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Fiscal frameworks in the European Union: Commission services country factsheets for the Autumn 2013 Peer Review

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European Commission

Directorate-General for Economic and Financial Affairs

Fiscal frameworks in the European Union:

Commission services country factsheets for the Autumn 2013 Peer Review

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This occasional paper is composed of factsheets prepared by Commission services (Directorate-General for Economic and Financial Affairs) with a view to the horizontal peer review of national fiscal frameworks conducted under the auspices of the Economic Policy Committee in October 2013. These factsheets are meant as an update and complement to the factsheets previously prepared for the countries reviewed in 2011, which had been published as Occasional Paper no. 91, as well as the interim factsheets for priority countries reviewed in 2012, published as Occasional Paper no. 113.

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CONTENTS

Acknowledgments 2
Contents 3
Glossary 4
Introduction and summary 5
Fiscal governance in Austria – 2013 update 11
Fiscal governance in Belgium – 2013 update 13
Fiscal governance in Bulgaria – 2013 update 15
Fiscal governance in Cyprus – 2013 update 17
Fiscal governance in the Czech Republic – 2013 update 19
Fiscal governance in Germany – 2013 update 21
Fiscal governance in Denmark – 2013 update 23
Fiscal governance in Estonia – 2013 update 25
Fiscal governance in Greece – 2013 update 27
Fiscal governance in Spain – 2013 update 30
Fiscal governance in Finland – 2013 update 35
Fiscal governance in France – 2013 update 37
Fiscal governance in Hungary – 2013 update 40
Fiscal governance in Ireland – 2013 update 42
Fiscal governance in Italy – 2013 update 46
Fiscal governance in Lithuania – 2013 update 48
Fiscal governance in Luxembourg – 2013 update 50
Fiscal governance in Latvia – 2013 update 52
Fiscal governance in Malta – 2013 update 55
Fiscal governance in the Netherlands – 2013 update 57
Fiscal governance in Poland – 2013 update 59
Fiscal governance in Portugal – 2013 update 63
Fiscal governance in Romania – 2013 update 66
Fiscal governance in Sweden – 2013 update 69
Fiscal governance in Slovenia – 2013 update 71
Fiscal governance in Slovakia – 2013 update 73
Fiscal governance in the United Kingdom – 2013 update 76

GLOSSARY

Acronym	Country	
AISP	AT	Austrian Internal Stability Pact
AIRF	ES	Independent Authority for Fiscal Responsibility
BFL	PT	Budget Framework Law
BSOL	ES	Organic Law on Budgetary Stability and Financial Sustainability
CNB	CZ	Czech National Bank
CPB	NL	Bureau for Economic Policy Analysis (Centraal Planbureau)
CBR	SK	Council for Budgetary Responsibility
ECB		European Central Bank
EDP		Excessive Deficit Procedure
EFP	ES	Economic and Financial Plan
EMU		Economic and Monetary Union
EPC		Economic Policy Committee
ESA 95		European System of Accounts 1995
FC		Fiscal Council
FDL	LV	Fiscal Discipline Law
FRA	IE	Fiscal Responsibility Act
FRBSL	CY	Fiscal Responsibility and Budget System Law
GDP		Gross Domestic Product
IFAC	IE	Irish Fiscal Advisory Council
IMF		International Monetary Fund
MoF		Ministry of Finance
MoU		Memorandum of Understanding
MTBF		Medium-Term Budgetary Framework
MTFS	EL	Medium-Term Fiscal Strategy
MTO		Medium-Term Objective (in the sense of the revised SGP)
OECD		Organisation for Economic Co-operation and Development
PBO	EL	Parliamentary Budget Office
PPB	CY	Programme and Performance Budgeting
PPP		Public-Private Partnership
SBA	EE	State Budget Act
SER	PL	Stabilising Expenditure Rule
SGP		Stability and Growth Pact
SOE		State-Owned Enterprise
TSCG		Treaty on Stability, Coordination and Governance in the Economic and Monetary Union

INTRODUCTION AND SUMMARY

One of the major policy lessons stemming from the current crisis is the need to strengthen Member States' ownership of the EU budgetary framework and ensure that national and EU fiscal governance are consistent with each other. This requires improvement in domestic budgetary frameworks[1] in order to reinforce their instrumental character by promoting compliance with the Treaty's fiscal provisions.

