avoid taking a political perspective when advising. IFIs may in particular fear to no longer be seen as completely independent and feel that they become implicitly accountable for recommendations followed up by the government. Promoting transparency is in only a few countries an explicit self-standing objective; IFIs nevertheless try contribute to it when performing their regular tasks. In particular, they are able to assess the quality and timeliness of the budgetary information they are using.

Table 1 also reports the SIFI index at the country level, which is based on a summation of the score on each of the aforementioned tasks, where each score is preceded by a weight (based on a specific choice of weighting scheme) and a “legal force coefficient”. The precise formula is found in European Commission (2021). The legal force coefficient can have a value of 0.25 for “Own-initiative tasks – sporadic output”, 0.50 for “Own-initiative tasks – proven and regular” and 1 for “Tasks stipulated in legal remit”. We find Austria at the top. It is important to put the score into some perspective, as the score is not by definition one-to-one related to the “strength” of a country’s IFI or its independence. A broader set of tasks (a broader “scope”) will ceteris paribus result into a higher score. This is also the case if the legal force, which provides some indication of functional independence, is higher. However, it is conceivable for an IFI to have a relatively low SIFI score, because it has been assigned a very limited set of tasks, but that it is fully independent and well-equipped to perform these tasks.
Table 1: Existing IFIs, tasks and SIFI index in 2021

<table>
<thead>
<tr>
<th>Country</th>
<th>Name of Institution</th>
<th>Monitoring compliance with numerical fiscal rules</th>
<th>Macro-economic forecasting</th>
<th>Budgetary forecasting and policy costing</th>
<th>Long-run sustain. analysis</th>
<th>Active promotion of transparency</th>
<th>Normative recommendations</th>
<th>SIFI INDEX 2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>AT</td>
<td>Fiskalrat + WIFO</td>
<td>2</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>83.57</td>
</tr>
<tr>
<td>BE</td>
<td>High Council of Finance - Section &quot;Public sector borrowing requirement&quot; + Federal Planning Bureau</td>
<td>1</td>
<td>2</td>
<td>0</td>
<td>1</td>
<td>0</td>
<td>1</td>
<td>60.00</td>
</tr>
<tr>
<td>BG</td>
<td>Fiscal Council</td>
<td>2</td>
<td>1</td>
<td>2</td>
<td>0</td>
<td>1</td>
<td>1</td>
<td>55.18</td>
</tr>
<tr>
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<td>2</td>
<td>0</td>
<td>1</td>
<td>1</td>
<td>66.79</td>
</tr>
<tr>
<td>CZ</td>
<td>Czech Fiscal Council</td>
<td>2</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>51.25</td>
</tr>
<tr>
<td>DE</td>
<td>Independent Advisory Board to the Stability Council</td>
<td>2</td>
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<td>1</td>
<td>0</td>
<td>1</td>
<td>1</td>
<td>51.96</td>
</tr>
<tr>
<td>DK</td>
<td>Danish Economic Council</td>
<td>2</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>46.25</td>
</tr>
<tr>
<td>EE</td>
<td>Estonian Fiscal Council</td>
<td>2</td>
<td>1</td>
<td>2</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>51.43</td>
</tr>
<tr>
<td>EL</td>
<td>Hellenic Fiscal Council</td>
<td>2</td>
<td>1</td>
<td>3</td>
<td>0</td>
<td>1</td>
<td>0</td>
<td>62.14</td>
</tr>
<tr>
<td>ES</td>
<td>Independent Authority for Fiscal Responsibility (AIReF)</td>
<td>2</td>
<td>1</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>68.93</td>
</tr>
<tr>
<td>FI</td>
<td>National Audit Office (Fiscal Policy Evaluation Function)</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>0</td>
<td>1</td>
<td>1</td>
<td>56.07</td>
</tr>
<tr>
<td>FR</td>
<td>High Council of Public Finances</td>
<td>2</td>
<td>1</td>
<td>2</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>46.43</td>
</tr>
<tr>
<td>HR</td>
<td>Commission on Fiscal Policy</td>
<td>2</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>42.50</td>
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<tr>
<td>HU</td>
<td>Fiscal Council of Hungary</td>
<td>2</td>
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<td>2</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>51.43</td>
</tr>
<tr>
<td>IE</td>
<td>Irish Fiscal Advisory Council (IFAC)</td>
<td>2</td>
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<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>68.21</td>
</tr>
<tr>
<td>IT</td>
<td>Parliamentary Budget Office</td>
<td>2</td>
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<td>2</td>
<td>1</td>
<td>1</td>
<td>0</td>
<td>74.29</td>
</tr>
<tr>
<td>LT</td>
<td>National Audit Office (Budget Policy Monitoring Department)</td>
<td>2</td>
<td>1</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>0</td>
<td>55.71</td>
</tr>
<tr>
<td>LU</td>
<td>National Council of Public Finance + STATEC</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>72.68</td>
</tr>
<tr>
<td>LV</td>
<td>Fiscal Discipline Council</td>
<td>2</td>
<td>1</td>
<td>0</td>
<td>1</td>
<td>1</td>
<td>0</td>
<td>52.50</td>
</tr>
<tr>
<td>MT</td>
<td>Malta Fiscal Council</td>
<td>2</td>
<td>1</td>
<td>3</td>
<td>0</td>
<td>1</td>
<td>1</td>
<td>72.14</td>
</tr>
<tr>
<td>NL</td>
<td>CPB Netherlands Bureau for Economic Policy Analysis + Council of State</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>70.54</td>
</tr>
<tr>
<td>PL</td>
<td>Supreme Audit Office</td>
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<td>0</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>17.50</td>
</tr>
<tr>
<td>PT</td>
<td>Public Finance Council (PFC)</td>
<td>2</td>
<td>1</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>0</td>
<td>71.43</td>
</tr>
<tr>
<td>RO</td>
<td>Fiscal Council</td>
<td>2</td>
<td>1</td>
<td>2</td>
<td>0</td>
<td>1</td>
<td>1</td>
<td>64.29</td>
</tr>
</tbody>
</table>
Note: data and format of table based on European Commission (2021). Further, the abbreviations are AT = Austria, BE = Belgium, BG = Bulgaria, CY = Cyprus, CZ = Czech Republic, DE = Germany, DK = Denmark, EE = Estonia, EL = Greece, ES = Spain, FI = Finland, FR = France, HU = Hungary, IE = Ireland, IT = Italy, LT = Lithuania, LU = Luxembourg, LV = Latvia, MT = Malta, NL = the Netherlands, PL = Poland, PT = Portugal, RO = Romania, SE = Sweden, SI = Slovenia, SK = Slovakia.

