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The Unsustainability of Independent Fiscal Institutions

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Since the economic and financial crises, the European Union (EU) is stepping up its efforts to develop credible and reliable independent fiscal institutions (IFIs). As a result EU IFIs are mushrooming in the member states. This policy brief assesses the governance framework surrounding the IFIs. How are IFIs managed, does this correspond with what we know about effective governance frameworks, and what does this tell us about the direction of European integration – European centralisation or decentralised network management –? The answers will shed light on whether there are sufficient safeguards in place that will ensure the sustainability of the IFIs' development, effectiveness and efficiency. The policy brief concludes that the governance framework is still underdeveloped and that it lacks a clear view on how coordination and control in a multilevel setting should take place.

1. Introduction

The economic and financial crises that battered Europe's Economic and Monetary Union (EMU) have revealed multiple problems concerning the budgetary frameworks in the European Union (EU) member states – take, for example, the misrepresentation of statistics in Greece.[1] To support EU fiscal rules, the 2011 six-pack and 2013 two-pack formally introduced independent fiscal institutions (IFIs). IFIs monitor compliance with EU fiscal rules and are responsible for independent macro-economic and budgetary forecasts[2] – and are therefore essential for the survival of the euro. In addition, following from *The Five Presidents' Report*,[3] the advisory European Fiscal Board (EFB) is scheduled to become operational in mid-2016, aimed at providing a public and independent assessment of how national budgets perform against economic objectives and recommendations. The EFB is

1 Featherstone, K. (2010), 'The Greek Sovereign Debt Crisis and EMU: A Failing State in a Skewed Regime', in: *Journal of Common Market Studies*, 49(2), pp. 193–217.

2 This Clingendael Policy Brief refers to these two tasks, following from EU legislation, when defining 'independent fiscal institutions'. The phrase 'IFIs' can be used interchangeably with 'national fiscal councils' in this policy brief, but independent fiscal institutions can be defined in a broader sense and might also include, for instance, normative recommendations. Throughout the policy brief, we use the phrase 'independent fiscal institutions'.

3 Juncker, J.-C. *et al.* (2015), *The Five President's Report: Completing Europe's Economic and Monetary Union*, 22 June.

a measure aimed to depoliticise the role of the European Commission in the European Semester.

Five years since the six-pack's implementation, it is time to evaluate the state of affairs concerning IFIs. Recent research has focused on the state of development of IFIs.[4] However, what is missing in the debate is an assessment of the governance of fiscal institutions. Does the governance system ensure European principles such as proportionality, subsidiarity, implementation and enforcement – and hence pave the way for trust in the system? This Clingendael Policy Brief therefore examines the governance framework underlying these fiscal institutions with a view to the central questions: are independent fiscal institutions sustainable; and what improvements could enhance trust in the system?

The goal of this Clingendael Policy Brief is twofold. First, it places discussions on fiscal institutions against the background of debates on effective European governance frameworks. How are IFIs managed and does this correspond with what we know about effective governance frameworks? Second, does the EU predominantly build on national capacities, on European capacities, or on a combination of the two (networks)? This has broader relevance, for it assesses the way in which European integration is heading: towards European centralisation; or decentralised network management.

A discussion is thus required on the ongoing developments regarding fiscal institutions. A short overview of the state of development of IFIs is provided in the second section. The third section provides a model for assessing the governance framework of fiscal institutions. The tasks and responsibilities of the governance of fiscalinstitutions are mapped in the fourth section, and are analysed in the fifth section. The final section of this Clingendael Policy Brief provides conclusions and recommendations to enhance the governance framework.

2. Background: The Development of IFIs

From the beginning of the euro, it was clear that member states should commit to the agreements made. In the 1990s, it was also clear that not all member states had sufficient reliable governance structures in place (resources and independent economic institutions) to be reliable euro partners. The quality of national institutions enhances long-term growth.[5] Statistics were known to be a problem, but the severity only came to the fore with the misrepresentations of Greece's statistics.

Independent fiscal institutions were also a notorious bottleneck. In part, IFIs are designed to constrain governments from stimulating the economy fiscally, especially prior to elections, on the basis of their independent and transparent judgement of government policy.[6] On the other hand, politicians may be inclined to constrain IFIs' actions in order to avoid critique.

