



**EU INDEPENDENT
FISCAL INSTITUTIONS**

The Network of EU Independent Fiscal Institutions

Contribution to the EFB Annual Conference 2023

*Working in the same or different directions? Assessing the relationship
between EU and domestic fiscal frameworks*

Abstract

The fiscal frameworks in EU countries rely on EU-level governance and a set of national rules and institutions, including national independent fiscal institutions (IFIs). In principle, EU and national governance frameworks could play a mutually reinforcing role and contribute to better overall fiscal governance. However, there is a risk that the two levels of governance could contradict or undermine each other. The forthcoming reform of fiscal governance, as proposed by the European Commission, aims to strengthen both EU and national fiscal governance.

This paper takes stock of (in)consistencies between EU and domestic fiscal frameworks, drawing specifically on the experience of EU IFIs as revealed in a new survey and case studies. It discusses issues related to the assessment of EU obligations and wholly domestic frameworks, and considers the key implications of proposed EU reforms.

Overall, it finds that the EU and national frameworks have been consistent most of the time, but with significant exceptions. In these cases, national requirements have generally leaned towards more prudent fiscal policies than the EU's requirements. The proposed EU reforms to economic governance could reduce the margin of discrepancy, but potential areas of divergence remain.

Contents

- Contents 2
- Authors 4
- Executive summary 5
- 1 Introduction 6
- 2 Consistency between national fiscal frameworks and EU fiscal rules 7
 - 2.1 A two-tier framework 7
- 3 Experience of harmony and conflict between EU and domestic frameworks 10
 - 3.1. Survey results on the experience of EU countries 10
 - 3.1.1 The relationship between EU rules and their implementation at the domestic level 10
 - 3.1.2 The interplay of EU and domestic rules 14
- 4 Interactions between the two frameworks: Case studies of Ireland, France and Finland 18
 - 4.1 Ireland 18
 - 4.1.1 Example 1 – Changes in the application of EU rules 19
 - 4.1.1. Example 2 – Distortions due to the use of inappropriate measures of potential output 20
 - 4.2 France 21
 - 4.2.1 Example 3 – Triggering the SGP’s escape clause during the Covid crisis 21
 - 4.2.2 Example 4 – The budget bill for 2017 22
 - 4.3 Finland 22
 - 4.4 Lessons from the case studies 24
- 5 Implications of the upcoming fiscal reform 25
 - 5.1 Implications of the proposed fiscal reform 25
 - 5.1.1 Consistency of *ex ante* assessments of national plans under the proposed EU framework 25
 - 5.1.2 Consistency of *ex post* assessments under the proposed EU framework and national frameworks 26
 - 5.1.3 Risks from legacy obligations of past governance frameworks 27
- 6 Conclusions 27
- 7 References 29

Figures, table and box

Figure 1. Frequency of IFI assessments differing materially from Commission assessments	11
Figure 2. Frequency of differing assessments of policy between IFIs and the policy permitted under the EU rules	13
Figure 3. Fiscal stance of CSRs as assessed by national IFIs.....	14
Figure 4. Presence of independent domestic fiscal rules (i.e. different in nature from the EU framework).....	15
Figure 5. Frequency of domestic requirements being stricter than EU requirements.....	16
Table 1. Possible cases of different assessments based on EU and national requirements	8
Box 1. Methodology for the IFI survey	10

Authors

This paper was prepared by an ad-hoc working group of the Network of the EU Independent Fiscal Institutions (IFIs). The group was composed of Inna Oliinyk and Danai Ellina (Secretariat of the Network of EU IFIs), Sebastian Barnes (Network of EU IFIs), Lucia Rodriguez Muñoz and Nara González (Independent Authority for Fiscal Responsibility, Spain), Eric Dubois and Guillaume Gilquin (High Council of Public Finances, France), Jenni Kellokumpu and Leena Savolainen (National Audit Office, Finland), Eddie Casey, Brian Cronin and Killian Carroll (Irish Fiscal Advisory Council, Ireland). Other Contributors include Esther Gordo Mora, and Richard van Zwol (Network of EU IFIs).

The authors would like to thank the members of the Network for their input during the preparation of this study and the extensive feedback provided during the review process.

Executive summary

EU countries have a two-tier framework to oversee fiscal policy, with budgetary rules and institutions at both the EU and domestic levels. In April 2023, the European Commission published its proposals for fiscal reform under the economic governance review. They call for strengthening EU and domestic frameworks to promote national ownership.

This study examines discrepancies between EU and national frameworks under the current regime, including between assessments of the European Commission and independent fiscal institutions (IFIs). It draws on evidence from a new survey and country case studies. The key findings are summarised below.

- At the EU level, a fiscal framework is needed to avoid negative spillovers from unsound fiscal policies and to coordinate fiscal policies so as to achieve the appropriate fiscal stance. Domestically, fiscal frameworks seek sound economic management and to ensure long-run sustainability. While these objectives are likely to be similar, they are not identical.
- EU countries are obliged to comply with both frameworks; some choose to mirror EU fiscal rules, but many have separate national frameworks.
- A new survey of national IFIs conducted for this study finds that EU and domestic fiscal frameworks have worked in harmony for most countries, most of the time.
- However, there have been cases of material disagreement between the EU and national levels in the assessments of public finances.
- The main areas of disagreement have been based on discrepancies in the assessments of output gaps and the structural balance, the size of discretionary revenue measures and one-off measures. They have also pertained to invoking and withdrawing the general escape clause of the Stability and Growth Pact as well as assessments of overall compliance with the rules.
- These disagreements have generally seen national frameworks and IFIs taking a more prudent approach than the EU rules or assessments of the Commission.
- National IFIs have reported some cases where their assessment of significant deviation from the fiscal rules was contradicted by an assessment of compliance by the Commission, which undermined their assessments and their credibility.
- The April 2023 legislative proposal for the reform of EU economic governance could reduce the margin of discrepancy and improve the framework's transparency by focusing on a simpler operational rule. Nevertheless, some potential areas of divergence could remain.

1 Introduction

The review of economic governance and reform of the EU fiscal framework envisage strengthening fiscal rules at the EU level, but the European Commission's proposals also aim to increase national ownership and bolster national fiscal institutions. In this context, the question of whether the EU and national frameworks are working in the same direction – their consistencies and conflicts – remains relevant.

This paper looks at the current regime through the lens of a new survey of EU independent fiscal institutions (IFIs) and case studies to reveal experiences with the existing framework, and explores how this might work in the future. The study aims to enhance understanding of the current two-tier framework and the potential implications of reforming the EU's requirements.

Section 2 discusses the effects of certain inconsistencies, particularly for the credibility of either the domestic or the EU framework. Section 3 outlines how IFI assessments differ from those of the Commission and the underlying reasons for this, drawing on new survey results. In particular, IFI assessments of the following aspects are considered: discretionary revenue measures (DRMs), output gaps and structural balances, and compliance with EU or EU-based domestic fiscal rules. Section 4 presents three case studies that reveal the different extent and nature of inconsistencies between the two frameworks, namely the perspectives of the Irish Fiscal Advisory Council (FAC), the French Haut Conseil des Finances Publiques (HCFP) and the National Audit Office of Finland (NAO). Section 5 discusses the ramifications of the proposed reforms. Section 6 concludes.

The study finds that while the EU and national fiscal frameworks are broadly consistent, there are instances of material discrepancies between IFI and European Commission assessments. In such cases, the national frameworks are often more prudent than the EU framework. The proposed reform of EU economic governance should reduce the scope for divergence through a simpler operating rule, but areas of difference may remain.

2 Consistency between national fiscal frameworks and EU fiscal rules

2.1 A two-tier framework

The architecture of the European Union allows sovereign and independent Member States to pool together sovereignty and delegate some of their decision-making powers to the EU institutions on specific matters. While specific decisions about tax and spending remain largely within the competence of Member States, there is a requirement that ‘Member States shall regard their economic policies as a matter of common concern and shall coordinate them within the Council’ (Article 121 TFEU).