### Table 2: Breakdown of all possible scores and corresponding answers for tasks 1 – 3

<table>
<thead>
<tr>
<th>Task</th>
<th>Score</th>
<th>Corresponding answer(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Monitoring of compliance with numerical fiscal rules</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Monitoring both ex-ante and ex-post</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>Monitoring either ex-ante or ex-post</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Monitoring neither ex-ante nor ex-post</td>
<td>0</td>
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<tr>
<td>Macroeconomic forecasting</td>
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<tr>
<td>Production of macro-economic forecasts used for fiscal planning (within the meaning of Art. 2.1b of the Two-Pack Regulation 473/2013)</td>
<td>2</td>
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<tr>
<td>Official endorsement of the government’s macroeconomic forecasts used for fiscal planning (within the meaning of Art. 2.1b of the Two-Pack Regulation 473/2013)</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Assessment of the official macroeconomic forecasts which is published before submission to the Parliament of the budgetary planning documents</td>
<td>1</td>
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<tr>
<td>The fiscal institution is consulted at the start or during the preparation of macroeconomic forecasts</td>
<td>0</td>
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<tr>
<td>Production of macro-economic forecasts, but these are not used for the national fiscal planning</td>
<td>0</td>
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<tr>
<td>Budgetary forecasting</td>
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<tr>
<td>Production of the official budgetary forecasts</td>
<td>3</td>
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<tr>
<td>Official endorsement of the government’s budgetary forecasts (within the meaning of Art. 4.4 of the Two-Pack Regulation 473/2013)</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>Assessment of budgetary forecasts BEFORE the adoption in the Parliament of the budgetary planning documents</td>
<td>2</td>
<td></td>
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<tr>
<td>Assessment of the budgetary forecasts AFTER the adoption in the Parliament of the budgetary planning documents</td>
<td>1</td>
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<td>The fiscal institution is consulted at the start or during the preparation of budgetary forecasts</td>
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<tr>
<td>Production of budgetary forecasts, but these are not used for the national fiscal planning</td>
<td>0</td>
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</table>

Note: Table is copy-pasted from European Commission (2021).
2.5. Legitimacy of the role of IFIs

In order to achieve price stability, there is now a wide consensus over the necessity to have an independent central bank. However, it did take some time to arrive at the insight that society would be better served by keeping monetary policy outside the realm of politics and put it in the hands of an independent central bank. Fiscal policy is different as it involves allocative and distributive choices, which some parts of society may welcome and others not, and, hence, are potential sources of political conflict. However, also certain decisions in the fiscal realm can be viewed as more technocratic in nature, such as ensuring overall fiscal sustainability; a rather broad consensus has emerged that it is desirable to constrain the hands of politicians.\(^4\)

So what is the legitimacy of the role of IFIs? Do they clash with the prerogative of the responsible politicians? The answer to this question depends on the IFI’s mandate. Going back to Table 1, the first five sets of tasks “Monitoring compliance with numerical fiscal rules”, “Macroeconomic forecasting”, “Budgetary forecasting and policy costing”, “Long-run sustainability analysis” and “Active promotion of transparency” are mostly of a factual and technical nature. For example, promotion of transparency should incentivise governments to improve the allocation of resources and reduce their incentive to spend resources on weak policies or diversion of resources for pet projects and personal benefit. Long-run sustainability analysis implicitly deals with the trade-off between current and future cohorts, which is indeed also a political choice. However, future cohorts and also the future self-interest of current cohorts are not or insufficiently represented by the current government. Long-run sustainability analysis enhances the awareness of intertemporal trade-offs and serves as a counterweight to political short-sightedness. When it comes to “Normative recommendations”, the delineation of the technocratic tasks of the IFI and the prerogative of the politicians may become blurred. For this reason IFIs may be reluctant to fulfil this task.

3. EFFECTIVENESS OF THE IFIS

The impact of the IFIs on fiscal policy does not depend only on its design on paper, as described above. Another relevant factor is the source of the fiscal policy imperfections (Jankovics and Sherwood, 2017). For example, if information problems, such as some systematic but unintended over-projection of economic growth, are at the source of a deficit bias, then an IFI should be of help in achieving more accurate predictions that will help to reduce this bias. However, if the deficit bias is the result of strategic behaviour or of political short-sightedness, then the government has less incentive to take on board IFI advice. We may also expect less effect on the fiscal outcomes, although reputational effects could still constrain the government in its behaviour. Of course, the IFI’s impact also depends on how it fulfils its role in practice, in particular how its leadership operates, and on the broader political and institutional culture of the country. Can an effective IFI only be the result of a culture of fiscal probity?\(^5\) The answer to the latter question seems to be no: some very high debt countries with a history of high deficits feature brave and effective IFIs – see below. However, a supportive political and institutional culture does, ceteris paribus, make it easier for an IFI to fulfil its mandate.

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\(^4\) Fiscal policy is known to suffer from biases caused by political “distortions”, such as the limited horizon of a government or common pool problems. This goes back to the seminal contributions by Rogoff and Sibert (1988) and Alesina and Tabellini (1990). Fiscal rules and IFIs are ways to limit the effects of these distortions. The European Fiscal Board (2019a) demonstrates that the EU fiscal rules have had only a limited constraining effect on Member States. Dissatisfaction with the current rules leads Caselli et al. (2022, p.1) to argue that “A medium-term fiscal framework that combines standards, rules, and strengthened institutions will strike a better balance between flexibility and credibility.”

\(^5\) The question is analogous to the question whether fiscal rules can only be effective in the presence of a supportive culture.
3.1. Channels of influence

An IFI's influence can be explicitly visible, but it does not necessarily need to be. An example of the former is Italy’s UPB leading the government to adjust the budget proposed in October 2018, after the UPB refused to endorse the macroeconomic projections at the basis of the draft budget law for 2019 (see UPB, 2018); the budget law was subsequently modified (in December 2018) – for more details, see UPB (2019). An example in which the IFI’s influence is not explicitly visible, but nevertheless present, would be when the threat to withhold its consent on the official macroeconomic projections incentivises the government to come up with a realistic growth projection in the first place.

IFIs do not have “hard power” in relation to the budgetary process. Such decisions are the prerogative of the political executive or legislature. More common are formal consultations or hearings and the obligation of the government to comply or explain. There is a wide range in practices regarding the latter. Governments may simply choose to ignore an IFI’s rejection of its forecasts or the IFI’s assessment may be overtaken by an agreement between the European Commission and the government. Common channels of indirect influence are through public reports and through a high visibility in the media and public debate in some countries. This should be important for a government that cares about its reputation for good policymaking.

3.2. Empirical evidence on the role of the IFIs

The impact of IFIs, and their specific design, on policy and macroeconomic outcomes will be generally hard to establish through econometric analysis, as these outcomes may be influenced by many other factors. Two types of outcomes are of relevance for IFIs. One is that IFIs reduce potential biases in macroeconomic and budgetary projections and make these projections more accurate. This benefits fiscal planning and reduces economic and financial uncertainty, which would be appreciated by financial markets in particular. The second is that IFIs may affect the fiscal policy outcomes themselves, for example because governments feel compelled to follow more disciplined policies.

