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NOTE

from:	Council Secretariat
to:	Coreper/Council
Subject:	National fiscal frameworks: Report on the exchange of best practice

Delegations will find attached a report prepared by the EPC and agreed by the EFC.

National fiscal frameworks: Exchange of best practice

Introduction

In May 2010, the Ecofin Council invited the Commission and the EPC to report on the main features of successful examples of fiscal framework reforms in specific Member States, particularly with regard to those frameworks that have proved effective in supporting fiscal consolidation and the sustainability of public finances. In the same Conclusions, the Council also called for a regular assessment and peer review of Member States' fiscal frameworks, including the impact of the crisis on existing frameworks and ongoing reforms.[1]

Of the countries identified by the Commission as good examples of successful fiscal governance reform[2], the Netherlands and Sweden volunteered to present their experience to the Economic Policy Committee on 16 September 2010. Austria also contributed to the discussion from the perspective of a Member State where significant improvements have been achieved in their fiscal framework.[3] This note presents the main messages of that discussion.

Main messages

While the reform of national fiscal frameworks must account for specific national circumstance and characteristics, successful national experiences identified by the Commission share some common features. In the case of the three countries under examination here, these include a comprehensive approach, rules-based frameworks, a medium-term perspective, an important role for independent institutions, a centralised budget process, a strong political commitment and regular evaluation and upgrading.

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[1] The EPC will consider a Commission proposal for the organisation of this peer review assessment exercise at the 27 October 2010 meeting.

[2] See Commission note "Overview of domestic fiscal framework reforms," March 2010. Both Sweden and the Netherlands have achieved significant debt reduction since the introduction of their frameworks and average budget deficits have been well below the EU average.

[3] In particular, with regard to the 2009 introduction of the Medium-Term Expenditure Framework (MTEF).

a. A comprehensive approach

The institutional changes implemented by these three countries since the 1990s were the result of broad and comprehensive reforms and represented a significant overhaul of the prevailing arrangements. In both Austria and Sweden, national authorities resorted to an extensive range of tools and arrangements to improve fiscal governance, in particular including numerical fiscal rules, independent fiscal bodies, medium-term budgetary planning and budgetary procedures. This is line experience in other countries and the economic literature on this issue, which suggest that partial or fragmented reforms will fail to achieve significant improvements. For example, the establishment of an independent monitoring body and the introduction of fiscal rules for example can be complementary rather than substitutive measures and there may be strong feedback effects between them. In the same vein, the introduction of multiannual fiscal rules as part of a broader medium-term budgetary framework may reinforce the positive effects of these two arrangements.

Reforms should also be comprehensive in terms of the coverage of all relevant general government subsectors layers of government by fiscal framework provisions. For instance, in each of the three countries examined, all government tiers are covered by numerical fiscal rules[1] and in the Netherlands and Austria, the mandates of the existing independent institutions extend to the whole of the general government sector.

b. Rule-based frameworks

A common feature of these three national approaches is their reliance on a rule-based framework, i.e. numerical fiscal rules that constrain the conduct of discretionary fiscal policies In particular, these three Member States have put in place an expenditure rule supplemented by a budget balance rule (AT and SE) or a revenue rule (NL). Recent research has labelled this a "smart" and effective combination of different types of rules as it seems to provide better budgetary outcomes in terms of fiscal discipline and stabilisation.[2] Further reforms to the rule-based systems in each of the three countries have placed an increasing emphasis on expenditure control. Spending ceilings in Sweden have recently been provided with a statutory basis, while Austria has introduced legally binding expenditure limits in its new medium-term planning and the Netherlands is considering extending the coverage of their spending thresholds.