Article 126 of the Treaty sets out specific requirements for fiscal deficits and public debt, provides for monitoring by the Commission, the possibility for the Council to make recommendations and allows the Council to impose sanctions for non-compliance. This is supported by Protocol 12 of the Treaty and a range of secondary legislation, collectively referred to as the Stability and Growth Pact (SGP).

Several EU countries have their own domestic fiscal rules and frameworks, including national IFIs. These also impose requirements, and provide for monitoring and corrective action in the setting of national budgetary policy.

This creates a two-tier framework for the oversight of national fiscal policy, with both an EU and a domestic level. At the EU level, a fiscal framework is needed not only to avoid negative spillovers from unsound fiscal policy, but also to manage spillovers and coordination more widely. Domestically, fiscal frameworks aim to achieve sound economic management and ensure long-run sustainability. These objectives are likely to be similar but not identical.

An interesting feature of this framework is that in several cases the EU has set requirements for domestic frameworks, including some leading to the creation of IFIs in many countries. For a start, the 2011 Directive on requirements for budgetary frameworks of the Member States (2011/85/E) sets out a range of requirements for budgeting at the national level. Furthermore, the EU requirement to have national macroeconomic forecasts undertaken or endorsed by a ‘functionally independent’ body has in practice stimulated the set-up of many IFIs at the national level. In addition, the EU Fiscal Compact requires countries to put some aspects of the EU fiscal rules into national law.

Both levels of oversight in the two-tier framework are likely to be concerned with the same outcome variables, whether directly in terms of targeting identical measures or indirectly because compliance with one rule affects compliance with another.

The two frameworks should ideally be mutually reinforcing in the sense that both contribute to fiscal sustainability and sound economic policy. This is to be achieved by broadly similar requirements in terms of fiscal outcomes, with any differences contributing to a richer fiscal framework that better takes into account all relevant circumstances than a single framework. For example, domestic frameworks could be better attuned to specific national circumstances, while the EU framework could provide a stronger focus on EU-wide objectives. If the more binding of the requirements is pursued¹, this effectively leads to a more richly parameterised fiscal framework taking the two levels together.

¹ Assuming that rules are set in terms of minimum standards.

If either framework is subject to enforcement difficulties, a two-tier framework may be more robust if one level of the framework proves to be more effective in practice than the other. In countries with a strong domestic framework, the EU level may be somewhat redundant. However, in countries where domestic fiscal frameworks are weaker, or relatively new and thus not yet well established, the EU level may provide an important backstop to national fiscal policy. For example, Germany’s debt brake post-2020 has been eroding and is thus less strict than that of the EU.

At the same time, the two-tier framework could also operate in such a way that there are significant inconsistencies between the two levels. First, there may be high-level differences in the objectives of the rules. For example, one level may require a much more prudent fiscal policy than implied by the other level. These differences might reflect alternative preferences or views of how the economy functions. Second, even with shared high-level goals, intermediate rules could have very different implications. For example, an EU requirement to meet a specific decline in the structural balance might imply a much faster reduction in the debt ratio than a domestic spending or a debt rule might imply. Third, despite similar frameworks, different assessments of the state of the economy, for example the output gap or medium-term growth, might have divergent implications.

There are a number of possible cases (assuming that the frameworks are asymmetric in terms of setting minimum requirements)² (Table 1).

Table 1. Possible cases of different assessments based on EU and national requirements

Frameworks assess policy as		EU requirements	
		<i>Too loose</i>	<i>Appropriate</i>
<i>National requirements</i>	<i>Too loose</i>	Agree on need to tighten	Domestic requiring tighter policy
	<i>Appropriate</i>	EU requiring tighter policy	Agree

Source: Authors.

These inconsistencies may be minor or usefully allow for a more richly parameterised fiscal framework (as noted above). Yet, they could also serve to undermine the credibility of either the domestic or the EU framework if politicians are able to use the contradiction to justify ignoring the requirements of one of the frameworks. In the worst case, they could game the system by systematically choosing to comply with the least binding of the requirements, remaining able to point to compliance with either framework while pursuing a riskier policy than either framework individually would imply. The additional complexity of having both a domestic and an EU-level framework may also make it more difficult to get buy-in from politicians and voters for either framework.

The inconsistencies between the two tiers of the fiscal framework in the EU can be problematic for national IFIs. As some of the EU requirements are transposed into national legislation (often using the same legal text), their assessment becomes a competence of national IFIs. This essentially means that

² There would be more scope for contradiction if frameworks could require a looser stance than the government is pursuing and not just a minimum fiscal position.

the same requirements are assessed by both national IFIs (national level) and the European Commission (EU level).

Depending on the outcomes of the two assessments, various issues arise. On the one hand, if the assessments differ, the Commission's assessment overrides that of the national IFI, whose credibility is undermined domestically. On the other hand, if the assessments are consistent, it essentially makes one of the assessments redundant. Even though in both cases the assessment by the IFI remains important in ensuring national ownership and enhancing the quality of the national debate around public finances, communicating the IFI's assessment can become challenging.

3 Experience of harmony and conflict between EU and domestic frameworks

This section considers EU Member State experience of whether the EU and national fiscal frameworks have worked harmoniously in the same direction or pulled in contradictory directions. It is based on the Network's new survey of EU IFIs and case studies of selected countries developed by their national IFIs.

The Network's survey sought to measure how often IFI assessments differ from Commission assessments and what the underlying reasons are (see Figure 1). In particular, IFI assessments of the following aspects were considered: Discretionary Revenue Measures (DRMs), the output gap and structural balances, and compliance with EU or EU-based domestic fiscal rules (see Box 1).

Box 1. Methodology for the IFI survey

The study builds on data collected from 30 EU IFIs as part of a survey conducted by the Network of EU IFIs in autumn 2022. Member IFIs were asked about the frequency of discrepancies between their assessments and European Commission assessments. IFIs responded with 'often', 'sometimes', 'rarely', 'never' or 'don't know'. IFIs elaborated on their responses.

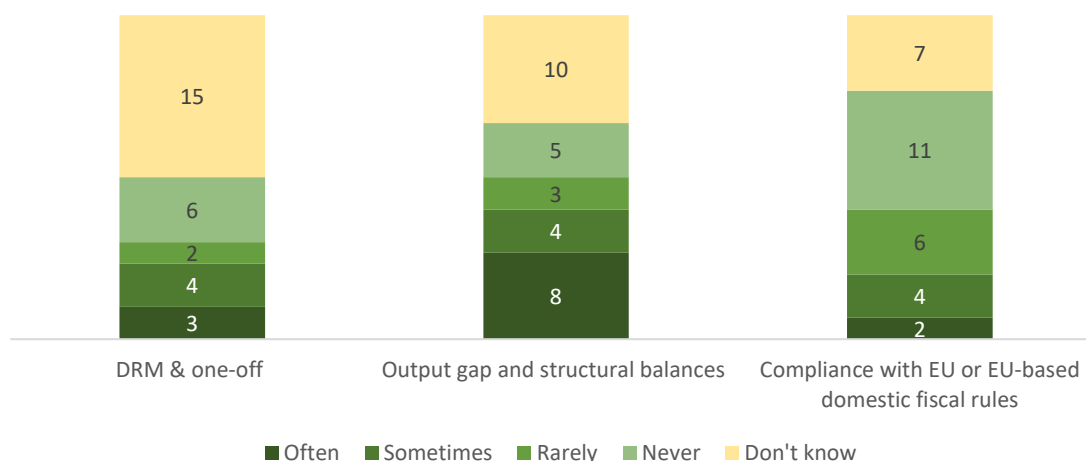
The results were interpreted as follows. Responses of 'often' or 'sometimes' were deemed as referring to discrepancies that have produced material differences between IFIs and the Commission at least once since 2012, and on a regular or irregular basis respectively. Responses corresponding to 'rarely' were identified as some instances that may have had a material impact. 'Never' implies no inconsistencies between the two frameworks, whereas 'don't know' responses have not been analysed since it is assumed that if there had been inconsistencies between IFI and Commission assessments, the IFIs would have been aware of it.

