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REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

Interim Progress Report on the implementation of Council Directive 2011/85/EU on requirements for budgetary frameworks of the Member States

{SWD(2012) 433 final}

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1. INTRODUCTION

Council Directive 2011/85/EU on requirements for budgetary frameworks of the Member States[1] entered into force in December 2011. It is an important component of the legislative package on the strengthening of economic governance (also known as the 'six-pack'). This Directive provided the first opportunity for the European Union to set minimum requirements for budgetary frameworks, providing legal certainty on top of the country-specific recommendations issued under the European semester process. With pressing consolidation demands in a large number of Member States, emphasis on delivery has now become paramount. Against this background, efforts to enhance national budgetary frameworks are strongly intertwined with fiscal consolidation policies since both aim to bring about lasting improvements in the quality of fiscal outcomes.

According to the Directive, a budgetary framework means the set of arrangements, procedures, rules and institutions that underlie the conduct of budgetary policies of general government, in particular: (i) systems of budgetary accounting and statistical reporting; (ii) rules and procedures governing the preparation of forecasts for budgetary planning; (iii) country-specific numerical fiscal rules; (iv) medium-term budgetary frameworks; (v) mechanisms that regulate fiscal relationships between public authorities across sub-sectors of general government. For each headline, the Directive specifies a number of essential standards. Member States have to transpose these into their law by 31 December 2013. In July 2011 added impetus was given by the political commitment of the Heads of State and Government of the euro-area Member States to transpose the Directive by the end of 2012[2]. Finally, the adoption of the intergovernmental Treaty on Stability, Coordination and Governance (TSCG) provided a follow-up to the Directive. 25 Member States committed to establishing a domestic budget-balance rule in structural terms.

Under Article 15(3) of the Directive, the Commission is asked '*to prepare an interim progress report on the implementation of the main provisions of this Directive on the basis of relevant information from Member States, which shall be submitted to the European Parliament and the Council by 14 December 2012*.' To that end, the Commission submitted to the Economic Policy Committee in May 2012 a questionnaire giving Member States the opportunity to report on measures in place, reforms already launched or concrete plans. Accordingly, this report is primarily based on the information reported by the Member States. Most Member States have delivered their contributions in September 2012[3]. Therefore the information reflects the state-of-play at the time of reporting. Detailed country *fiches* are presented in the accompanying Commission staff working document (SWD(2012) 433).

[1] OJ L 306, 23.11.2011, p.41.
[2] Statement of 21 July 2011, p.4, point 14.
[3] NL, SI, LT PT, IT and HU reported in October; CY, LV, MT and UK in November.

The purpose of the Interim Progress Report (IPR) is to inform the Council, the European Parliament and the public of the progress made in transposing the Directive. It should therefore not be construed as a full-fledged assessment of the conformity of national provisions with the Directive, which will be performed following expiry of the transposition deadline in accordance with EU law. In order to provide a suitable overview, section 2 of the present report is structured around five sub-sections corresponding to the main provisions of the Directive, followed by a conclusion summarising the main findings.

2. PROGRESS IN TRANSPOSING THE MAIN PROVISIONS OF THE DIRECTIVE

2.1 Accounting, statistics and transparency provisions (Chapter II and Article 14 of the Directive)

Sound fiscal policy should be based on sound fiscal reporting. Comprehensive, timely and accurate information on budgetary execution is essential for policy-makers in many ways. First, it ensures that the budgets voted by legislative bodies are correctly executed. Second, it allows fiscal authorities to monitor in almost real time any deviation from agreed fiscal trajectories. Third, from a forward-looking perspective, it ensures that budgetary planning is conducted on the most up-to-date basis, minimising base effects caused by subsequent revisions of fiscal data.

Up until recently, high-frequency fiscal reporting has been patchy in the majority of Member States. Even where reporting duties were properly defined, general government data have been collected for different parts of government under different accounting rules or statistical principles in terms of frequency, reporting deadlines or compilation methodologies. Against this background, negative budgetary developments have remained undetected for an overly long period of time, especially when they originated in non-central government entities. One of the first steps to be taken by Member States under economic adjustment and growth programmes was the preparation of high-frequency fiscal reports for all general government entities[4].