Isolating the IFI’s effects on the outcomes is generally difficult. The main reasons are the limited number of observations, because the number of IFIs and the number of years they have been active are limited, the variation over time in their design is limited, and there are potential confounding factors. For example, countries with a stronger culture of fiscal discipline may be more inclined to set up an IFI with a strong mandate, good access to information and adequate resources. Then, observing a positive association between budgetary performance and an index that measures the strength of the IFIs might mislead researchers into concluding that a stronger IFI is a source of more budgetary discipline. This is why it is important for empirical research to have enough time variation in the design of the IFI for a given country. Assuming that the discipline culture changes at a slower pace, this opens the possibility to detect a causal relationship. Still, variation in budgetary outcomes is driven by many factors, also unexpected shocks, such as changes in the global economy. This is why it is important to have as large a number of observations as possible. The conclusion is that any results from econometric analysis in this area need to be interpreted with care. Therefore, the alternative of detailed inspection of the specific arrangements in place and of a detailed analysis of the national budgetary processes driving a country’s budgetary outcomes might be more informative. This would be beyond the scope of this study. However, next subsection tries to collect a set of experiences and best practices so far that may inform other IFIs, as well as stakeholders concerned with an effective functioning of the IFIs.

What is the evidence from econometric analysis? Without claiming to provide a complete overview here, let us first turn to analysis of predictive accuracy. Beetsma et al. (2019) investigate for a broad set of EU countries the influence of IFIs on the budgetary forecasts and the monitoring of compliance with
Strengths and weaknesses of independent advisory fiscal institutions in the EU economic governance framework

The former is more technical in nature and can be done by studying the absolute forecast errors. This latter is more loosely connected to the council's sphere of influence. Their findings do indeed suggest that having a fiscal council is associated with more forecasting accuracy and possibly less optimism in the fiscal forecasts, as well as better compliance with the fiscal rules in place. Statistical analysis in EFB (2022) suggests that involvement of IFIs that endorse macroeconomic forecasts is associated with a smaller optimistic bias in real GDP growth projections. Debrun and Kinda (2014) find that only well-designed IFIs are associated with improved fiscal outcomes (as well as less biased forecasts). Important design features in this respect are functional independence, visibility in the public debate, a mandate to monitor numerical rules and producing or assessing the official macroeconomic forecasts. Beetsma et al. (2023) revisit an earlier study (Beetsma et al., 2009) with a substantially expanded data set and explore the drivers of fiscal forecast errors in the EU’s SCPs, both optimistic and pessimistic (so they are not specifically concerned with predictive accuracy). They also investigate how IFIs shape forecast errors. They find that those with a high media impact producing or assessing the macroeconomic forecast are associated with an improvement of the budgetary outcome relative to the original projections.

3.3. Experience and best practices of IFIs

Interaction among the EU IFIs, for example through the Network of EU IFIs, allows each one of them to benefit from experiences and best practices in peer institutions. In Chapter 3 of its Annual Reports, the European Fiscal Board (EFB) has adopted a tradition of portraying two specific IFIs and collecting the experiences of these IFIs. The EFB further gathers experiences on specific items through surveys among IFIs. Part of the collected information relates to the IFI’s institutional setting, including its mandate. However, notwithstanding a given institutional setting, the approach and decisions by the IFI’s leadership matter for what it can achieve. Below, we report a number of experiences and best practices:

- As we discuss in more detail below, IFI production of the official macroeconomic forecasts may be preferable to its mere endorsement (EFB, 2022). The former is the practice of the Dutch CPB, which enjoys a strong reputation, even though some of its peers enjoy stronger legal independence (EFB, 2017). In those cases where IFIs do not produce the official macroeconomic forecasts themselves, they may still compare these with their own model-based projections (Spain’s AIReF, the Portuguese Public Finance Council (CFP), Italy’s UPB and Ireland’s IFAC) or with forecasts produced by international institutions. The comparison with own model-based projections instead of forecasts by other institutions should make it easier to understand the divergencies with the official forecasts.

- A strong commitment to enhance budgetary credibility would be to outsource budgetary forecasts to a group of independent experts with a strong reputation of impartiality; this is the case for the UK’s Office of Budget Responsibility (OBR) – see EFB (2018). An alternative would be to task the IFI with the formal endorsement of the official budgetary forecasts. In the euro area this is done by the IFIs of Greece and Malta.

- The forecast endorsement process can be laid down in a specific Memorandum of Understanding (MoU) between the IFI and the Ministry of Finance (as, for example, in Ireland and Latvia), describing in detail the parameters of the endorsement process, including the scope of the official forecasts to be assessed, the type of information the IFI needs and the moments of interactions. In the case of Portugal’s CFP, an MoU lays down the institutional cooperation mechanisms between the CFP and other signatories, ensuring the CFP’s access to data as well as its involvement in methodological exchanges on the statistical treatment of certain operations and transactions and the consistency of statistical results (EFB, 2022). The MoU could in addition describe a two-step procedure of first validating projections based on an official no-policy change scenario, so as to have a numerical benchmark for the assessment of policy measures, and a second step of endorsement of official projections that include the
planned new measures. Discrepancies should then be traceable to the planned measures. Such a two-step procedure is followed in the case of Portugal’s PFC (see EFB, 2022) and Italy’s UPB. The MoU may also contain a reconciliation mechanism in the case of divergencies of views, as in Ireland and Latvia (EFB, 2022).

- Formal non-endorsements may force the government to modify its macro-projections. Italy’s UPB successfully deployed them in the autumns of 2016 and 2018. In both cases the government revised its macro-projections.

- Enshrine the independence of the IFI in the Constitution – an example is Italy’s UPB. The non-partisan reputation of an IFI can moreover be enhanced by including foreign experts on the Board. A good example is the Portuguese CFP – see EFB (2022).

- Younger and less well-established institutions would benefit from a strong focus in their work, which calls for a targeted and confined mandate. Once the institution has acquired a strong reputation, it can cover a wider range of tasks. This has been the path followed by the Dutch CPB (EFB, 2017).

- To ensure their effectiveness, small IFIs, like the German Independent Advisory Board to the Stability Council and the Czech Committee on Budgetary Forecasts and the Czech Fiscal Council, need to rely on high-level institutional cooperation with other bodies (EFB, 2020). Cultivating good relationships with these bodies is essential.

- Regarding the supply of information (EFB, 2018), a dual system may be recommendable, as in the case of Slovakia’s Council for Budget Responsibility (CBR), which combines legal provisions for the supply of information with more practical elements in the form of MoUs with all levels of government. The case of Spain demonstrates the usefulness of such MoUs, even in the presence of strong legal provisions. In particular, Spain’s AIReF took the government to court in 2015, because a Ministerial Order of 2015 introduced the obligation to first request information from the Economic Financial Information Centre of the Ministry of Finance. The Order was repealed when AIReF appealed before the relevant administrative jurisdiction. As in the case of Finland, one could envisage sanctions on a government that does not supply the requested information (EFB, 2018). When it comes to information provision:
  - This should be done without charge, or an extra budget should be made available for the acquisition of information.
  - Data on budgetary procedures at the non-central government level, such as on social security and state-owned enterprises, is needed.
  - Governments need to provide methodological details and assumptions underlying the budget. Ireland’s IFAC had good and prompt access to such information (EFB, 2017). Yet, through MoUs it could have benefited from access to information from all relevant public entities, as concluded by Jonung et al. (2015).
  - Limit the discretion of the government with respect to which information it provides or not.