Responses to whether the Commission's decisions and perspectives have differed materially from those of the national IFIs are entirely based on the individual assessment and calculations of each IFI.

3.1. Survey results on the experience of EU countries

3.1.1 The relationship between EU rules and their implementation at the domestic level

Between a third and half of EU IFIs have experienced at least some material differences between their assessment of the fiscal position and compliance with the rules and assessment of the European Commission (see Figure 1). For those experiencing such contradictions, these occurrences have been rare or occasional with only a small number experiencing differences often.

Figure 1. Frequency of IFI assessments differing materially from Commission assessments

Note: This figure is based on the survey responses of 30 IFIs from 26 EU countries. IFIs were asked: ‘How often has your IFI’s assessment of items below differed materially from that of the Commission since 2012?’

Source: Network of EU IFIs (2023).

The most prominent difference between IFI and Commission assessments is observed for output gaps and structural balances: half of the IFIs have experienced at least some contradictions in assessments since 2012. Out of these IFIs, 8 have seen discrepancies often. There are two sources that explain this. First, there can be differences in the forecasts for GDP and other variables between EU and national institutions. This will impact the output gap and potential GDP. Many national IFIs point out that the EU’s commonly agreed methodology for output gap produces highly volatile and implausibly procyclical estimates for some countries. For this reason, many national IFIs have adapted their own methodologies and indicators in calculating output gaps. Second, there may be differences in how structural deficits are derived from the headline balance because of different revenue elasticities from those published by the European Commission (see Section 5).

The critical role of the structural balance in the current EU governance framework and sensitivity to key assumptions and methodologies implies that differences of approach can quickly lead to material differences in the assessment of the Commission and the national IFIs. Sometimes, the differences are as big as to lead to a sign switch or to make the distinction between compliance and non-compliance. For example, in 2019 the Slovakian Council for Budgetary Responsibility recommended triggering the correction mechanism after the balanced budget rule was assessed. There were significant deviations mainly due to revenue windfalls. However, the European Commission and the Slovak Republic’s finance ministry did not consider the deviation as significant when assessing Slovak public finances.

For about a third of surveyed IFIs (9 out of 30), their assessment of DRMs and one-offs has been materially different from that of the Commission at least once since 2012 (see Figure 1). The classification of one-off measures adopted by the European Commission has not always coincided with that of the national IFIs, particularly during crises (the EU sovereign debt crisis and following adjustment programmes, and the Covid-19 crisis). This was particularly prominent during the pandemic. On the one hand, some IFIs considered Covid-19 support measures to be one-offs. On the other, the Commission did not consider them in their calculations of structural balances, despite having stated that the

exclusion of temporary emergency measures leads to a more appropriate assessment of the underlying fiscal support for economic activity³.

The cases in which differences in one-offs and DRMs occur can stem from national IFIs using alternative principles for one-off identification from those of the Commission (e.g. OECD analyses and observations such as in Girouard and Price (2004)). Even when IFIs base their classification on the Commission's principles⁴, differences may occur. This could be attributed to varying interpretations of the Commission's principles. IFIs also employ different calculations of the budgetary impact associated with the one-off measure as a result of secondary and multiplier effect assumptions. These differences are usually reasonably small and do not pose many issues. Nevertheless, they can contribute to a significant worsening or improvement of the calculation of the structural balance, especially in times of crisis.

Overall, differences in the assessment of national IFIs and the Commission on compliance with EU or EU-based domestic rules have been rather infrequent, with many institutions experiencing only rare or infrequent divergences. Slightly less than half of all surveyed IFIs (12 out of 30) have seen differences in assessment at least once since 2012. But for two IFIs, these divergences occurred often. The IFIs note they lack detail in knowledge of the Commission's calculations to identify the sources of difference on compliance assessment.

According to national IFIs, there are several reasons for the differences. Interpretations of the law can diverge, leading to different assessment results. This is primarily the case for national (EU-based) fiscal rules. Differences in compliance assessments can also be caused by differences in calculations in the application of the rules. This relates to the methodologies underlying the calculations of certain fiscal indicators (the structural balance, expenditure benchmark, etc.), but also to the flexibility in the application of the rules themselves (especially regarding the application of the unusual event clause and use by the Commission of compliance and adjustment margins).

In addition, divergence in compliance assessments can stem from national IFIs lacking access to information. Some IFIs report that assessment of *ex ante* compliance has sometimes differed because their assessment has typically been carried out at an early stage, with only partial information for interpretation of the EU rules. This includes a case where major indicators used by the Commission in assessments have changed during a crisis. Others report that their assessment of *ex ante* compliance has sometimes differed due to lack of information on the estimation of the DRMs. Having limited access to the Commission's methodology on estimating the DRMs, the IFIs usually resort to using government estimates. These can diverge from the Commission's estimates, but IFIs have no access to information as to why the two diverge.

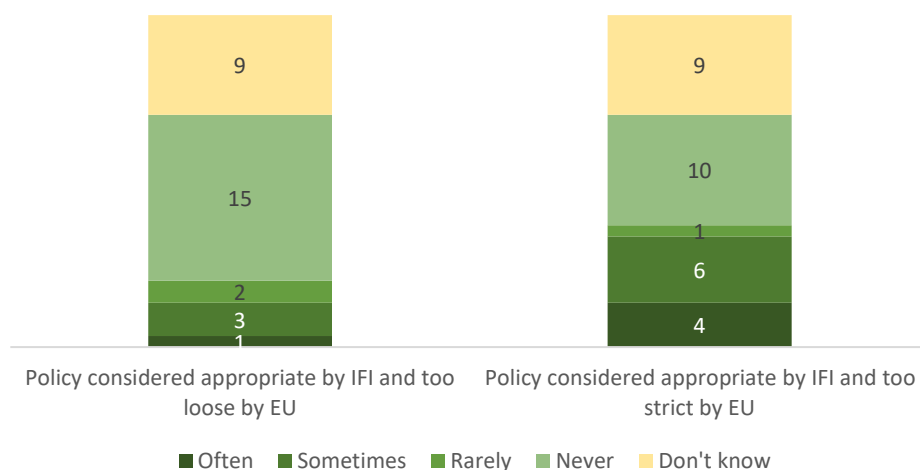
Several IFIs have reported that their warning of significant deviation from the fiscal rules has been contradicted by an assessment of compliance by the Commission (see Figure 2). In the perception of IFIs, this has undermined their assessments as governments were able to point to the Commission's assessments as an alternative. Over time, this may weaken the reputation and perceived effectiveness of the national IFIs.

³ See page 9 of [the Commission's communication summarising its assessment of 2021 Draft Budgetary Plans \(European Commission, 2020\)](#).

⁴ The five basic principles are set out in the European Commission publication, 'Guiding Principles for the Classification of One-Off Measures', Report on Public Finances in EMU 2015.

Instances where the policy was considered appropriate by the IFI but was stricter than the one permitted by EU rules have happened more frequently than vice versa. Around a third of surveyed IFIs (11 out of 30) have assessed, at least once since 2012, national policies as being appropriate but these have not been permitted under the EU framework (see Figure 2). The opposite situation, where the EU framework is deemed too demanding, has occurred more rarely and in fewer countries (6 out of 30).

Figure 2. Frequency of differing assessments of policy between IFIs and the policy permitted under the EU rules



Note: This figure is based on the survey responses of 30 IFIs from 26 EU countries. IFIs were asked: ‘Has your IFI’s assessment of appropriate policy differed materially from what was permitted by any of the EU fiscal rules since 2012?’