Therefore the Directive provides a major opportunity to harmonise accounting conventions within general government, streamline reporting lines, and ensure an effective data feed to decision-makers and external observers. Enshrining existing informal collection processes and new statistical requirements in law would ensure that the hundreds —and sometimes thousands— of entities within general government are properly integrated within a comprehensive data collection system.

Almost all reporting Member States make monthly data for the central government bodies available in cash or in other accounting basis (BG, DK, DE, EE, EL, ES, FR, IE, IT, LT, MT, NL, AT, PT, RO, SK, FI, SE, SI and UK)[5]. However, fiscal data availability in compliance with the Directive is markedly lower for social security entities (BG, DK, EE, EL, NL, RO, PT, and FI) and on-going reforms are not yet completed for State government entities in AT, DE and ES[6]. At the local level, for which the Directive requires relatively lower standards

[4] Extensive work has been conducted in this regard in Greece; see European Economy — Occasional Paper No 94. 'The Second Economic Adjustment Programme for Greece — March 2012'.

[5] However, it is not always evident from Member States' reporting whether all entities and bodies outside the state budget but within central government are effectively contributing to data collection.

[6] In some cases, however, social security is included in central government while many Member States have no regional level budgets according to the European system of accounts (S.1312).

(quarterly reporting on a cash basis or equivalent), only eleven Member States (BG, DK, EE, EL, IT, LT, MT, PT, RO, FI and UK) report some data. Consequently, there is still a great deal to be done in most Member States for non-central government sub-sectors. This is especially topical given the sometimes sizeable share they represent in total public expenditure, especially in highly decentralised states.

In parallel with the Member States' efforts, the Commission is also taking steps in the statistical field. In order to assist Member States in the practical implementation of the statistical provisions in Articles 3 and 14 of the Directive, Eurostat has established a Task Force on the implications of the Directive on the collection and dissemination of fiscal data. The output from the Task Force is expected to be a set of templates and related notes indicating the methodology, the scope of compulsory details, and the periodicity and timeliness for national publication of individual indicators to guide the efforts of national statistical institutes. Most Member States have indicated their willingness to take into account the conclusions of the Task Force when finalising their efforts in the statistical field.

Moreover, Article 16(3) of the Directive stipulates that '*by 31 December 2012 the Commission shall assess the suitability of the International Public Sector Accounting Standards (IPSAS) for the Member States*'. In this regard, over sixty contributions have been received following the Commission's public consultation. The assessment report is due to be published before the end of 2012 and will cover the importance and usefulness of accrual accounting, the current use of accrual accounting in Member States, a summary and assessment of the suitability of IPSAS, the links and differences between IPSAS and statistical accounting, the potential cost of implementing new accounting standards and governance-related issues.

Finally, for the implementation of Article 4(7) of the Directive, Eurostat released on 6 February 2012 for the first time a dedicated, regular press release on quarterly government debt, providing data for the EU, the euro area and individual Member States. A similar initiative is envisaged for the quarterly deficit.

2.2 Macroeconomic and budgetary forecasts (Chapter III of the Directive)

Macroeconomic and budgetary forecasts used for fiscal planning have long been considered a weak spot in the production of annual budgets. Some Member States have been seen for a long time to be suffering from a bias in their fiscal estimates. In such cases, budgets underpinned by biased assumptions could hardly be considered as providing a true and fair image when submitted to Parliament and the general public. This is why the Directive pays particular attention to forecasting by devoting a chapter to this issue, which essentially requires Member States' fiscal planning to be based on realistic macroeconomic and budgetary forecasts using the most up-to-date information.

While setting standards for forecasting is a challenging endeavour, Member States should exert due diligence when preparing, publishing and evaluating their forecasts. Appropriate steps at the implementation stage would normally include a clear delineation of tasks between the entities involved in the forecasting process and include *ex post* evaluation. While the latter need not be conducted every year, it is a valuable step that could alert fiscal authorities to the existence of a bias.