- Strengthen the medium-term orientation of budgetary plans and assign IFIs a role in monitoring adherence to the medium planning. Indeed, Council Directive 2011/85/EU of the “Six-Pack” requires Member States to introduce credible and effective medium-term budgetary frameworks (MTBFs), with a planning horizon of at least three years and procedures for establishing comprehensive and transparent multiannual objectives in terms of government deficit and debt, projections for major expenditure and revenue items of the general

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7 The fact that the budget law is legally binding, but the SCPs, which also contain projections further into the future, are not, is reflected in the fact that the SCPs tend to be more overoptimistic, the further ahead are their projections (see Beetsma et al., 2023).
government, and a description of medium-run policies as well as their impact on long-term budgetary sustainability. This is laid down in a national medium-term fiscal planning document connected to the budget process and grounded in national law. The consistency between the annual and medium-term plans is important for the credibility of the plans and needs to be continuously stressed (EFB, 2021).8

- The Fiscal Compact imposes binding and permanent national correction mechanisms alongside compulsory structural budget balance rules. The correction mechanisms may be automatically triggered in a transparent way by the IFI, thereby increasing the effectiveness of the correction of deviations from the medium-term budgetary objectives (EFB, 2021). An example is the High Council of Finances in Belgium, which can trigger a correction when targets have not been reached, provided that the different government levels (in the “Concertation Committee”) had earlier reached an agreement on the targets. So far, IFIs have triggered the correction mechanism \textit{ex post} only in a couple of cases. They did so for Estonia and Slovakia in late 2019. However, in both these cases the enforcement process was suspended because of the Covid-19 crisis. It would be desirable to have more automatic \textit{ex-ante} triggering of the correction mechanism, though based on an assessment of the IFI, instead of the current automaticity that is typically tied to a formal EU-level decision pointing to a significant deviation from the requirements of the SGP. (The exceptions are Belgium, Bulgaria and France.) This makes the mechanism vulnerable to the weaknesses of the SGP, in particular its reliance on unobservable variables.

- The work of an IFI, for example when it comes to its role in the national correction mechanism, is more complicated if a country has a federal government structure with autonomous regions. To have a good perspective on the sustainability of the public finances, all levels of government need to be taken into account. In this regard, Spain’s AIReF provides an example of an effective design. Its mandate instructs it to assist all public administrations to comply with the constitutionally enshrined principle of budgetary stability. It assesses the individual fiscal targets of each autonomous region, before they are approved by the government. It also reports on the risks of non-compliance with the fiscal targets for the current year by each public administration. See Escriva (2018) and (EFB, 2019b).

- Council Directive 2011/85/EU stipulates that the application of escape clauses for national numerical fiscal rules must be limited to certain specific circumstances and be subject to stringent procedures. The Fiscal Compact, in turn, stipulates that escape clauses are only activated in the case of an unusual event with a major budgetary impact beyond the government’s control or in a severe economic downturn, in line with the notion of exceptional circumstances as agreed in the SGP. The Compact formally requires IFIs to always provide a public assessment “over the occurrence of circumstances for triggering, extending and exiting escape clauses”. In relation to this assessment, the Compact also imposes a comply-or-explain requirement on the relevant national authorities. For some countries, the national escape clause becomes active when the corresponding SGP clause on exceptional circumstances is activated, while for other countries the national clause is triggered independently. Survey responses by IFIs show that they would like to see an operational definition for triggering the clause and clear conditions for deactivating it. Without the latter the IFI’s position could clash with the outcome from SGP surveillance.

- A strong comply-or-explain procedure is needed, in which the government responds formally and publicly to issues raised by the IFI (EFB, 2017). It may need commitment from other institutions, in particular the legislature. In Italy, Parliament did not activate the procedure, despite UPB’s repeatedly signalling of a risk of a significant deviation. One reason was the ongoing discussion between the government and the Commission about more flexibility in the

\[8\] Nerlich and Reuter (2013) point to the complementarity of numerical fiscal rules, presence of an IFI and an effective MTBF.
fiscal rules (EFB, 2018). A successful case was that of Slovakia’s CBR which established a significant deviation from the medium-term objective or the adjustment path to it in 2015 (EFB, 2017). The government had to explain in a report why it ignored the CBR’s findings. Spain’s AIReF and the Malta Fiscal Advisory Council (MFAC) forced their governments to better respond on issues related to budgetary risks. In the case of AIReF, there were some other successes resulting from “comply-or-explain”, such as triggering a debate on the social security system’s financial sustainability, consistent calculation of the spending rule across the different government levels and more transparency of the government’s macroeconomic forecasts.

Some general improvements of “comply-or-explain” can be achieved along the following general lines (EFB, 2017):

- Comply-or-explain should be anchored in national legislation.
- The response to IFI views should be submitted and published within a reasonable amount of time to maintain relevance and public attention.
- The response should contain all relevant information with sufficient detail and precision.

There are a number of choices more directly under the control of IFIs themselves:

- Assuming they have sufficient resources, they can make use of quantitative models to inform decisions about the endorsement of the official macroeconomic forecasts (EFB, 2022).
- Council Directive 2011/85/EU also requires the forecasts underlying fiscal planning to be evaluated on a regular basis. Although ex-post evaluation is sometimes done by the government, it seems preferable to formally assign this task to the IFI. A good example is the UK’s OBR in its annual “Forecast evaluation report”, in which it evaluates the accuracy of its own forecasts; other examples are Finland, Portugal, Spain and Sweden (see EFB, 2020). However, if they are not formally involved, IFIs may also informally take up this activity. Ex-post evaluation by an IFI may limit discretion during the execution of the budget and encourage governments to critically consider potential deviations from their original plans. Hence, systematic ex-post forecast evaluation should help to improve future forecasts (EFB, 2022).
- Because IFIs have no or only few formal levers, they are advised to secure sufficient public visibility (Beetsma et al., 2023).9 Ireland’s IFAC is an example of an IFI that quickly created public awareness about its work and was able to affect the government’s budget for 2017 (EFB, 2017). Another example is AIReF, which explicitly invested in a communications team (EFB, 2019b). Obviously, such investment is only feasible for a sufficiently large IFI. IFI’s can also choose to communicate their endorsement decision of the official macroeconomic forecasts in real time via press statements or open letters (EFB, 2022).
- Cultivate strong ties with Parliament and ensure frequent invitation to hearings. A good example is Spain’s AIReF – see EFB (2019b).
- General elections offer a particular window of opportunity for IFIs to disseminate impartial information on fiscal policy. It has become a tradition in the Netherlands for the CPB to offer political parties to calculate the budgetary impact of their election platforms. Inspired by the Dutch experience with costing election manifestos, Latvia’s IFI has taken the first steps towards similar assessments (EFB, 2019b).