The 2011 six-pack directive on budgetary frameworks, which was followed by the Fiscal Compact and two-pack, took up the gauntlet to establish and/or reform IFIs.[7]

The 473/2013 two-pack regulation defines and reinforces two tasks that should be carried out by independent bodies (IFIs): 1. Monitoring of compliance with fiscal rules; and 2. Production or endorsement of

4 Take, for instance, Debrun, X. and T. Kinda (2014), *Strengthening Post-Crisis Fiscal Credibility: Fiscal Councils on the Rise – A New Dataset*, IMF Working paper; and Trapp, L. von, I. Lienert and J. Wehner (2015), 'Principles for Independent Fiscal Institutions and Case Studies', in: *OECD Journal on Budget*, Vol. 2015/2.

5 Masuch, K., E. Moshammer and B. Pierluigi (2016), *Institutions and Growth in Europe*, CEPS Working Document No. 421, April.

6 Ademmer, E. and F. Dreher (2015), 'Constraining Political Budget Cycles: Media Strength and Fiscal Institutions in the Enlarged EU', in: *Journal of Common Market Studies*, 54(3), pp. 508–524.

7 Council Directive 2011/85/EU of 8 November 2011 on *requirements for budgetary frameworks of the Member States*, O.J.L. 306, 23 November 2011.

macro-economic forecasts.[8] Furthermore, it specifies the legal requirements that define the 'functional autonomy' of such an independent body: a statutory regime grounded in national laws; not taking instructions from other (budgetary) authorities; the capacity to communicate publicly in a timely manner; appointment procedures; adequate resources; and appropriate access to information. These safeguards should provide sufficient support for formal and informal independence of IFIs *vis-à-vis* their respective government. The legal requirements should facilitate an IFI's effectiveness: to become a credible player; give meaningful contributions to the budgetary process; and exert pressure on governments. However, it is difficult to define criteria to assess an IFI's effectiveness.[9]
As Xavier Debrun and Tidiane Kindra assess, 'only well-designed fiscal councils are associated with stronger fiscal performance, as well as more accurate and less-biased forecasts'.[10] The new legislation ignited a mushrooming of independent fiscal institutions in the EU member states after the crisis. The last peer review by the European Commission of 2013 signalled varying degrees of implementation, however, where problems occurred regarding the lack of authority, lack of visibility in the public debate, non-compliance with independence criteria and delays in the legislative/ implementation process.[11] Today there are around 30 European independent fiscal institutions. Not every member state has an operational IFI in place, but one has to consider that tasks might be divided among different institutions. Moreover, little is known about their effectiveness in practice.

3. A Model for Assessing the Governance Framework

This brings us to the governance framework that should ensure effective IFIs. Governance is defined here as 'a set of multilevel institutions and instruments (legal framework, management roles of in particular the Commission, codes of procedures, budgets and operational procedures within the European network) necessary to manage the European network'.[12] As Majone explains, there are different modes of governance: hierarchy (legislation and direct supervision); markets; and networks of national institutes.[13] Of these, markets do not fall within the scope of this Clingendael Policy Brief.
Legislation is one form of hierarchical governance where intervention in the member states is based on sufficient tools in the hands of the central level – in this case, the European Commission. The (commonly agreed) legislation explicates to national administrations what they should do, and when and how to do it. In European governance, the Commission usually supervises implementation of legislation and enforces it as 'guardian of the Treaties'. Control should be backed by a credible and transparent sanctioning procedure. Furthermore, the Commission has the right of initiative to come up with new legislative and policy proposals.
Another form of hierarchical governance is the *organisation of control* in the execution of policy. Traditionally, EU member states' main task is to implement policy ('primary control'), while the Commission supervises the quality of implementation ('secondary control') – that is, assesses how institutions operate. This system, which is based on

8 Regulation (EU) No. 473/2013 on *common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area*, O.J.L. 140, 27 May 2013.

9 Kopits, G. (2011), *Independent Fiscal Institutions: Developing Good Practices*, prepared for the 3rd Annual Meeting of OECD Parliamentary Budget Officials, Stockholm.

10 Debrun and Kinda, *Strengthening Post-Crisis Fiscal Credibility*.

11 European Commission (2013), *Fiscal Frameworks in the European Union: Commission Services Country Factsheets for the Autumn 2013 Peer Review*, European Economy Occasional Papers 168, December. The exercise took place before the introduction of the two-pack.

12 Mijs, A. and A. Schout (2016), *Governance of the European Statistical System: Coordinating Expectations* (forthcoming).