Forecasting may also include the involvement of independent institutions or bodies with functional autonomy, as proposed in the 'two-pack' draft regulation for monitoring the

budgetary plans of the euro-area Member States[7], which extends and further specifies some of the Directive's provisions. When eventually adopted, the two-pack fiscal regulation may well provide effective support for achieving the Directive's objectives in this area.

Overall a third of Member States (BG, DE, DK, EE, PL, RO, SE, SI, SK and UK) report having structured processes in place involving several institutions or bodies to ensure transparency and accountability of forecasts. Other Member States are still at the drawing board stage or have so far reported only vague declarations of intent. The drafting of alternative macroeconomic and budgetary scenarios —a sound preventive step that facilitates budget shifts at the budget execution stage when actual parameters depart from the central scenario— is reported by AT, BG, CY, DE, DK, EL, RO, SE and UK. Only a minority of Member States report that they compare (or plan to compare) their forecasts with those of the European Commission (BG, CY, DE, EE, EL[8], FR, RO and SI), although some Member States use some Commission assumptions as input to their own processes (EE and PL). Few Member States report at this stage any specific measures to assess *ex post* the quality of forecasts in the sense of Article 4(6) of the Directive.

2.3 National numerical fiscal rules (Chapter IV of the Directive)

The Directive requires Member States to have in place country-specific numerical fiscal rules that effectively promote compliance with Treaty obligations in the field of budgetary policy (Articles 5 to 7). While the Directive does not specify such rules in detail, they must include requirements to the effect that the targets and scope of the rules are well defined, effective and timely independent monitoring is put in place, strict compliance mechanisms exist and only well-circumscribed escape clauses are defined[9].

Well-designed rules-based frameworks are known to significantly enhance budgetary discipline. Several pre-requisites need to be met when Member States design such rules. First and foremost, national fiscal rules must be fully compatible with the EU fiscal framework. Second, it is important to avoid two opposite pitfalls. On the one hand, coverage gaps would weaken the effectiveness of the entire framework by providing openings for budgetary overruns. On the other hand, over-stacking of national rules may increase the probability of conflicts between them if not properly designed and as a result weaken their overall authority. Finally, for the rules to fully make their presence felt and effectively ensure fiscal discipline, compliance needs to be assessed on a regular basis. Effective monitoring and *ex post* assessment are especially warranted when the rules are complex or there are numerous national rules whose interplay might be less straightforward to interpret. Periodic checks by monitoring institutions with sufficient authority would also provide an opportunity to raise awareness of fiscal sustainability, and foster a healthy debate with fiscal authorities and the general public on shared fiscal objectives.

Spurred by the introduction of the Directive and the TSCG, major reforms leading to an overhaul of fiscal rules have been unveiled or are reportedly already completed in twenty

[7] Proposal for a regulation of the European Parliament and of the Council 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 – COM(2011) 821 final.

[8] This is carried out within bilateral discussions in the context of the economic adjustment and growth programme.

[9] The inter-governmental TSCG constitutes a concrete application of the Directive for euro-area Member States and other Member States that have ratified it on a voluntary basis. It mandates the introduction of a budget balance rule in structural terms at national level, which would naturally have to comply with the Directive's requirements like any other national numerical rule.

Member States (AT, BG, CY, CZ, DE, DK, EE, ES, IE, IT, FR, LT, LV, NL, PL, PT, RO, SE, SK, and SI). Including proposed legislation, new budget balance rules have been unveiled in eleven Member States (CY, IE, ES, FR, IT, LT, LV, NL, PL, PT and SI). Furthermore, budget-balance rules are being updated with a view to strengthening them in five others (BG, DK, DE, EE, and AT). Some budget-balance rules would fully enter in force only after a transitional period. This is the case for Germany (2016 for the federal government, 2020 for the *Länder*), Austria (2017), and Spain (2020). Expenditure rules are being established in ten Member States (AT, CY, DK, EE, ES, IT, LT, LV, PL, and PT) and reformed in five other Member States (BG, CZ, RO, SI, and SK). The creation or strengthening of national debt rules is a new development in twelve Member States (AT, BG, CY, CZ, EE, IE, IT, ES, NL, PL, PT, and SK). In addition, Member States under an adjustment programme are subject to a multi-annual, multi-target framework constraining their fiscal policy as a *de facto* fiscal rule with enhanced features for monitoring and enforcement.