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9 Claeys (2019) collects IFI media mentions over the period 2012 – 2018 and finds substantial differences among the IFIs. Media presence gives some indication of the influence of an IFI, although it is a very imperfect indicator. A country with fewer budgetary issues would ceteris paribus see less media presence of its IFI. Also, too much presence in the media can blur a really important warning by the IFI when it becomes hard to distinguish such a warning from less important signals ventilated through the media.
4. IFIS IN THE COMMUNICATION FOR REFORM OF ECONOMIC GOVERNANCE

On 9 November 2022, the European Commission (2022) issued a Communication on the orientations for its long-awaited review of the economic governance framework. The orientations focus on the sustainability of debt and growth, and consist of three pillars: fiscal prudence promoted through a revised EU fiscal framework; reforms and investment stimulated by a “new tool for enforcing reforms and investment”; and a revised macroeconomic imbalances procedure. Objectives of the Commission with the first pillar are to increase national ownership embedded in the EU fiscal framework, simplification and focus on fiscal risks, and better enforcement. For Member States with a substantial or moderate public debt challenge, the Commission will put forward a reference adjustment path for net primary expenditure covering at least four years, which is then converted into a corresponding structural primary balance level to be reached at the end of this period. The reference adjustment path will be based on a debt sustainability analysis (DSA). Following the Commission, Member States can make their own proposal for their medium-term fiscal-structural plans, which should, however, be at least as fiscally prudent as the path proposed by the Commission. Annual budget plans will need to be aligned with the agreed fiscal trajectory, to ensure that for “Member States with a substantial public debt challenge, the reference net expenditure path should ensure that by the horizon of the plan (4 years), i) the 10-year debt trajectory at unchanged policies is on a plausibly and continuously declining path and ii) the deficit is maintained below the 3% of GDP reference value at unchanged policies over the same 10-year period”; for “Member States with a moderate public debt challenge, the reference net expenditure path should ensure that, i) at most 3 years after the horizon of the plan, the 10-year debt trajectory is on a plausibly and continuously declining path at unchanged policies; and ii) by the horizon of the plan, the deficit is maintained below the 3% of GDP reference value over the same 10-year period”, and for “Member States with a low public debt challenge, the deficit should be maintained below that reference value at unchanged policies over a 10-year period at most 3 years after the horizon of the plan” (European Commission, 2022, pp. 11 and 12). Member States can ask for an extension of the adjustment horizon on the basis of reform and investment plans that benefit fiscal sustainability. The design of these plans, in particular their impact on the composition of the public finances, will play an important role in raising potential growth and, hence, debt sustainability by affecting the denominator of the debt ratio.

4.1. Roles of the IFIs in the fiscal-structural plans

The Commission communication foresees a larger role for IFIs than before. In particular, it writes “To increase ownership and transparency at the national level, independent fiscal institutions could play a role in the monitoring of compliance with the national medium-term fiscal-structural plans in support of the national governments.” More specifically:

- At the design phase of the fiscal-structural plan, IFIs “would play an important role in each Member State in assessing the assumptions underlying the plans, providing an assessment on the adequacy of the plans with respect to debt sustainability and country-specific medium-term goals, and monitoring compliance with the plan. This would entail improving the set-up and performance of independent fiscal institutions. The outcome would be a greater debate at national level and thus a higher degree of political buy-in and ownership of the medium-term plan.” (European Commission, 2022, p.10). According to the Network of EU IFIs (2023a), IFIs would ideally have the ability to signal the risks associated with the envisaged fiscal path. The Commission could benefit from the IFI’s input before it proposes the reference path and the government could benefit from its input when it constructs its “counter-proposal”. Ideally, a legal obligation
would be created at the EU level to take into account the IFI’s assessments, to avoid the danger that they are ignored. Obviously, the power to propose and adopt decisions of the Commission and Council would remain unaffected. However, in taking a position in the Council also other Member States can benefit from the IFI’s analysis.

The IFI mandates could be extended to not only undertake or endorse the macro-projections for the new budget and the SCPs, but to cover the entire horizon of the fiscal-structural plan. IFIs could also be mandated to undertake or endorse the budgetary forecasts, and they might be involved in assessing the impact of the structural reforms and public investments. Indeed, in the recent past the Network of EU IFIs (2022a) has argued for extending IFIs’ mandates into a number of directions, in particular expanding the mandate of the IFI to not only endorse the short-term, but also the medium-term national macroeconomic projections and to extend the endorsement decision to short- and medium-term forecasts of expenditure, revenue, the budget balance and debt projections. Overall, given that the Commission orientations envisage more tailor-made budgetary agreements between the Commission and individual Member States, there will be more need for an independent perspective, which could be provided by the IFIs.

The independent perspective will be particularly important when it comes to assessing the impact of structural reforms and public investment, as these form the basis of a potential extension of the planning horizon from 4 to 7 years. Any conclusions drawn on proposed reforms and investments will be surrounded by substantial uncertainty, and likely be qualitative instead of quantitative, because it is extremely difficult to quantitatively model the effects of these measures on potential growth and, hence, on debt sustainability. However, the IFI can present its views on the underlying assumptions and it can assess the plausibility of the forecast reform and investment impacts by comparing these with what is known in the literature. Of course, resources and, hence, technical capacities of IFIs would need to be brought to adequate levels – see below.

The starting point for the Commission in determining a country’s reference adjustment path will be a debt sustainability analysis (DSA). Recently, the Network of EU IFIs (2021) discussed the potential contribution of IFIs to a DSA. IFIs can bring in expertise about their country’s economy and finances, as well as increase ownership in the debate on fiscal risks, while at the same time enhancing transparency around national fiscal matters, including contingent liabilities, which will affect risks to a country’s debt sustainability.

- During the ex-post phase, IFIs could assess compliance of the budgetary outcomes with the agreed multiannual net primary expenditure path and, in case of a deviation from this path, they could assess the validity of the justification for this deviation. This would require some comply-or-explain procedure regarding the realised path.

One would expect that involvement of the IFIs in assessing the fiscal-structural plans should also strengthen the consistency between the surveillance of the EU and national fiscal frameworks, as the

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10 The Network of EU IFIs (2022a) would also see a role to undertake some measurement tasks like estimating one-offs and discretionary revenue measures, assessing potential output and corresponding revenue elasticities. IFIs would thereby oversee all the projections serving as an input to assess budgetary sustainability at national level.

11 The recent legislative proposals by the European Commission (2023) no longer propose the reference adjustment paths to be based on a DSA. Scepticism expressed about the use of a DSA may have compelled the Commission to not include it in its proposals; DSAs are sensitive to the underlying assumptions, for example about the path of the interest rate.
IFIIs would monitor both the compliance with the national fiscal rules and with the fiscal-structural path that should be consistent with the EU fiscal rules.