13 Majone, G. (1996), *Regulating Europe* (London: Routledge).

Table 1 A Model for Analysing the IFI Governance Framework

Governance mode	Tasks
Hierarchy I: Legislation	• Compliance with EU law • Formulation of legislative and policy proposals

Hierarchy II:
Organisation of control
	• Implementation of policy
	  • *Production/endorsement of macro-economic forecasts*
	  • *Monitoring compliance with EU fiscal rules*
	• (Systematic) quality control

Networks[18]	• Exchange of information/best practices • Building common standards and professional values • Mutual (quality-)control mechanisms • Collective ownership for the functioning of the network (including quality control of the network) • Management of the network • Budget management

subsidiarity, is the core theme of good governance in the EU. It strengthens the EU's credibility, contributes to national ownership, and decentralised structures are likely to prevent information asymmetry at the central level.[14] Organisation of control sheds light on whether the Commission should take more or less ownership. Rather than depend on national institutions, it might start carrying out certain tasks and responsibilities itself (centralisation).
The third governance mode – *networks* – is based on cooperation with and between national institutions. In the network, there is collective responsibility for and collective management of several functions: implementation; quality control; improvement of the network and of individual actors; and the management of a communal budget.[15] Steering takes place via 'soft' tools (including exchange of best practices, peer reviews, naming and shaming, and budgets) and 'hard' tools (such as fines and even exclusion from the network).[16] EU member states are expected – in cooperation with the European Commission – to participate actively to build common standards, exchange information and to supervise quality control.
In many instances,[17] the Commission is responsible for management of the network – that is, to ensure that processes run effectively. Its tasks range from initiating and developing work programmes to providing a platform for collaboration. As a network manager, it has the capacity to steer the network towards centralisation (primary control) or towards a European network of national institutions (secondary control). For the latter to occur, the Commission's main aim is to strengthen the network (as the secretariat) and national institutions. However, the former (that is, centralisation) is often the preferred direction for reasons of efficiency and the difficulties regarding national reform.

These modes are complementary, because a proper legal framework should be accompanied by an effective, decentralised network. Together they provide a 'sustainable' governance framework. If hierarchy has the

14 Akerlof, G.A. (1970), 'The Market for "Lemons": Quality Uncertainty and the Market Mechanism', in: *The Quarterly Journal of Economics*, 84(3), pp. 488–500.

15 Schout, A. and A. Jordan (2005), 'Coordinated European Governance: Self-Organizing or Centrally Steered?', in: *Public Administration*, 83(1), pp. 201–220.

16 Héritier, A. (2003), 'New Modes of Governance in Europe: Increasing Political Capacity and Policy Effectiveness', in T.A. Börzel and R.A. Cichowski (eds), *The State of the European Union* (Oxford: Oxford University Press), pp. 105–126.

17 See other networks and agency-type structures, for example: Groenleer, M. (2009) *The autonomy of European Union agencies: a comparative study of institutional development*, (Delft: Eburon).

18 This is a basic, non-exhaustive list based on: Jordan, A. and A. Schout (2006), *The Coordination of the European Union: Exploring the Capacities of Networked Governance* (Oxford: Oxford University Press).

upper hand, this may lead to 'integration by stealth';[19] conversely, the absence of hierarchy may lead to ineffective and inefficient systems.

4. Analysing the Current IFI Governance Framework

A schematic overview is given below of the stakeholders concerned with EU IFIs and their corresponding tasks.

4.1 Hierarchy I – Legislation

After the haggling over growth figures in 2003, the European Commission – at the request of the Council[20] – started to take IFIs seriously and established a monitoring process starting in 2005.[21] The legal framework took form with the 2011/85 six-pack directive and the 473/2013 two-pack regulation, which placed tools in the hands of the Commission. This led to a peer review by the Commission in 2013, which was presented at the Economic Policy Committee (EPC), an advisory council for the Economic and Financial Affairs Council (ECOFIN). At the moment, the Commission monitors and assesses the EU member states' compliance with the six- and two-pack, but it has not yet led to opening up an infringement procedure. The need for EU member states' compliance with EU law is essential for the credibility of IFIs. Lack of credibility has occurred in Hungary where, after a head start, Hungary's Fiscal Council was severely cut in resources and denied access to information in 2010 after critical views of the Hungarian government's medium-term budgetary plan.[22] Therefore, in order to build sufficient safeguards, the Network of EU Independent Fiscal Institutions (the 'Network') calls for 'a set of minimum standards IFIs should comply with in order to reinforce them',[23] such as, for instance, what constitutes a 'sufficient' level of resources and what 'appropriate' access to information means. The lack of clear indicators will prove difficult for the European Commission in the application of an infringement procedure.