Many Member States declare that the new or updated rules will have features in line with the Directive's requirements. In particular, several Member States report that monitoring institutions will be tasked with assessing the implementation of fiscal rules (BG, CY, CZ, DK, DE, EE, IE, IT, LV, PL, and SK). Escape clauses have been defined in BG, CY, CZ, DK, DE, ES, IE, LV, AT, PL, and SK. The scope of fiscal rules is being expanded to include other sub-sectors of general government outside central government. Local or regional government is being subjected to fiscal rules, whether budget-balance rules (BG, DE, ES, FR, LT, LU, NL, AT, RO, SE, and SK), debt rules (BG, CZ, EE, ES, IT, AT, PT, RO, and SK), or expenditure rules (BG, ES, and AT). Overall, the establishment of national numerical fiscal rules appears to be on the right track. However, their specific features and overall consistency would eventually have to be assessed against the requirements of the Directive's Articles 5 and 6.

2.4 Medium-Term Budgetary Frameworks (Chapter V of the Directive)

Under the Directive, Member States are required to establish a credible, effective Medium-Term Budgetary Framework (MTBF), enabling them to expand fiscal planning beyond the annual horizon and thereby fostering more consistent, effective and potentially ambitious policy-making over the medium term. The MTBF must contain multi-annual budgetary objectives in combination with projections of each major revenue and expenditure item based on unchanged policies, with explanations of corrective medium-term policies to bridge the gap between the no-policy change projections and policy targets. Additionally, it must contain an assessment as to how the policies envisaged are likely to affect the long-term sustainability of public finances.

While the Directive dedicates a chapter to MTBFs (Articles 9-11), it is important not to see the drafting of a national MTBF in isolation. The timing of the preparation of the MTBF and its integration within the annual budget cycle have to be carefully considered so that it can fully serve as a strategic document for the state, functioning in tandem with regular annual budget documents. Wherever necessary the MTBF should replace existing planning documents or consolidate them into a single, well-identified, strategic document. Consistency is critical and should be understood along several dimensions. First, the MTBF should genuinely serve as a basis for the subsequent preparation of the annual budget. Second, as some Member States have developed multi-annual binding fiscal rules, figures derived from these fiscal rules should naturally feed into the MTBF. Finally, the MTBF document should also be consistent over time by documenting in detail and transparently numerical adjustments, whether they derive from base effects, deviations in outturns or discretionary changes.

Multi-annual frameworks are reported to be in place or concrete plans exist to establish them, in twenty-two Member States (BG, CY, CZ, DK, DE, EE, IE, EL, FR, HU, IT, LT, LV, NL, AT, PL, PT, RO, SE, SI, SK and UK). Almost all are of a rolling nature and consequently updated at least every year with the inclusion of an outer year. However, NL updates its framework only to accommodate price developments during the course of a legislature, whereas FR updates it every two years. SI operates a two-yearly budget, through adjustments conducted every year in combination with an expenditure framework for three years. Reported multi-annual frameworks span three years (BG, CY, FR, IT, LT, LV, HU, RO, SE, and SK), four years (CZ, DK, EE, EL, NL, PL, AT, PT and SI) or five years (DE, UK). Legislative provisions ensuring consistency between national multi-annual frameworks and the corresponding annual budget processes can be found in BG, CZ, EE, LV, PL and SK. Multi-annual frameworks are also a vehicle of choice for setting expenditure ceilings or targets (CZ, DK, EE, EL, FR, LT, LV, NL, AT, PT, SE, and SI), although the presentation of medium-term developments only for expenditure would not suffice to qualify as a medium-term budgetary framework in the sense of the Directive. Finally, only a few Member States report that multi-annual projections are presented under a no-policy change basis, although it is crucial to establish a baseline scenario in combination with policy measures to ensure achievement of the policy targets or values implied by existing fiscal rules.