On 26 April 2023 the European Commission (2023) published proposals for a replacement of Regulation (EC) No 1466/97 on the preventive arm of the SGP and amendments of Council Regulation (EC) No 1467/97 on its corrective arm and of Council Directive 2011/85/EU on the requirements for the national budgetary frameworks. This is only the start of the legislative process of which the eventual outcomes cannot yet be predicted.

The proposed new Regulation (EC) No 1466/97 (Article 22) foresees the IFIs to assess compliance of the budgetary outturns data reported in the annual progress report with the net expenditure path in the fiscal-structural plan, as well as to analyse the drivers of potential deviations from the path. The assessment of the IFI will be included with the annual progress report to be submitted by April 15 the latest each year. For a Member State in the Excessive Deficit Procedure, the proposed amended Regulation (EC) No 1467/97 foresees the MS in its reporting on effective action to include the opinion of the IFI on the adequacy of the actions taken with respect to the required correction (Article 3.5).

The proposed amended Council Directive 2011/85/EU, Article 4.1, now envisages the macroeconomic and budgetary forecasts to be either produced or endorsed by the IFIs. Article 8.4 requires MS to endow their IFIs with the following tasks “(a) producing the annual and multiannual macroeconomic and budgetary forecasts underlying the government’s medium-term planning or endorsing those used by the budgetary authorities; (b) producing debt sustainability assessments underlying the government’s medium-term planning or endorsing those provided by the budgetary authorities; (c) producing assessments on the impacts of policies on fiscal sustainability and sustainable and inclusive growth or endorsing those provided by the budgetary authorities; (d) monitoring compliance with country-specific numerical fiscal rules…; (e) monitoring compliance with the Union fiscal framework…; (f) conducting, on a regular basis, reviews of the national budgetary framework, in order to assess the consistency, coherence and effectiveness of the framework, including mechanisms and rules that regulate fiscal relationships between public authorities across sub-sectors of general government; (g) participate in regular hearings and discussions at the national Parliament.” In line with the desiderata outlined above, the Directive would expand the role of the IFIs towards also producing or endorsing the budgetary forecasts for fiscal planning, extending these beyond the annual horizon, and to the EU-wide monitoring of compliance with the SGP regulations.

Of course, many questions would still need to be worked out in detail. For example, what would be the format the IFIs’ assessments, both ex-ante and ex-post, and how would their input be treated by the Commission? Would the assessments merely be a factual description of the expected impact of the plans or would they also contain an advice to the Commission on whether the plans and ex-post adherence to them are adequate? Would the Commission adopt a formal position in relation to the advice provided by the national IFIs, that is either follow the advice or formally explain why it deviates from the advice?

4.2. **Strengthening the IFIs – what would be needed?**

What can the IFIs potentially deliver and what would they need to deliver what is asked from them? These questions are important, and they will become even more important, if they obtain an expanded role in the context of the potential fiscal-structural plans.
Based on an anonymous survey, Network of EU IFIs (2022c) asks individual EU IFIs on their capacity to do certain tasks.\(^{12}\) Almost two-thirds answer that they have a strong capacity to assess/endorse macro and short-term budgetary forecasts, while more than three quarters have a strong capacity to assess/endorse medium-term budgetary forecasts, and even more than 80% have a strong capacity to assess one-offs, discretionary revenue measures, etcetera. Numbers are lower for long-term assessments of public finances, with slightly more than half having strong capacity, and assessing the medium-term trajectory of public finances and public debt, where a quarter have a strong capacity. Finally, slightly less than 60% have a strong capacity to assess ex-ante or ex-post compliance with the EU fiscal rules. Weak capacities are posted by one or more IFIs in five out of the seven categories. There seem to be a couple of IFIs that have general difficulties to carry out their current tasks. Taken together, and given the small size of many of them, this suggests that even only a limited increase in their human resources can make a substantial positive difference for those that are struggling. An increase by, say, two analysts would bring most of them up to speed with their tasks in the area of assessing the official macroeconomic projections.

Expansion beyond the existing set of tasks would require more investment. For example, the European Fiscal Board (2022, Box 3.1) reports on their involvement with the Recovery and Resilience Plans. It shows that this involvement was very limited. As is noted in the Box “none of them were formally mandated to undertake an independent scrutiny of the government’s cost estimates. Less than a fifth were involved in some official manner in the preparatory works, and most of those assignments concerned the macroeconomic aspects of the draft RRPs.”

European legislation sets only general criteria that IFIs need to fulfil. EU Member States differ in many respects and the varied landscape of national IFIs reflects this reality for good reasons. Therefore, it is important to establish a number of minimum requirements that the IFI needs to fulfil. Indeed, the European Commission recognises that not all national IFIs are sufficiently equipped for potential additional roles, which is an implicit call to strengthen them. However, adopting a set of minimum requirements would require the Commission to find a way to enforce these requirements and clarify how it intends to do this. Some of these requirements have been put forward by the Network of EU IFIs (2022a, 2022c) and some are already contained in the OECD’s (2014) principles:\(^{13}\)

- A minimum amount of resources to be able to carry out the mandate, while the IFI’s budget should be based on a special provision in the law to be better protected against potential attempts to defund it.
- Ideally, the independence of IFIs would be legally enshrined in a variety of dimensions, such as the management of financial and human resources, transparent recruitment on the basis of expertise and political independence.
- Timely access to relevant information from government and statistical offices. The requirement that IFIs obtain on demand and without delay accurate information from governments and national statistical offices should be legally enshrined – a good example is that of the UK’s OBR.

\(^{12}\) The OECD has conducted a series of reviews of specific IFIs that give a more fully-fledged picture of what IFIs are doing and achieving. For example, for Ireland the OECD (2021) found that “Over almost ten years, the Council has helped strengthen fiscal management in Ireland. For example, it has developed new tools, tailor-made for the Irish economy, for assessing compliance with fiscal rules and measuring the output gap; these have also been adopted by other key stakeholders. Furthermore, its reports and outreach activities have improved the awareness of fiscal issues among the wider public.”

\(^{13}\) Some years ago the European Commission (2017) unsuccessfully attempted to bolster the IFIs with a proposal for a Council Directive aimed at strengthening fiscal responsibility and the medium-term budgetary orientation in the Member States. The proposal called for national legal anchoring, enhanced independence, more communication freedom, nomination of members based on expertise and competence and through a transparent procedure, sufficient and stable own resources, and timely and adequate access to relevant information.
whose right to relevant information is enshrined in Budget Responsibility and National Audit Act 2011 (2023). Any restrictions on access to information should be clearly legally anchored. As alluded to above, an enhanced role of the IFIs in the fiscal-structural plans with a potential of more bilateral exchange between the Commission and individual Member States makes this even more relevant. Specifically, IFIs would need timely information on the Commission’s reference adjustment paths, underlying methodologies, projections and data used in budgetary planning.