1 While the new Austrian MTEF applies only to the federal government sector, the Austrian Stability Pact (ASP) encompasses all levels of government

2 See recent work by the IMF, OECD (Guichard et al. (2007) 'What promotes fiscal consolidation' , OECD

c. A medium term perspective

A distinctive feature of fiscal policy making in these three countries compared to many other Member States is the medium-term perspective of their fiscal planning. A multiannual approach is implemented through an effective medium-term budgetary framework (MTEF) closely linked to existing fiscal rules and providing binding budgetary targets over the next years (mainly expenditure objectives). The binding character of the MTEF is important in ensuring its influence on the annual budget law, which should followi the targets and fiscal strategy set out for the corresponding year of the multiannual framework (i.e., targets under the annual budget law for t+1 are based on the targets of year t+1 of the MTEF) This contrasts sharply with the current situation in a large number of other Member States, in which this link is established in the opposite direction (i.e. targets considered in the first year of the MTEF are annually revised according to the figures of the annual budget law), which of course limits budgetary policy making to a very short-term perspective.

d. Important role for independent institutions

A further common characteristic of fiscal frameworks in these Member States is the important role of independent public bodies entrusted with some technical tasks related to the conduct of fiscal policy. Austria has two long-standing independent bodies: the Austrian Institute of Economic Research (WIFO) provides macroeconomic forecasts for the budget preparation and the Government Debt Committee (GDC) conducts analysis of public finances and gives recommendations on fiscal policy issues. In turn, the Netherlands Bureau for Economic Policy Analysis (CPB), produces short and long-term forecasts and projections used for the annual budget law and supports appropriate checks and balances for the monitoring of the fiscal framework. Finally, the Fiscal Policy Council introduced in Sweden in 2007 is responsible for assessing the achievement of the announced fiscal policy objectives. This includes long-term sustainability, the respect of the current fiscal rules (i.e. budget balance target over the cycle and expenditure ceilings) and the fiscal policy stance. In addition, it also analyses government's budget proposals and reviews the methods used in official forecasts that prepare the budget.

Overall, there is a broad agreement that these institutions have considerably promoted transparency and credibility and have helped ensure sound and sustainable fiscal policies.

Economic Department Working Paper n° 553) and the European Commission's 2010 Public Finance Report

e. A centralised budget process

National budgetary procedures currently in each of these three Member States provides for a strongly centralised process, particularly at the planning stage. This centralisation is mainly achieved by giving the Ministry of Finance considerable power in its budget negotiations with the line or spending ministries. This is supported by the use of top-down budgeting, which in turn relies on binding expenditure ceilings stemming from multiannual spending rules. In the Netherlands and Austria, the centralisation at the planning stage is combined with a more flexible approach at the execution stage, when line ministries may be permitted to reallocate resources within overall expenditure ceilings.

f. A strong political commitment

A strong and enduring political commitment to the national fiscal framework has been essential to its success in each of the three countries examined. While deep fiscal crises may have been a key driver for initial reforms, a clear and transparent analytical and communicative framework has helped sustain support for robust multiannual frameworks. While this commitment has successfully been maintained by the Netherlands for many years at a political level through coalition agreements, Sweden and Austria have built up a strong statutory foundation for their frameworks. For instance, the new Austrian MTEF has recently been enshrined into law, as has the Austrian Stability Pact. Likewise, the existing fiscal rules in Sweden have recently been provided with a legal basis.

g. Regular evaluation and upgrading

All three of these successful domestic fiscal frameworks have been regularly reviewed and improved over time. While the main features of the original frameworks have remained unchanged since their inception, national authorities have introduced numerous changes aimed at increasing resilience and tackling observed shortcomings.

In the Netherlands, the non-partisan Budgetary Framework Commission, an advisory body of high-level officials, has helped ensure the further evolution of the framework in response to practical policy experiences and new fiscal challenges.[1] For instance, long-term considerations related to sustainability have gradually gained more influence on the fiscal target setting while the revenue rule was strengthened in 2003 to avoid the use of windfall revenues to finance additional spending. More recently, the Budgetary Framework Commission recommended increasing the coverage of the expenditure ceiling. In Sweden, the government recently introduced changes to improve the functioning of the existing budget balance rule defined over the cycle, and has also reinforced the legal basis of the fiscal framework. In Austria, the 2009 reforms are expected to be followed up with further measures to effectively implement performance-oriented budgeting from 2013 onwards.

In conclusion, a learning-by-doing approach has led national authorities in these three Member States to regularly revise and refine their fiscal frameworks to ensure a disciplined and consistent fiscal policy.

[1] The Budgetary Framework Commission (also known as the Study Group on the Budget Margin) issues formal advice to the Government every four years on the challenges for fiscal policy and proposes relevant changes to the underlying framework.