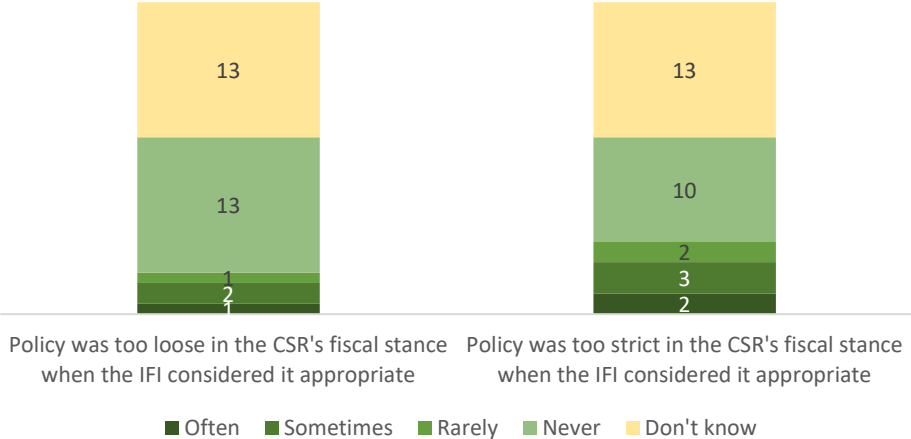
Source: Network of EU IFIs (2023).

According to national IFIs, three reasons explain the differences in assessments. First, in some countries national rules are stricter where applicable, compared with EU legislation. Second, IFIs are generally more prudent in their assessments. In particular, many IFIs consider that EU thresholds and rules should be reached exactly as a limit rather than using stated margins of tolerance or other de facto discretion used by the Commission. This may reflect a different approach to the rules, but also the independence of the national IFIs and their legal obligations towards assessing compliance with the rules. Third, as the output gap estimates that underpin EU fiscal indicators can be procyclical, IFIs sometimes use their own indicators, leading to a difference in the assessment.

There is a similar pattern with respect to IFI assessments of the appropriateness of the overall fiscal policy stance in country-specific recommendations (CSRs)⁵, albeit to a lesser extent than the overall policy stance. Around a fifth of all surveyed IFIs (7 out of 30) have assessed national policies as being appropriate, in contradiction to the fiscal policy stance in the CSRs, at least once since 2012 (see Figure 3). The opposite situation, where the overall fiscal policy stance in the CSRs was too tight compared with IFI assessments, has happened more rarely – for only 4 IFIs out of 30.

⁵ Some IFIs do not regularly assess the fiscal policy’s appropriateness due to their mandates. This explains some of the ‘don’t knows’, while other institutions may have provided an informal assessment for this survey.

Figure 3. Fiscal stance of CSRs as assessed by national IFIs



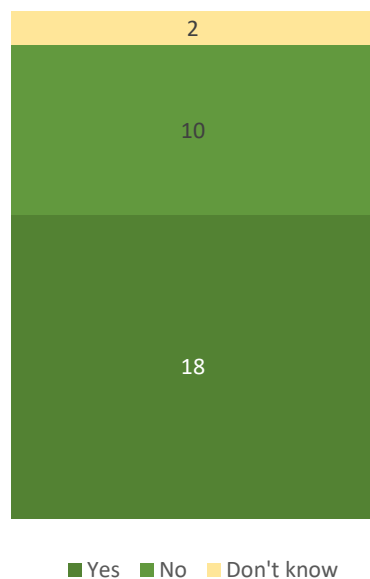
Note: This figure is based on the survey responses of 30 IFIs from 26 EU countries. IFIs were asked: ‘Has your IFI’s assessment of appropriate policy differed materially from the overall fiscal policy stance in the CSRs since 2012?’

Source: Network of EU IFIs (2023).

Some of the differences have occurred during crisis periods, such as the post-2012 sharp fiscal consolidation and the pandemic. The crises hit countries differently across the eurozone, where some national IFIs were more concerned about fiscal sustainability than shown by the fiscal stance of the CSRs. Some national IFIs were worried about the expansionary and more permanent nature of the measures taken amid Covid-19 while the EU fiscal rules were on hold.

3.1.2 The interplay of EU and domestic rules

In a large majority of EU countries, there are domestic fiscal rules that are independent of the EU fiscal framework (see Figure 4). About two thirds of EU countries (18 out of 30) have domestic fiscal rules that are independent and different in nature from the EU framework. One example is the objective set by Member States for the structural balance to be fully linked to long-term sustainability measurements, whereas the EU Medium-term Objective (MTO) considers a third of future costs related to population ageing for the structural balance. Another example is the trend-based fiscal policy pursued by some European governments, which does not guarantee a certain outcome with regard to EU fiscal targets. That is, annual expenditure ceilings and revenue frameworks are set separately to ensure that public finances remain within the limits imposed at a national level.

Figure 4. Presence of independent domestic fiscal rules (i.e. different in nature from the EU framework)

Note: This figure is based on the survey responses of 28 IFIs from 25 EU countries. IFIs were asked: ‘Are there domestic fiscal rules that are independent (i.e. different in nature) from the EU framework?’

Source: Network of EU IFIs (2023).

There are several reasons why countries might have separate arrangements. They may reflect different institutional histories that predate the EU framework, which may imply different policy goals and targets. They may also be better adapted to national circumstances, covering issues beyond the scope of the EU rules. For example, country-specific rules integrate national and sub-national interactions. Finally, the Directive on medium-term budgetary frameworks (2011/85/EU)⁶ calls directly for countries to put in place a country-specific framework for spending control.

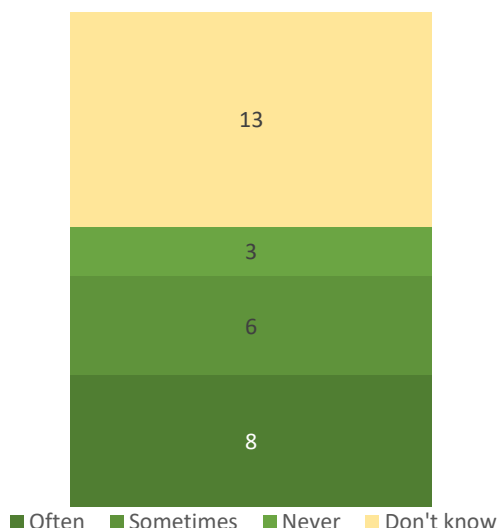
Almost half the surveyed IFIs (14 out of 30) report that domestic fiscal rules have been stricter than EU fiscal rules at least once (see Figure 5), while most of the others do not know (13 out of 30). In countries where it is often the case, the debt-level rule and structural deficit limit are tighter than the national MTO. Prior to the pandemic, some EU countries chose an MTO within the range established by the EU framework that was stricter than the relevant national fiscal rules. Some domestic rules consider types of debt that are not encompassed in the Maastricht Treaty’s SGP, such as the regional debt limits in Spain. Overall, where national fiscal rules are stricter or touch upon country-specific features, they support compliance with EU fiscal rules – particularly because the extent of monitoring compliance with EU fiscal rules is less than that for national ones.

In other Member States, while rules regarding the structural balance have been stricter than the EU counterparts, other rules on national expenditure have been looser. The reasons why national expenditure rules may be looser include (i) the exclusion of certain government expenditures, such as pensions; and (ii) the maximum growth rate of expenditure aggregates, which are either measured differently or vary among countries. On the latter, some countries have a stricter structural balance rule than the EU framework, whereas others are bound by the previous year’s expenditure level.

⁶ Council Directive 2011/85/EU on requirements for budgetary frameworks of the Member States.

In some countries, the national rules use a framework similar to the EU rules but determine key parameters using country-specific approaches. For example, the floor on the structural balance at the national level may differ from the MTO, and is based on a formula taking into account macroeconomic variables such as nominal GDP growth, population ageing costs and debt-reduction efforts. Also, structural reform and investment clauses may not be reflected in domestic laws, in part because they were added later to the EU framework.

Figure 5. Frequency of domestic requirements being stricter than EU requirements



Note: This figure is based on the survey responses of 28 IFIs from 25 EU countries. IFIs were asked: '[Are] domestic requirements much stricter than EU requirements?'

Source: Network of EU IFIs (2023).