In its May 2010 conclusions[2], the Ecofin Council laid down a two-pronged approach in the field of national fiscal frameworks. Firstly, a set of minimum requirements should be met by national fiscal frameworks, to be consistent with the EU budgetary rules. The Directive on national budgetary frameworks[3] was the final outcome of this process; it outlines fundamental elements of fiscal frameworks, namely accounting, statistics and forecasts, numerical fiscal rules, medium-term budgetary frameworks and transparency. Secondly, supplementing this first pillar, the regular assessment and peer review of domestic fiscal frameworks was envisaged, in order to seek policy advice and evaluate other desirable but non-binding features of domestic fiscal frameworks which could also support the adequate conduct of fiscal policy. The Council invited the Commission and the Economic Policy Committee (EPC) to promote the exchange of best practices, in particular in view of the elements that have proven to be most successful in underpinning fiscal consolidation efforts and contributing to building up sustainable public finances.

The peer review process therefore arose from the implementation of the second pillar and emerged for the first time in the course of 2011 (following a pilot session in 2010). The original horizontal peer review was carried out under the aegis of the Economic Policy Committee in two sessions. The first session in May 2011 reviewed the frameworks of 14 Member States (Estonia, Ireland, Greece, Italy, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Portugal, Romania, Slovakia and the United Kingdom). The second session covered the (then) remaining 13 Member States in November 2011 (Belgium, Bulgaria, Czech Republic, Denmark, Germany, Spain, France, Luxembourg, Netherlands, Austria, Slovenia, Finland and Sweden).

Commission services had contributed to that initial peer review by preparing country factsheets, providing for each Member State a description of the situation of its fiscal framework at the time of the review, an assessment of the framework's performance and detailed information on major components of the fiscal framework, i.e. fiscal rules, independent fiscal institution(s) and medium-term budgetary framework then in force. The review materialised in the EPC endorsement of policy advice outlining key needs for improvement for each Member State's framework. The Commission country fiches and the ensuing policy advice were subsequently published[4], and this document is the follow-up to that publication.

After the initial cycle of the peer review, an interim review was conducted in May 2012, focusing on the Member States with the most severe perceived shortcomings in the state of their frameworks at the time. On the basis of the quantity and importance of the policy advice initially issued, five Member States (Greece, Portugal, Cyprus, Latvia and Ireland) were reviewed. New Commission country factsheets were issued analysing progress achieved since the initial review and updated policy advice was issued for these five countries[5].

Meanwhile, as initially envisaged in the adoption of the two-pronged approach to improving national fiscal frameworks, many concurrent developments have accompanied the fiscal framework reforms heralded under the peer review process in the period since the initial review.

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[1] Budgetary (or fiscal) framework is meant as the set of arrangements, procedures, rules and institutions that underlie the conduct of budgetary policies of general government.

[2] Supported by the final report of the Van Rompuy task force on economic governance.

[3] Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States.

[4] ECFIN Occasional paper No. 91 of February 2012, "Fiscal frameworks across Member States: Commission services country fiches from the 2011 EPC peer review", http://ec.europa.eu/economy_finance/publications/occasional_paper/2012/op91_en.htm

[5] ECFIN Occasional paper No. 113 of July 2012, "Fiscal Frameworks in the European Union: May 2012 update on priority countries", http://ec.europa.eu/economy_finance/publications/occasional_paper/2012/op113_en.htm

In particular, the binding component formed by the first pillar was buttressed by complementary legal initiatives: the Directive on national budgetary frameworks was adopted as part of the broader "Six-pack" set of legal instruments upgrading the framework of the Stability and Growth Pact; in parallel, Euro-area Member States and some other Member States set up an inter-governmental initiative to accelerate the adoption of a "Fiscal Compact"[6] primarily based on a reaffirmation of the commitment to balanced budgets as spelled out in the SGP; and finally, the complementary regulations applicable to Euro-area Member States reinforcing coordination and surveillance in the budgetary process, known as the "Two-pack", were adopted in mid-2013 and strengthened *inter alia* the role of independent fiscal institutions in domestic budgetary processes.

Commitments to improve economic policy coordination under the European Semester, introduced in early 2011, also acquired more momentum in the first review and update of country-specific recommendations (CSRs) which included major fiscal-structural items, among which the improvement of fiscal frameworks. The policy advice formulated in the context of the 2011 peer review provided a substantial and very relevant pool of policy directions to inform the subsequent formulation and revision of related Semester CSRs[7].