4.2 Hierarchy II – Organisation of Control

The organisation of control, meaning the extent to which the Commission exerts primary or secondary control, can be derived from assessing the execution of the two tasks of IFIs: compliance with the numerical fiscal rules; and production of macro-economic forecasts. At the national level, the IFIs publish compliance assessments, as well as make public their (endorsement of) forecasts. A systematic quality-control mechanism of these institutions is lacking. At the European level, the Directorate-General for Economic and Financial Affairs (DG ECFIN) makes its own analyses on compliance with the fiscal rules and prepares its own forecasts.[24] On this basis, it writes recommendations for a decision in the Council. *The Five Presidents' Report* introduced the EFB, which would 'provide a public and independent assessment, at European level, of how budgets – and their execution – perform against the economic objectives and recommendations'.[25] In the subsequent Commission Decision, the EFB was tasked with the 'evaluation of the implementation of the Union fiscal framework'[26] – that is, an assessment of the horizontal consistency of decisions – and

19 Majone, G. (2005), *Dilemmas of European Integration: The Ambiguities and Pitfalls of Integration by Stealth* (Oxford: Oxford University Press).

20 Council of the European Union (2005), *European Council Brussels, 22 and 23 March 2005 – Presidency Conclusions*, Brussels, 7619/1/05.

21 For reports and databases, see online at http://ec.europa.eu/economy_finance/db_indicators/fiscal_governance/independent_institutions/index_en.htm (accessed 6 April 2016).

22 Kopits, *Independent Fiscal Institutions*.

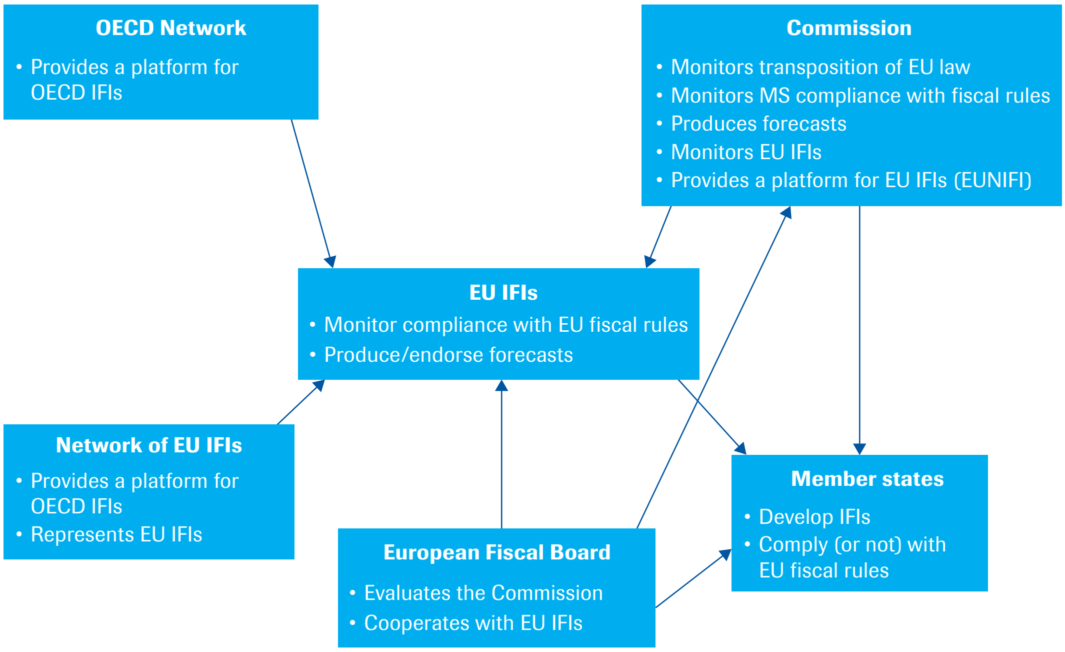
23 Network of EU Independent Fiscal Institutions (2015), *Position Paper on Initiatives to Strengthen the EU Fiscal Framework*, 5 November, p. 2.