There are also deeper differences where the domestic framework is completely at odds with the EU framework. For example, the budget rules steer towards expenditure ceilings as an operational target. The treatment of assorted budget items in the national ceilings and EU expenditure benchmarks may be a cause for clashing fiscal frameworks. Other countries differ in the coverage of expenditure limits in comparison with EU fiscal rules. This results in diverse definitions of 'expenditure', particularly for output gap estimations and the classification of national temporary measures. This may be of particular relevance for countries with a decentralised form of government, where there are differentiated targets for various levels of administration.

Also, national expenditure ceilings have multi-year timeframes, whereas assessments of whether a country is complying with its MTO occur on a rolling, annual basis. This can result in different conclusions about a country's fiscal stance. In cases where the structural budget balance is employed as an operational target, the national fiscal policy may have different adjustment objectives than in the EU framework.

In general, comparisons between the national and EU frameworks were especially difficult due to the activation of the EU's general escape clause, introduced under the Six-Pack reform of the SGP in 2011, which was extended to the national level in many cases. The MTO has not been applied since the Covid-19 crisis, especially regarding the structural deficit. Moreover, some national IFIs have reported that EU fiscal rules play a secondary role in the national fiscal scene. This links to EU fiscal rules usually being

looser than domestic rules. As a result, automatic compliance with the former is achieved should the latter be met.

Overall, there are some measures that could minimise the effect of discrepancies between national and EU fiscal rules. More tracking by the European Commission and Council of the alignment of IFI assessments and CSRs could increase attention on CSRs in public debate in the medium term. Also, the national budgetary process could be transposed into the Stability Programme by focusing more on policy and ensuring coherence with the National Reform Programme. This would improve the quality of national contributions to the European Semester.

Furthermore, the methodology and measurement of fiscal rules as well as the correction mechanism for debt excesses differ from EU rules in some Member States. For IFIs, having access to information related to changes in the methodology used to calculate variables in EU fiscal rules would be useful. This would enable IFIs to compare national and EU rules more readily.

4 Interactions between the two frameworks: Case studies of Ireland, France and Finland

This section looks more in depth at experience of the relationship between domestic and EU fiscal frameworks. The following case studies prepared by the national IFIs of Finland, France and Ireland are used to more closely examine the interplay between the EU and national fiscal frameworks in their countries. All three countries have domestic frameworks that draw fairly closely from the EU framework, but nevertheless show some occasional divergences. Some EU Member States have translated the EU fiscal framework into domestic legislation, whereas others have decided to establish fiscal rules that are different from those at the EU level. For both approaches, interactions with the European Commission involves interlinkages and inconsistencies. The following case studies reveal variations in methodologies and assessments between IFIs and the European Commission, showing the scope for better interaction between the two stakeholders. Efforts to develop frameworks better suited to domestic circumstances, such as in Ireland, could also have led to greater frictions over time.

4.1 Ireland

Ireland has until very recently relied on EU fiscal rules, directly and as mirrored in domestic law, rather than developing a separate national framework. While this means that EU and domestic rules point in the same direction, conflicts have arisen on occasion. This is due to the Commission's reliance on measurements of the cycle, which were often inappropriate and procyclical – such as using GDP as a measure of Ireland's output. Also, discretionary decisions by the Commission on the implementation of the EU fiscal rules were poorly communicated. More recently, the Irish Fiscal Council and the government moved to approaches that are more distinct from the EU framework.

In 2012, Ireland opted to transpose the Fiscal Compact⁷ into Irish law with the Fiscal Responsibility Act (FRA) (2012). The Act established a 'budgetary rule'. This set requirements for achieving a structural balance, which is defined as the MTO and adjustments to the structural balance towards this. The Act required any plans in relation to the budgetary rule to be consistent with the rules of the Stability and Growth Pact. Although not explicitly mentioned in the Act, the Council received legal clarifications that judged the expenditure benchmark to be part of any assessment of compliance with the budgetary rule. The Act also sets out provisions for exceptional circumstances and a 'comply or explain' provision⁸. In addition, the Fiscal Compact was included in the Constitution by referendum.

In general, Ireland has complied with the requirements of the EU fiscal rules as assessed by the European Commission and with the domestic equivalents of the EU rules set out in the FRA as assessed by the Irish Fiscal Advisory Council. There were breaches, but not significant deviations that would lead to an overall assessment of non-compliance. The Council's approach to assessing compliance was largely based on applying the framework set out by the Commission in the *vade mecum*, but using its own assessments of the parameters and domestic forecasts.

⁷ Officially known as the Treaty on Stability, Coordination and Governance.

⁸ The comply-or-explain provision essentially states that if the Commission addresses a warning to the state or if the government considers there to be a failure to comply with the budgetary rule constituting a significant deviation from the rules, the government shall prepare a plan specifying requirements to secure compliance with the budgetary rule (Fiscal Responsibility Act, 2012).

This compliance partly reflects the relatively benign position of Ireland relative to these fiscal requirements since exiting the Excessive Deficit Procedure in 2016. First, the relevance of GDP-based rules faded as distortions increased the level of measured GDP compared with underlying measures of domestic national income (modified gross national income or 'GNI*' is now the preferred measure). Second, Ireland has enjoyed strong growth over this period, falling interest rates and a rapid growth of corporation tax receipts from the multinational sector.

In August 2019, the Council decided to move away from mirroring the Commission's approach to assessing compliance with the fiscal rules and to apply its own 'principles-based approach' to assess the domestic budgetary rule ([Irish Fiscal Council, 2019](#)). The Council cited two main shortcomings with the Commission's approach:

- Structural balances estimated on the basis of output gap estimates produced under the commonly agreed methodology were highly problematic. These estimates proved to be excessively procyclical and, often, implausible. In addition, they relied on GDP, which, in the Irish context, was subject to large distortions from multinational activities.
- The Commission's approach was judged to introduce excessive complications with questionable merit, such as the approach to freezing vintages of estimates⁹.

The Council's new approach simplified assessments, relying instead on more plausible and latest-vintage estimates of potential output based on a new domestic measure developed by the Department of Finance and drawing on the Council's own work.

There were some trade-offs involved in the Council moving to a simpler approach to assessing compliance with the domestic FRA while increasing the risks of conflict with Commission assessments. Nonetheless, in practice the approach made for a more stable framework for Council assessments and the simpler and less distorted framework has helped the Council assess fiscal policy. Ultimately, this regime was only in place for a short period before the Covid pandemic.

More recently, the government introduced a new nominal spending rule based on its own assessment of potential output in 2019. The Council had argued for such a new domestic framework, independent of the EU rules, as best meeting Ireland's needs. The new rule has similarities with the approach proposed by the Commission under the economic governance review, although the Irish rule has not been put into law and many key details have not been spelt out explicitly.

There are two notable examples of where the EU and domestic frameworks have been in conflict, discussed below.

4.1.1 Example 1 – Changes in the application of EU rules

In October 2015, the Fiscal Council made a public pronouncement that the government's budget was likely to breach the fiscal rules. Specifically, the Council assessed that the planned adjustment to the structural balance was unlikely to be sufficient, given strong growth, a positive output gap and a need for a larger adjustment to the structural balance on those conditions.

⁹ The freezing approach added further layers of complexity and meant numerous vintages of potential output were required to assess compliance. These estimates were often subject to end-point bias, and using estimates based on information from a number of years prior to the present day exacerbated such problems. By contrast, more up-to-date estimates tended to be closer to the parameter values and more consistent with intuition.

Yet, the Council was unaware of a poorly communicated decision by the Commission to adjust how the rules were applied, which meant that earlier and smaller requirements for Ireland's adjustment in its structural balance would be frozen and kept in place. Instead of a 1 percentage point adjustment on the basis of the latest available economic and fiscal information, a smaller, frozen adjustment requirement of 0.6 percentage points would apply for the Commission's assessment (Irish Fiscal Advisory Board, 2015).

While the government introduced a budget that year involving a sharp increase in net spending, the government was still able to comply with the rules based on the Commission's freeze of the adjustment requirements. The conflict between the Fiscal Council's assessment and what the finance ministry believed would be the Commission's assessment was a source of public controversy.