2.5 Mechanisms of coordination across government sub-sectors (Articles 12 and 13 of the Directive)

Article 12 stipulates that the measures provided for by the Directive must be consistent across, and comprehensive in the coverage of, all sub-sectors of general government. This reflects the fact that initial efforts to improve budgetary frameworks concerned central government level only. With the Directive, the scene is set for a broad-based extension of the principles for accounting, statistics, forecasting and fiscal rules to social security funds and local government, which taken together, account for a sizeable share of total expenditure. To ensure good administration, Article 13 of the Directive also stresses the importance of a clear delineation of budgetary responsibilities among government tiers, and lays down the principle that '*Member States shall establish appropriate mechanisms of coordination across sub-sectors of general government to provide for comprehensive and consistent coverage of all sub-sectors of general government in fiscal planning, country-specific numerical fiscal rules, and in the preparation of budgetary forecasts and setting-up of multiannual planning as laid down, in particular, in the multiannual budgetary framework.*'

National provisions should accordingly make sure that the constraints deriving from fiscal targets for general government are properly internalised by all government levels. Such detailed provisions can only be of a country-specific nature given the specificities of the sometimes complex horizontal and vertical redistribution schemes among and within levels of administration. While clear and effectively enforced rules and procedures are essential for that purpose, such instruments should ideally be accompanied by fora where representatives of government entities have the opportunity to exchange views and participate in the overall annual budgetary cycle at a strategic level, before each government level prepares its annual budget according to its own procedural rules.

Beyond the establishment of fiscal rules for (or their extension to) sub-national governments, Member States report a variety of coordination instruments at various stages of the annual budgetary process. In BG, consultations with municipalities are held during the MTBF drafting process. The minutes of such consultations provide input for discussion of the draft State Budget Law by the Council of Ministers. In DK, a closer linkage is to be established

between agreed targets and central government grants to municipalities. In DE, the monitoring institution for the budget-balance rule (Stability Council) includes members of the federal government and the *Länder*. The longstanding practice of jointly forecasting revenue from shared taxes in a committee also constitutes some form of 'built-in' coordination. In ES, the new Organic Law lays down debt ceilings broken down by government levels, with corrective procedures applicable to sub-national governments. This type of domestic stability pact is also encountered in AT, where deficit targets are also assigned to each level, with a conciliation body to settle disputes between government levels. In NL, the draft law on the sustainability of public finances aims to legally anchor the obligation for local governments to contribute their fair share to achieving the Medium-Term Objective. Failure to achieve common targets may result in the imposition of fines on all 'failing' government levels. In RO, the Ministry of Public Finances submits instructions to local authorities in a Framework Letter on the drafting of local budgets, the macroeconomic framework, and ceilings for fiscal transfers from the state budget. In addition, BE, DE, IE, FI, FR, LU, and SI are considering adaptations to their coordination arrangements.

3. CONCLUSION

Overall, Member States reported substantial but uneven progress in transposing the Directive. With regard to Chapter II of the Directive, Member States have still some way to go to ensure timely and comprehensive statistical coverage for all general government sub-sectors. Reported forecasting provisions lack detail in quite a few Member States. Progress is somewhat more advanced regarding numerical fiscal rules as specified in Chapter IV of the Directive: a wide array of national instruments is being prepared to buttress national fiscal policy-making. The mutually-reinforcing nature of all pieces of legislation contained in the 'six-pack' that relate to the reform of the Stability and Growth Pact, combined with the additional impetus brought by the TSCG, has helped to place these issues high on the Member States' reform agenda. While many Member States report that MTBFs in the sense of Chapter V of the Directive are in place or planned, the details given are sometimes scarce and do not provide enough evidence that they will fully comply with the Directive's specifications. Finally, work on effective coordination arrangements for sub-national governments is being carried out in many Member States, but the positive intentions reported need to be turned into concrete and enforceable arrangements. A number of Member States considered good fiscal performers have reported fewer completed reforms at this stage, but are considering formalising part of their currently informal framework for increased efficiency. The Commission will continue implementing the Directive for the sections it is responsible for, and after the transposition deadline will conduct a full-fledged compliance assessment in accordance with standard EU procedures.