24 Schout, A. and A. Mijs (2015), 'The Independent Commissioner: An Administrative Analysis', in: E. Ongaro (ed.), *Multi-Level Governance: The Missing Linkages* (Bingley: Emerald).

25 Juncker, *The Five President's Report*.

26 Art. 2(b), Commission Decision (EU) 2015/1937 *establishing an independent advisory European Fiscal Board*, O.J.L. 282, 28 October 2015.

Figure 1 Overview of the IFI Governance Framework



budgetary surveillance as implemented by the Commission and the Council.
The EFB was established via a Commission Decision, not in a regulation adopted by the co-legislators, for reasons of efficiency. The current institutional structure of the EFB lacks the desired independence, according to Eurogroup President Jeroen Dijsselbloem.[27] The Chair of the Board and one out of four Board members are directly appointed by the Commission. Furthermore, the Secretariat of the Board is attached to the Secretariat-General. The first alleged internal spat became clear when the Commission changed the appointment procedure for the Head of the Secretariat.[28] Analysts therefore perceive the EFB to be an internal advisory body of the Commission.[29] In any case, it does not 'conform to the same standard of independence' as national fiscal councils.[30]
In effect, the Commission judges the policies of the EU member states (twice), instead of judging the quality of the IFIs, which are entrusted with the same task. A similar task that falls under the fiscal rules is judging one-off fiscal measures. This is done nowadays by member state governments and the Commission, but, according to some,[31] in the future should also be done by an independent EU body. Here, too, IFIs could replace member state governments and the EU body if they were of sufficient quality.
This issue illustrates that there is a tendency towards primary control at the European level – that is, centralisation.

4.3 Networks

At present there are three main networks in which IFIs operate: the Network of EU Independent Fiscal Institutions (the 'Network'); the EU Network of Independent Fiscal Institutions (EUNIFI); and the Organisation for Economic Cooperation and Development's (OECD) Network

27 Gilbert, N. and J. de Jong (2014), *Does the Stability and Growth Pact Induce a Bias in the EC's Fiscal Forecasts?* DNB Working Paper No 451, December; and Steinhauser, G. (2015), 'Not All On Board with the European Fiscal Board', in: *The Wall Street Journal*, 13 November.

28 Marks, S. and M. Saltmarsh (2016), 'Will EU's New Independent Fiscal Board Turn into a Commission Committee?' in: *MNI Euro Insight*, 15 March.

29 Claeys, G., Z. Darvas and A. Leandro (2016), *A Proposal to Revive the European Fiscal Framework*, Bruegel Policy Contribution, 29 March, p. 17.

30 Juncker, *The Five President's Report*.

31 Claeys, Darvas and Leandro, *A Proposal to Revive the European Fiscal Framework*.

Table 2 Analysis of the IFI governance framework.

Governance mode	Tasks to be executed	Status	
Hierarchy I: Legislation	• Compliance with EU law • Formulation of legislation and policy proposals	• In progress • Unknown	

Hierarchy II: Organisation of control	• Implementation of policy
	  • *Production/endorsement of macro-economic forecasts*
	  • *Monitoring compliance with EU fiscal rules*
	• (systematic) Quality control
		• In progress
		
		• No	

		'Network'	***EUNIFI***
Networks	• Management of the network • Exchange of information/best practices • Building common standards and professional values • Mutual (quality) control of statistics • Collective ownership for the functioning of the network (including quality control of the network) • Work programmes • Budget	• IFI • Yes • In progress • No • No • No • Limited	• Commission • Yes • No • No • No • No • Limited

of Parliamentary Budget Officials and Independent Fiscal Institutions (the PBO). The Network was created on 11 September 2015 and is open to all independent EU fiscal oversight bodies. The Network appoints the Chair and Deputy Chair, and the Secretariat is financed via voluntary contributions from the EU IFIs. The Network's mission is twofold: first, it provides a platform to exchange views, expertise and pool resources in areas of common concern; and second, it represents the common interests of the members on matters concerning the EU fiscal framework.[32] EUNIFI is an informal network established by the Commission that aims to share best practices across the EU, on average twice a year. The PBO is also primarily a forum to exchange information. A system of peer reviews is lacking at the moment. The PBO is in the process of creating a framework for external evaluations of the performance of IFIs. The Network, however, is refraining from developing such a framework. The Commission is in the early stage of developing criteria for assessment[33] and currently works on the basis of self-assessment questionnaires. The Commission leaves it to the member states to design their rules and procedures, and advises installing a Code of Practice in the field of forecasts.[34] This could provide a basis for a quality-control mechanism. The Network invites 'independent experts' to carry out evaluations for the development of national institutions, but they are not inclined to do it via the Network.[35] Compare, for instance, the European Statistical System, where quality control is carried out by the Commission, via a peer review process, and by an independent body, based on the European Statistics Code of Practice. All three networks lack a clear form of steering and, as a consequence, lack systematic quality control to upgrade the network as well as individual actors.