This led the chairperson at the time to issue a retraction of his initial assessment, which entailed some reputational damage to the Council. The experience showed how difficult monitoring the rules could be when trying to mirror the details of the approach taken by the Commission, with the Council not the ultimate owners or architects of the fiscal rules. In effect, it was enforcing rules where the implementation could change with little warning and with little input from the Council. The incident also highlights the importance of full transparency and timely provision of information from the Commission about even very detailed aspects of its application and its interpretation of the rules.

4.1.1. Example 2 – Distortions due to the use of inappropriate measures of potential output

A second earlier example of conflict related to how the expenditure benchmark was applied. Coming out of the financial crisis, estimates of Ireland's potential output based on the commonly agreed methodology were giving extremely low numbers. This reflected the depth of Ireland's recession and the use of 10-year averaging for potential output growth rates as the basis for how fast expenditure could grow under the rule.

For 2016, the expenditure benchmark would have limited Ireland's spending growth to -0.7 % in real terms, taking into account the 10-year average potential growth rate and the required adjustment in the structural balance. However, using the most up-to-date estimates of potential growth would have entailed an allowable growth rate of 0.4 %.

The Council assessed that these measurement issues would have implied an excessively restrictive stance. It meant an allowable growth rate for expenditure that was plainly too low and would have caused disruptions and distortions in the management of public finances. The Council publicly noted that the government should ignore this requirement of the EU framework with the Council's reasoning outlined in an analytical note ([Irish Fiscal Council, 2015](#)).

4.2 France

French numerical fiscal thresholds proceed from the European framework. Before entering the monetary union, France had no explicit fiscal rules regarding the debt and deficit thresholds. Therefore, divergences between the national and European fiscal rules as regards numerical ceilings are limited. Nevertheless, some possible contradictions between the national and EU fiscal frameworks can be identified on other aspects (Example 3). In addition, there might be relative divergences of opinion between the IFI and the European Commission (Example 4).

At present, the French parliament is rejecting the public finance programming bill presented in September 2022 by the government. Yet this programming bill, covering the period 2023-2027, is needed to comply with the Fiscal Compact, the national fiscal framework directive and the French recovery and resilience plan agreed with the EU.

The Fiscal Compact was transposed into French law in 2012 by a new organic law, then modified and merged with the organic law governing finance acts in 2021. The organic law envisages that public finance programming laws will set the MTO for public administration and determine a multi-year trajectory for the public balance in order to achieve this medium-term objective. The MTO was set at -0.4 % of potential GDP in France in the last two public finance programming laws (2014-2019 and 2018-2022). This MTO has not been achieved over the past decade. Furthermore, the last public finance programming law did not aim at a return to the MTO by the end of the programming period.

In the new public finance programming bill, the structural balance is planned to return to below 3 % of GDP by the end of the period in 2027 (-2.9 % of potential GDP), entailing a significant gap with the MTO (-0.4 % of potential GDP).

This bill has not yet been adopted by the French parliament, even though the previous programming law has reached the end of its programming period. The adoption of a new programming bill was among the milestones envisaged in the French recovery and resilience plan.

On the interaction between the two frameworks, there have been two cases where the French IFI saw inconsistencies with the EU fiscal framework.

4.2.1 Example 3 – Triggering the SGP’s escape clause during the Covid crisis

The French organic law states that the government can ask the High Council of Public Finance, the French IFI, if the conditions for the exceptional circumstances clause as set out in Article 3 of the TSCG have been met. The Fiscal Compact clause is formulated as follows: ‘Exceptional circumstances refers to the case of an unusual event outside the control of the Contracting Party concerned which has a major impact on the financial position of the general government or to periods of severe economic downturn as set out in the revised Stability and Growth Pact (SGP).’

The national and EU fiscal frameworks might in theory lead to diverging decisions with respect to exceptional circumstances. At the beginning of the Covid crisis, the French government asked the HCFP on 17 March 2020 if the conditions for exceptional circumstances as specified in the Fiscal Compact had been met and the HCFP concurred in its opinion. The HCFP indeed considered that the Covid crisis and its economic and financial consequences were unusual events beyond the control of the government and therefore fell within the scope of exceptional circumstances as set out in the TSCG (HCFP, 2020). The government therefore presented its draft amending budget bill on 18 March 2020,

including a public deficit above 3 % (Council of Ministers, 2020). The triggering of the exceptional circumstances clause occurred in France 3 days before the European Commission proposed to activate the SGP general escape clause to respond to the pandemic and 6 days before it was officially triggered by Member State finance ministers.

Although the two decisions at the French and EU levels were consistent in the end, this is not guaranteed by the current framework. This example shows that the exceptional circumstances clause can be triggered at the national level before the Commission and Member State finance ministers have made a decision. In the event of an asymmetric economic shock, the French IFI could theoretically consider that the conditions for exceptional circumstances as set out in the Fiscal Compact have been met, and the European Commission could consider the opposite. The same applies to the timing, but also to reasoning regarding the withdrawal of the exceptional circumstance clause.

4.2.2 Example 4 – The budget bill for 2017

Opinions of the European Commission and French IFI on the draft budgetary plans are mostly in line, but they can sometimes differ. This was the case in 2016. The HCFP published on 24 September 2016 an opinion on the macroeconomic forecasts underpinning the draft budget bill of France for 2017 as well as on the underlying budgetary strategy (HCFP, 2016). The European Commission published its opinion on this draft budgetary plan on 16 November 2016.

Both assessed the 2017 GDP growth forecast of the French government as optimistic. But, on the fiscal side, the opinions of the HCFP and the European Commission were different. The HCFP considered that the reduction of the general government deficit set out in the 2017 budget bill was unlikely to be achieved and that it was uncertain whether the government would be able to bring back the nominal budget deficit to below 3 % of GDP by 2017. The European Commission believed that the deficit would be slightly below the threshold value of 3 % in 2017 and that the draft budgetary plan of France, which was at the time under the corrective arm, was broadly compliant with the provisions of the SGP. The High Council considered that the government expenditure forecast was too low whereas the Commission expenditure forecast was close to it, if marginally higher (+0.1 %) ¹⁰. These differences in diagnosis mattered, as exit from the corrective arm was at stake for France in 2017.

4.3 Finland

In Finland, fiscal policy targets and the expenditure ceiling are effectively decided by the government after its appointment. This means that the targets (e.g. budget balance and debt) and the binding expenditure ceiling for central government expenditure differ depending on the government in power. These targets are set out in the government programme, usually for the last year of the four-year government term.

In theory, there is a direct link between the EU fiscal framework and domestic framework. The legislation requires the government to set an MTO as necessitated by EU requirements. The government is also required to present, in its General Government Fiscal Plan, multiannual targets for the general government budget balance, debt and expenditures, and balance targets for subsectors of

¹⁰ In the end, the public deficit in 2017 is today estimated at 3.0 points of GDP, but with expenditure almost 1 % higher than the government's forecast, validating the High Council's diagnosis. Revenues were also higher because both growth and tax elasticity to growth surprised (on the upside) the government, the High Council and the Commission.

general government. The nominal balance (net lending) targets must be in line with the MTO. However, the MTO target has guided fiscal policy very little in practice. Balance targets have not played a significant role either. For example, there are no significant consequences for non-compliance, because the correction mechanism relies on an EU process that is almost never exercised (the Significant Deviation Procedure).

Finnish governments have been most committed to the central government expenditure ceiling in the past 20 years – with the exception of the current government term (2019-2023). The expenditure ceiling sets the limit only for central government expenditure, while the interest expenses on central government debt and automatic fiscal stabilisers, such as unemployment-related benefits, fall outside the ceiling. The expenditure ceiling covers approximately 85 % of central government budget expenditure in 2023, while local government expenditures and social security funds fall outside the expenditure ceiling. Hence, the expenditure ceiling has covered around 40 % of total general government expenditure.

In the past 20 years, the level of the expenditure ceiling has not been set in a way that would lead to the achievement of the fiscal policy targets. Instead, the achievement of the fiscal policy targets (e.g. budget balance and debt) has been dependent on the employment and GDP growth targets. The importance of the employment target has made the assessment of employment measures one of the key areas of fiscal policy monitoring by the National Audit Office, alongside monitoring the MTO, through the development of the structural balance and the expenditure benchmark.