- The process of endorsement of the macroeconomic projections could follow a codified script based on best practice. For example, Italy’s UBP first assesses the official no-policy-change scenario, which is followed by the assessment of the policy scenario with the new measures and their impacts. The appropriate no-policy-change scenario should include realistic projections of future costs, such as those related to ageing, that can only be dealt with by taking new measures. Otherwise, an illusion of an unrealistically large amount of space for new policy is created. Ideally, at each stage there would then be a mechanism whereby the government might only proceed if the IFI approves its forecast.

- IFIs could be mandated to extend their endorsement of macroeconomic forecasts to the official budgetary forecasts. IFIs have a good understanding of revenue forecasting and developing no-policy change baselines. At the same time, they are likely to remain dependent on information from the government, particularly regarding spending plans. Going even further, they could be charged with the production of budgetary forecasts, as is the case for the UK’s OBR.

- Reconsider the mandate of those IFIs that only endorse the official macroeconomic projections, but do not produce them. Assigning production of the official macro-projections to the IFI would be preferable for various reasons. It would obviate any potential reluctance of the IFI to reject the official projections and enhance the objectivity of the projections.14

- However, it would be difficult to have governments give up on their capacity to produce the official macro-projections. As a second best, an IFIs should at least produce its own forecasts, which would strengthen its technical capacity and its capacity to understand in detail how a government’s budget is constructed. This way it would be able to effectively challenge the government on its macro- and budgetary projections.

- Regarding the macroeconomic and budgetary forecasts, the IFIs’ role would ideally be enshrined as an obligation in EU law, such as though an amendment of Council Directive 2011/85/EU on requirements for budgetary frameworks of the Member States, and translated into national law, as well as included in the European Semester timeline.

- Strengthen the comply-or-explain principle, which requires the budgetary authority to publicly react to the IFIs’ assessments of deviations from the fiscal rules, by extending it to areas of the rules where it does not yet exist, and legally anchoring the principle. The principle would need a set deadline and define what would happen if the IFI’s advice is rejected.

- The IFI should be free to publish what it deems necessary, as long as it is relevant for its mandate.

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14 In practice it is difficult for an IFI not to endorse the macroeconomic projections, also because the uncertainty about the precise figures is too large.
Importantly, it is the combination of the above elements that would enhance the value of the IFIs’ work. For example, assigning additional tasks without the commensurate resources and enhanced independence where needed will not work. Involvement of the IFIs with the fiscal-structural plans would also require the Commission to further clarify certain elements in its upcoming proposal on the review of the economic governance framework, such as the interpretation of “plausibly and continuously declining” public indebtedness – see Network of EU IFIs (2023a). The Network also calls for more transparency, i.e. publication of the reference adjustment paths and the underlying data and methodology.

4.3. Relationship between IFIs and Ministries of Finance

It is important to realise that a watchdog is never likely to be “loved” by the institution it is monitoring and in particular not at a moment when it criticises this institution. This is also the case for the relationship between a Ministry of Finance and an IFI. The Ministry sees itself as the guardian of responsible fiscal policy and does not want its work “duplicated” by an IFI, which may question the Ministry’s inputs or the numbers it generates. Broader for the government, when an IFI produces a negative assessment, this becomes a nuisance for the former and there will always be a temptation to refute the criticism and maybe even curtail the IFI. Tellingly, the conclusion of 14 March 2023 of the Council of the European Union (2023, p.6) reads “The current role of national independent fiscal institutions (IFIs) in producing or endorsing macroeconomic projections should be maintained and adapted to the medium-term fiscal-structural plans while minimum standards could be explored. IFIs should not play a role in the design phase of the national plans.”

However, all the other countries in the EU would benefit from a responsible fiscal policy in some Member State X, even though the government of X would have an incentive to deviate from what is good for the collective. For example, the government of X may for opportunistic reasons be tempted to expand fiscal policy when the output gap is already positive. Given that all the governments in the EU individually face the same temptation, they may be all better off if they collectively manage to restrain their own fiscal profligacies, rather than all of them deviating by following an unduly expansionary policy. For this reason, they would all be better off when they are all constrained by numerical fiscal rules rather than none of them being subject to such rules. Analogously, they would all be better off from having strong IFIs throughout the EU, even though the government of an individual country would prefer to curtail its IFI. Compared to its government, which represents only part of the population, society at large is better off having a strong IFI, irrespective of whether other EU Member States have a strong IFI. Figure 1 illustrates the welfare configuration of a government being better off when all other Member States have a strong IFI than when none of them has. Society is always better off with a strong IFI in its own country, rather than a weak one.

The appreciation of the collective interest is hampered by the fact that each Ministry of Finance tends to focus only on “its own” IFI, while it does not oversee the entire IFI-landscape. This is where there is a crucial role for the European Commission and the European Parliament to facilitate internalising the externalities that governments exert on each other as well as the externalities that current governments exert on future governments, by strengthening the position of the IFIs. In particular, the

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15 Society’s position is comparable to that of a political party behind a “veil of ignorance”, so it does not know who will be elected to power. Party Y will be in favour of having a strong IFI, because in expected terms policy outcomes will be better with a strong IFI. When it is elected to power, the party may experience the IFI as a nuisance, but when competing party Z is elected to power, party Y benefits from the IFI constraining the actions of its competitor.

16 Notice that the welfare levels of the government and society cannot be compared with each other. We can only compare the welfare levels of the same entity across different situations.
Commission would have a role in enforcing minimum standards on the IFIs and in standing behind the IFI in conflicts with the government.

It is interesting to observe that the IFIs of Italy, Spain and Portugal, countries with relatively high levels of debt, have developed strong reputations. These IFIs were originally conceived with adequate resources and they interpreted their mandate in an extensive and independent manner. Important factors include an excellent staff, the reputation of their board members (among them well-known academics and experts in public finances), strong connections with the parliament (who hear the IFI regularly and on various topics) and systematic interactions with European institutions. Substantial presence in the public debate, also in terms of media coverage has helped as well. Governments of Member States with a tradition of strong fiscal discipline and concerns about discipline elsewhere in the EU would advance their own cause by embracing a strong position of their own IFI and Commission initiatives to set minimum standards for IFIs throughout the EU. By setting examples of good practice in their own country, thus demonstrating that they treat their own IFI as a serious partner, governments of fiscally disciplined countries strengthen the credibility of calls for discipline elsewhere, thereby implicitly bolstering the position of institutions that are charged with helping to advance such discipline. Member States with concerns about discipline elsewhere could, for example, support proposals for IFIs becoming responsible for the production of the official macroeconomic, or even budgetary, forecasts throughout the EU and for the comply-or-explain process to share a set of concretely spelled out implementation steps and for a shared minimum level of interaction of IFIs with national parliaments.

**Figure 1**: Welfare as function of number of strong IFIs in the EU

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17 This part is partially based on informal exchange with knowledgeable insiders.
4.4. Relationship of the IFIs with the European Commission and the European Parliament

A successful change in economic governance requires two conditions to be met: a strengthening of national ownership and enhancing budgetary transparency. These conditions will be more easily met by giving IFIs a more central role. While the Commission has substantial discretionary powers, it operates at a distance from the national fray with a necessarily limited understanding of how national politics works in each country. Moreover, the governance framework that it operates is abstract and generally difficult to understand beyond the Ministries of Finance at the national level. This also the case for the suggested revision, which would still amount to quite a complex set of rules and which is untested yet.