With regard to the European Commission's management role, in EUNIFI the Commission takes up the role of a secretariat that would like to strengthen the network and the national institutions. The European Fiscal Board also has a potential role to play. In the establishment of the Commission Decision, one of the most heavily debated issues was that the EFB should 'cooperate' with national

32 Network of EU IFIs (2015), *Agreement of EU Independent Fiscal Institutions*, 11 September.

33 The Commission is developing a framework, but for the moment is limited to working with media hits.

34 European Commission (2014), *Specifications on the Implementation of the Two-Pack and Guidelines on the Format and Content of Draft Budgetary Plans, Economic Partnership Programmes and Debt Issuance Reports*, 7 November.

35 Network of EU IFIs (2015), *Position Paper on Initiatives to Strengthen the EU Fiscal Framework*.

fiscal councils instead of 'coordinate'.[36]
It depends on the new EFB how this role will be executed. It is unclear how the EFB will relate to the Commission, which is currently responsible for EUNIFI, and how the division (or overlap) of tasks and responsibilities will play out.

5. Conclusions and Recommendations

First and foremost, it is up to the EU member states to invest in the development of IFIs. This Clingendael Policy Brief has examined the governance framework underlying IFIs. It has done so by answering the central question: are independent fiscal institutions sustainable and what improvements could enhance trust in the system? The different governance modes of hierarchy (legislation and supervision) and networks provide an **image of a slowly developing framework without a clear direction. Within the current governance framework, sustainability of effective and efficient IFIs is possible, but still far from ensured**.
Hierarchical control is lacking in the application of IFI legislation. First, the legal framework is not specific enough to ensure effective IFIs, for example on the level of resources. Compare, for instance, sectoral statistical regulations. Second, a credible and transparent enforcement procedure is lacking. The absence of these types of safeguards makes it inherently difficult to set up sustainable IFIs. **The establishment of these standards calls for multilevel discussions. Subsequently, it is the responsibility of the European Commission – together with the co-legislators – to initiate and establish a credible and transparent enforcement procedure.**
In the organisation of control, the European Commission appears to focus on primary control. The European level refrains from supervision on the quality of IFIs, but instead duplicates the tasks that are being executed at the national level. Moreover, with the creation of the EFB, the Commission is drifting even farther away from the subsidiarity model of governance. Similar choices in the governance framework surface in discussions on the National Competitiveness Boards and on control of the new EU border force.[37] The lack of an effective quality-control mechanism seems to justify this approach. However, this centralised form of steering might prove unsustainable in the long run. **On the basis of good governance principles, it is thus vital to establish a credible quality-control mechanism.** Here, EU member states should play their part in order for the Commission to take the initiative. **A clear view on how coordination (and hence control) will take place is essential in the effective and efficient application of the system.** The preferable outcome would be that EU member states can execute primary control and that the European level sticks to secondary control.
The networks surrounding EU IFIs are under construction and many essential network functions are lacking. **A first step would be to carry out an independent management audit of what tasks and responsibilities should be executed at what level within the multilevel context**, based on prior experiences with EU agency-type organisations. **Second, a broadly-backed Code of Practice would give guidance to IFIs in how to execute their tasks. Subsequently, this could provide the basis for a much needed peer review system.**
With these concrete steps, independent fiscal institutions in the European Union would get on a sustainable and trustworthy path towards a more solid fiscal governance framework.

36 Art. 2C, Commission Decision (EU) 2015/1937 *establishing an independent advisory European Fiscal Board*, O.J.L. 282, 28 October 2015.

37 European Commission (2015), Recommendation for a Council Recommendation on the Establishment of National Competitiveness Boards within the Euro Area, COM(2015) 601 final, 21 October 2015. See also Zalan, E. (2016), 'EU States Should Control New Border Force, MEPs Say', in: *EUobserver*, 12 April, available online at https://euobserver.com/justice/133011 (accessed 13 April 2016).

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