The decade of slow growth following the financial crisis and the rising costs of population ageing have made it more difficult for Finland to meet the 3 % deficit and 60 % debt reference values (European Commission, 2020). In 2010, Finland breached the deficit reference value based on the 3.9 % deficit planned by the government and an Excessive Deficit Procedure was launched. But, in spring 2011 it turned out that the deficit was only 2.5 % of GDP due to misestimating the speed of the economy's bounce back after the financial crisis. Hence, the EDP was stopped.

In spring 2015, the deficit in 2014 surprised at 3.3 % of GDP, while the no-policy-change deficit for 2015 was 3.4 %¹¹. The Commission considered launching an EDP. Yet, after decisions taken by the incoming government in its government programme, a deficit below the 3 % reference value was planned for 2016. The Commission then considered that Finland had complied with the deficit criterion when taking into account the closeness to the 3 % reference value, the temporary nature of the breach and other relevant factors. Although Finland has breached the debt reference value nine times in total, the Commission has assessed that the debt criterion has been complied with overall.

The finance ministry reviews the functionality of the spending limits system (and from time to time the whole fiscal policy framework) at the turn of each government term. In its review of 2 November 2022, the ministry proposed that the central government ceiling should be set based on longer-term debt sustainability analysis regarding the general government. This proposal is in outline similar to the proposal of the Commission to renew the EU fiscal policy framework, which also emphasises longer-term debt sustainability. The main difference is that in the finance ministry's proposal, the expenditure ceiling covers only the central government (although derived from the debt sustainability of the general government), whereas in the Commission's proposal the expenditure path covers general government

¹¹ As there were parliamentary elections in spring 2015, the Stability Programme was a no-policy-change one.

expenditure. Still, the new government to be formed after the parliamentary elections in spring 2023 will independently decide whether it will follow the proposal made by the finance ministry.

4.4 Lessons from the case studies

Overall, the case studies for these countries confirm the wider conclusion that EU and domestic frameworks have generally co-existed in harmony, either because the domestic framework was somewhat separate (Finland) or because the two approaches were relatively closely aligned (France and Ireland). That said, in each country there have been occasional episodes of material disagreement between the EU and domestic frameworks. These have centred on different views of technical parameters, notably forecasts and the measurement of potential output. They include cases where more demanding assessments from the national institutions have been undermined by a more benign view from the Commission.

Although in Finland there is less reliance on EU fiscal rules, the frameworks interlink on expenditure limits following a more long-term path, while the IFI plays a key role in monitoring the Finnish government's compliance with both sets of rules. The Irish case highlights the need for better communication between the European Commission and IFIs to avoid inconsistencies in assessments. The French experience shows that despite national fiscal rules mirroring the EU framework, the frameworks might still lead to diverging decisions with respect to exceptional circumstances and entering/exiting the corrective arm of the SGP. Overall, efforts to develop frameworks better suited to domestic circumstances, such as in Ireland, could also have led to greater frictions over time.

5 Implications of the upcoming fiscal reform

This section discusses how the EU and national fiscal frameworks could work together or generate inconsistencies under proposed EU governance reforms. In November 2022, the European Commission published its Communication on *Orientations for a Reform of the EU Economic Governance Framework* (hereafter the ‘Orientations’) and in April 2023 the subsequent legislative proposals. The aim is to increase national ownership of the rules, simplify them and improve compliance. This is a major shift in the framework and would likely change the interplay between the EU and domestic frameworks, ideally with greater coherence to support national ownership.

The implications of the new framework could materialise in the *ex ante* and *ex post* assessments of the IFIs and the Commission. There may be inconsistencies in assessments under the proposed EU framework and national frameworks and compliance with them. *Ex ante*, the choice of the output gap and other variables in the European Commission’s debt path projections and those made at the national level could have different implications for what national trajectories should look like. *Ex post*, the framework reduces the potential of discrepancies in European Commission and IFI assessments for compliance with national fiscal trajectories because of the use of a simpler operational rule based on the spending levels. However, a lack of clarity on adjustments for one-off measures and DRMs could still lead to inconsistent assessments. Finally, it will be crucial for national governments to consider whether their national legislation could be streamlined to avoid unnecessary conflict with the new EU level framework.

5.1 Implications of the proposed fiscal reform

The Communication follows an approach based on national medium-term fiscal-structural plans, setting out ‘specific fiscal trajectories as well as priority public investment and reform commitments’ (European Commission, 2022). The plans are approved by the European Commission and the Council. They will be proposed based on a common EU framework by ‘setting the requirements to ensure that the debt ratio is put on a downward path or stays at prudent level’ (ibid.). The Commission will propose a reference path that would put the debt ratio on a ‘plausibly’ declining path for countries assessed as having a substantial or moderate debt challenge. This would be operationalised by a single variable, i.e. a nationally-financed primary expenditure path net of discretionary revenue measures and cyclical unemployment spending. While the 3 % deficit and 60 % debt ceilings remain, much of the existing framework based on the structural balance would disappear at the EU level.

5.1.1 Consistency of *ex ante* assessments of national plans under the proposed EU framework

The Commission will assess national plans on the basis of a common assessment framework. Countries will set their national trajectories, and will be asked for a revised version should it not be accepted at the EU level. While some may align with the Commission’s reference path, others may propose paths that are somewhat different, including those that are motivated by existing or future domestic frameworks. An *ex ante* multilateral discussion between governments and the Commission on projections would help to achieve coherence between the EU and domestic levels.

The variables (e.g. output gap) and methodology used by the Commission to design the reference path may play an important role in whether a country chooses to adopt this as a national trajectory. There is scope here for different projections of the future fiscal trajectory and risks around it, including different methodological assumptions. There is potential for divergent EU and national assessments of

the output gap, significantly affecting views of the required fiscal adjustment. This problem may be particularly acute for taking into account the role of public investment and structural reforms for growth, which is difficult to evaluate and where there may be strong political pressure to show success.

The Network for EU IFIs has argued that national IFIs should have an assessment role in national macroeconomic and budgetary projections in this context, as well as in producing technical analysis of debt paths and risks to ensure that national positions are based on robust analysis. In addition, it has called for a legal obligation at the EU level to take into account the assessment of national IFIs, whether or not this is followed. This would enshrine existing practices and could provide the basis for a consistent approach to understanding the risks surrounding a country's proposed national fiscal trajectory (Network of EU IFIs, 2022a).

As highlighted above, different views of potential output and concerns about the accuracy of the commonly agreed methodology have been among the main areas of divergence between the EU and national levels in past years. While the proposed approach removes explicit reference to the output gap, the assessment of potential output will continue to play a key part in setting the Commission's reference path and long-term forecasts will now play a critical role. This introduces the possibility of continued divergence along existing lines between the EU and national levels.

5.1.2 Consistency of *ex post* assessments under the proposed EU framework and national frameworks

Setting the operational target as the level of spending over the medium-term should simplify compliance and monitoring, making it easier to embody in national frameworks. The single EU oversight variable is likely to improve transparency: it is related to general government expenditure – a variable that is both (mostly) observable and considered to be under the control of governments¹². In practice, some aspects, such as including inflation, may be more difficult to handle and have not been fully addressed in proposals to date.

The proposals suggest that fiscal adjustment plans or reference paths from the Commission will not be required for countries assessed as having low debt and fiscal sustainability risks. This implies that a number of countries will not be covered by this aspect and will face less intense oversight. While this will reduce the scope for conflict between the EU and national levels, it also places a greater onus on national fiscal frameworks to maintain good outcomes in terms of both ensuring budgetary stability and an appropriate fiscal stance. In this context, the new framework would desirably spell out the role of IFIs in conducting *ex ante* and *ex post* assessments at the national level of the implications of national budgetary policies for both the fiscal stance and fiscal sustainability.