As the Network of EU IFIs (2022b) writes “At the EU level, a greater role for the national IFIs could improve the assessment of national economic and budgetary conditions, help to inform the use of discretion at EU-level in applying the fiscal rules and help to achieve greater coherence between national and EU-level decisions, helping to strengthen the fiscal governance as a whole. This approach could also reduce the risk that national IFIs are unduly weakened by contradictory assessments at the EU level or vice versa.”

Inconsistencies between the national numerical fiscal rules and the EU fiscal rules should be avoided as much as possible. This is particularly important when the rules are very similar or even identical. The European Commission’s assessment takes precedence over that of the IFI, which in the case of conflicting assessments would undermine the position of the IFI at the national level if the government points to compliance with the Commission’s assessment to justify its position. Avoiding such a conflict is easier with a better flow of information from the Commission on the interpretation of the EU fiscal rules, such as in relation to the estimation of potential output and the treatment of one-off measures. Avoiding diverging assessments also requires early access of the IFI to budgetary information, and for the IFI to have the same information as the Commission. Based on this information, the IFI can ensure that there is no misunderstanding or unnecessary difference with the Commission’s assessment. Not only IFIs would benefit from exchanging views with the Commission, also the latter would benefit from the more detailed country-specific knowledge of the IFI, for example regarding measurement issues, budgetary forecasting (in particular, relating to the medium term, as SCPs are non-binding) and the overall assessment of the fiscal position in the light of long-term fiscal trends, including demography, healthcare and climate. Commission documents could refer to the IFIs assessments and the Commission could be required to explain differences with its own assessments.

The enhanced budgetary transparency resulting from a strengthening of the IFI would be particularly useful to the European Parliament, which does not get any budgetary information beforehand and may find it hard to interpret budgetary information. The information and interpretation that the IFIs can provide would give the European Parliament a stronger position in challenging national economic and financial policies. This requires national IFIs to have a sufficiently central role and strong position.

Within the EU Semester, IFIs could formally assess/endorse the macroeconomic forecasts and budgetary projections before the Commission assesses the SCPs and the draft Budget (with the

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18 An example concerns the Italian UPB (Parliamentary Budgetary Office – PBO). As noted in European Fiscal Board (2020): “Notwithstanding the UPB’s assessment of serious non-compliance with EU and national fiscal rules in 2019, the Commission reached different conclusions at the end of 2019 by using the ‘margin of discretion’ in assessing compliance with the fiscal rules.” The EU and national fiscal frameworks have mostly co-existed in harmony although there have been some cases of material disagreement, with the Commission typically taking a more lenient position towards the Member State (Network of EU IFIs, 2023b). Differences may arise for different reasons, such as differences in the assessment of potential output, the output gap or the plausibility of the official forecasts.

19 The importance of this is discussed by Jankovics and Sherwood (2017), who write “Issuing compliance assessments with such national rules in advance of the Commission’s SGP assessments could prove to be a tricky exercise both ex post and ex ante, given that the SGP deliberately provides room for the Commission to use economic judgment to decide on a number of elements.”
Commission explaining potential deviations in its views from those of the IFI). This would require a number of conditions to be fulfilled: the IFI should have timely access to budgetary information, as argued above, and room should be created in an already crowded agenda, for example by shifting the deadline for submission of the draft budgetary plan to the Commission from mid- to end-October, so that there is space for the IFI to share its views with the government and the national parliament. Further, a concrete comply-or-explain procedure would need to be formalised in response to views raised by the IFI: governments choose to ignore a diverging IFI view by referring to agreement with the Commission on its plans, while the IFI’s view weighs too little for the Commission to take it up with the government. A legally enshrined comply-or-explain procedure would force the government to respond to the IFI’s view.

4.5. Relationship between IFIs and EFB

The Five Presidents Report (2015) led to the creation of the European Fiscal Board (EFB). Its mandate is to assess the Commission’s application of the EU budgetary rules with a specific focus on horizontal equity, to advice the Commission on the prospective euro area fiscal stance, to advice the Commission President and to collaborate with national IFIs. Because the EFB primarily takes an EU or euro area perspective, while the IFIs take their own country’s perspective, the institutions are highly complementary to each other. The EFB cannot be expected to have the detailed information that an IFI has on the economic and political situation of its own country. However, so far the EFB has been able to make only very limited use of information from the latter. Information is largely confined to the input that the EFB receives for Chapter 3 of its Annual Report on the IFIs.

An expansion of the IFIs’ mandate to become involved in the assessment of the national fiscal-structural plans could be conducive to an intensified collaboration between the IFIs and the EFB. The ex-ante assessments and ex-post monitoring of the fiscal-structural plans by the IFIs would ideally form an input for the EFB in its assessment of the Commission’s treatment of the plans. The EFB in its Annual Report, which is published in October, could discuss possible deviations between the IFIs’ views and those of the Commission at both the ex-ante stage and on the realisation of the plans in a given year. Regarding the former, the EFB would pay particular attention to those cases in which the Commission finds a plan acceptable that the IFI advises to reject. However, this would involve a shift from the EFB’s traditional ex-post analysis towards more ex-ante analysis. Obviously, the EFB itself would need to have sufficient resources if a revision of the fiscal governance framework leads to intensified collaboration with the IFIs.
5. CONCLUDING REMARKS

This paper has conducted an in-depth analysis of the strengths and weaknesses of the EU IFIs. They fulfil an important role in the EU’s fiscal governance framework. Their role is almost exclusively focused on the national level. An upgrading of their role as suggested in the European Commission’s (2022) Communication would require imposing minimum standards on IFIs such as in terms of their resources, access to information, legal enshrinement of their independence and freedom to publish. Experience so far suggests that IFIs have played a useful role in making macroeconomic projections more accurate and less biased, although it is difficult to detect strong evidence due to the still limited data and other possible drivers of the quality of projections and fiscal outcomes. IFIs have little to no coercive powers. There strengths are their independence, the quality of their analyses and their visibility, which can be strengthened by legal anchoring of concrete comply-or-explain procedures. The position of an IFI is often precarious: it is not easy to see an institution “love” its own critics. Yet, collectively, EU societies are better off with a set of strong IFI’s. This puts specific responsibility on the European Commission and the European Parliament promoting strong IFI’s and protecting their positions.
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National independent fiscal institutions (IFIs) are an important element in the EU fiscal governance landscape and can play a role in the envisaged fiscal-structural plans. To this end, minimum standards are needed. Even though an individual government may be reluctant to strengthen its IFI, it is in the collective interest to have a set of strong IFIs throughout the EU. This would need the support from the European Commission and the European Parliament, being the institutions that “internalise” fiscal policy externalities.

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