Despite these areas where inconsistencies may be rarer, a number of aspects that have led to material divergences in the past between EU and domestic frameworks may still cause inconsistencies: DRMs, one-offs and adjusting for structural unemployment, as well as the aforementioned output gap.

The impact estimation of discretionary revenue measures will likely remain a potential source of discrepancy between the different institutions tasked with assessing *ex ante*, in-year and/or *ex post* compliance with the agreed expenditure path. They are not the most common source of difference

¹² This may not be valid for entities that are included in the general government sector but are not directly under the control of the central government.

between the EU and national level, probably because the starting point of both assessments is usually the quantitative estimation of the impact of measures reported in draft budgetary plans. Even so, improved EU guidance would help to narrow differences that occur.

The Orientations published by the European Commission include no reference to adjusting for one-off measures when calculating the net expenditure path. This implies that the distinction between permanent and one-off measures could become irrelevant. National IFIs consider the ability to correctly identify one-off measures as important for carrying out fiscal oversight subject to appropriate supervision. These should be taken into account so that governments can handle ad hoc circumstances. Therefore, this creates potential tension between the EU and national levels. The current scope for disagreement would be reduced if EU guidance on one-off measures were clearer on whether and under what conditions initiatives impacting more than one fiscal year can be considered one-offs.

The new fiscal reform implies that correction for cyclical unemployment in the net expenditure path will continue. This has the potential to perpetuate past discrepancies in its estimation by different institutions.

5.1.3 Risks from legacy obligations of past governance frameworks

Many requirements of the existing EU framework have been mirrored in domestic legislation, also as a result of the Fiscal Compact¹³. These requirements are likely to differ from those under the new governance framework, which may lead to conflict between the EU and national levels. For countries that wish to maintain alignment with the previous framework, this could be used as a basis for the national trajectories, although over time divergences from the fixed-spending trajectory may arise.

It will be important for countries to ensure their national legislation is streamlined to avoid the risk of undue conflict with the new EU-level framework, although countries may still wish to legislate more restrictive rules at the national level. This is of particular importance for national IFIs with legal obligations to monitor compliance with the requirements derived from the existing EU framework: their credibility would be damaged if they are left monitoring irrelevant provisions or if their role is scaled back to a minimal level now that these provisions no longer apply. The Network of EU IFIs has highlighted a number of areas where IFI roles could evolve to support the new framework and ownership at the national level (Network of EU IFIs, 2023).

6 Conclusions

This study finds that EU fiscal rules have generally worked in harmony with national rules. However, there have been material and important inconsistencies between EU and national rules. These have appeared in the assessments of IFIs and the European Commission, notably of the output gap and structural balance, one-offs and DRMs, as well as compliance. The most prominent differences in assessments are observed for the output gap and structural balances – primarily due to variations in the forecasts for GDP and other variables between EU and national institutions.

Where there have been differences in frameworks (albeit with similar policy goals), it is more often the case that the European Commission's framework has been less prudent in its assessments, by employing different methodologies from the IFIs.

¹³ Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (2012).

The case studies of Ireland, France and Finland show the complementary functioning of the two frameworks but also some weaknesses in this infrastructure. Differences in methodologies and assessments between the IFIs and the Commission highlight areas where better communication and clearer guidelines from the Commission could have avoided conflicting assessments. The discrepancies mostly arose from differing Commission and IFI views of technical parameters, specifically forecasts and potential output. These included instances where the Commission's more lenient perspective undermined the more demanding assessments of the national institutions and thus their credibility. Attempts to develop approaches more appropriate for country-specific conditions, like those in Ireland, may have increased tensions over time.

Looking ahead, the new framework may offer opportunities to reduce divergences between EU and national frameworks *ex ante* and particularly *ex post*. A key question is how far national trajectories reflect national frameworks rather than exactly following the Commission's reference paths. In other words, national frameworks could aim at more prudent policies that at the same time comply with common EU rules. Currently, there remains scope for differences in the *ex post* assessment of DRMs, one-offs and structural unemployment. This could be reduced by clearer guidelines and greater transparency regarding the methodology applied at the EU level.

To avoid undue inconsistencies with the EU framework it will also be vital to review national legislation and for IFIs and the Commission to communicate. Finally, it is important to remove legacy obligations deriving from the existing EU framework that are no longer relevant.

7 References

- Caselli, F., Davoodi, H., Gonçalves, C., et al. (2022), 'The return to fiscal rules', IMF Staff Discussion Note 2022/002. Washington DC. International Monetary Fund.
- Council of Ministers (2020), 'Compte rendu du Conseil des ministres du 18 mars 2020', [Compte rendu du Conseil des ministres du 18 mars 2020 | Gouvernement.fr.](#)
- '[Council Directive 2011/85/EU Of 8 November 2011 On Requirements For Budgetary Frameworks of the Member States](#)' (2011), Official Journal of the European Union, L 306.
- Darvas, Z., Martin, P., Ragot, X. (2018), 'European Fiscal rules require a major overhaul', Bruegel.
- Delivorias, A. (2021), 'Introduction to the fiscal framework of the EU: The Maastricht Treaty, the Treaty on Stability, Coordination and Governance, and the Stability and Growth Pact', European Parliament, European Parliamentary Research Service.
- European Commission (2020), 'Report from the Commission: Finland', COM(2020) 540 final.
- European Commission (2021), 'Fiscal Sustainability Report 2021, volume 1', Institutional Paper 171, Brussels.
- European Commission (2022), 'Communication on orientations for a reform of the EU economic governance framework', COM(2022) 583 final.
- European Fiscal Board (2019), 'Assessment of EU fiscal rules, with a focus on the six and two-pack legislation'.
- European Union (2012), Treaty on Stability, Coordination and Governance in the Economic and Monetary Union.
- Friis, J.W., Torre, R., Buti, M. (2022), 'How to make the EU fiscal framework fit for the challenges of this decade', CEPR.
- Girouard, N., Price, R. (2004). Asset Price Cycles, "One-Off" Factors and Structural Budget Balances. OECD Economics Department Working Papers.
- Haut Conseil des Finances Publiques (2020), [Opinion n° HCFP-2020-1 on the first amending budget bill for 2020.](#)
- Haut Conseil des Finances Publiques (2016), [Opinion n° HCFP-2016-03 of the High Council of public finance on the budget bill for 2017.](#)
- Irish Fiscal Advisory Council (2015), '[The EU Expenditure Benchmark: Operational Issues for Ireland in 2016](#)', Analytical Note No. 7.
- Irish Fiscal Advisory Council (2019), '[Box in the Assessment of Compliance with the Domestic Budgetary Rule in 2018](#)'.
- Law Reform Commission (2012). Fiscal Responsibility Act 2012.
- Network of EU IFIs (2022a), '[Strengthening the role of national IFIs at EU level](#)', Network of EU IFIs position paper.
- Network of EU IFIs (2023), '[EU Economic Governance Proposal Reform: Issues and Insights from EU IFIs](#)', Network of EU IFIs position paper.
- Rodriguez, L., Uittenbogaard, R., Ramos, J.M., et al. (2021), 'How to Strengthen Fiscal Surveillance Towards a Medium-Term Focus?', Applied Economics Quarterly Journal Vol. 67. N°3 (2021).
- [Treaty On The Functioning Of The European Union - Part Three: Union Policies And Internal Actions - Title VIII: Economic And Monetary Policy - Chapter 1: Economic Policy](#), OJ L 115, 9.5.2008, pp. 97-98.

The Network of EU Independent Fiscal Institutions

The Network is composed of 30 independent fiscal institutions representing 25 EU countries and the UK. It is voluntary and inclusive, open to all independent fiscal oversight bodies operating in the EU. It provides a platform to exchange views, expertise and pool resources in areas of common concern. The Network supports the efforts to review and reinforce the EU fiscal framework, seeking to better exploit the synergies between rules and institutions, as well as between different levels of administration whilst respecting the principle of subsidiarity and enhancing local ownership and accountability.

For further information, visit the website: <https://www.euifis.eu/>



**EU INDEPENDENT
FISCAL INSTITUTIONS**