The current period therefore represents a turning point in this process of fiscal framework reform: with many deadlines on the legislative front approaching, the impetus for reform has become stronger than ever, finalising the current rapid levelling of frameworks to baseline requirements, and opening the door to addressing novel challenges in operational implementation. Revisiting achievements two years after the issuance of dedicated EPC policy advice represented an adequate opportunity to pause and review the meaningful progress already achieved, while also revealing outstanding issues to be addressed. This is the rationale underpinning the autumn 2013 horizontal peer review, organised at the 461st meeting of the EPC on 22 October.

In preparation for the review, the Commission had conducted an assessment of progress in implementing the 2011[8] policy advice. This assessment was provided in the form of horizontal findings as well as individual country factsheets for each reviewed Member State. This publication is the compilation of these country factsheets, updated as appropriate following the peer review discussions.

It is important to stress that the analysis performed by the Commission services focussed on the incremental progress achieved along the dimensions defined in the EPC policy advice (while also offering selected insights into other fiscal framework dimensions); this analysis was **not intended to provide an all-encompassing picture and overall qualitative assessment of the full range of elements composing the fiscal framework in each Member State**, but rather to focus on the somewhat narrower scope of items highlighted as priority avenues for reform in the 2011/2012 review in the form of policy advice. From a global perspective on national situations, it should therefore be obvious that the evaluations proposed on policy advice progress should by no means be read as ratings of the overall strength of the domestic fiscal frameworks.

In this context, policy advice achievement was evaluated as having been either "Implemented", "Partially implemented" or "Not implemented". The broad "Partially implemented" category describes items where some progress has been made but where the initial recommendation cannot be considered to be entirely fulfilled; as such, it encompasses a very broad range of situations from limited progress to advanced reforms in the final stages of adoption.

It is also important to stress that the following country factsheets were prepared for the purpose of supporting EPC discussions in the peer review, as a working document reflecting the views of Commission services based on available information at the time of writing. They should not be construed as formulating or anticipating the Commission's opinions or formal assessments in other concurrent

[6] Title III of the inter-governmental "Treaty on Stability, Coordination and Governance in the EMU", signed on 2 March 2012
[7] CSRs are available on http://ec.europa.eu/europe2020/making-it-happen/country-specific-recommendations/index_en.htm
[8] 2012 in the case of Cyprus, Greece, Ireland, Latvia and Portugal which were assessed in the May 2012 interim peer review.

processes such as EDP, the European Semester, transposition assessments (for Council Directive 2011/85/EU or the fiscal compact), or financial assistance programme reviews.

Each factsheet is structured as follows: after recalling the latest policy advice issued by the EPC (in 2011 for most cases, 2012 for the five countries who took part in the interim review), each item is analysed in further detail. A second section provides an overview of other on-going or planned fiscal framework developments in each country, not directly related to policy advice. The cut-off date for information included in the factsheets was 30 October 2013.

A horizontal overview feeding on the information provided by the country factsheets reveals that common patterns have emerged, outlining key general features of fiscal framework reforms across Member States, since the launch of the peer review process.

According to the Commission's **horizontal assessment of progress in implementing the EPC policy advice on fiscal frameworks**, the overall picture of reforms across Member States is encouraging, while recalling that fiscal framework reform is typically a structural effort set in a long-term perspective, where improvements in the framework take time to set up and even longer to fully deliver their benefits. While inter-country comparisons are difficult, considering the varying scope and nature of policy advice items, implementation records are roughly evenly distributed among three categories: around 30% of policy advice items have been implemented, 40% are still undergoing some progress, and 30% have not been implemented.

A key finding is that implementation of fiscal policy advice items is, on average, higher for countries which have received financial assistance from the EU/IMF, which is explained by the fact that many of these fiscal framework issues were part of programme-related documents.

The achievement rate of EPC policy advice to date reflects the relative complexity of reforms in the area of fiscal frameworks. One of the findings is that policy advice related to minor changes in existing laws displays a higher rate of achievement. For instance, introducing or amending numerical fiscal rules, while politically more demanding, appears to be more easily achieved. On the other hand, creating a fiscal council, and to an even larger extent, introducing a (binding) medium-term budget framework, are long-term initiatives for which the observed achievement rate remains low over the period considered.

The European Semester has provided a natural outlet for many peer review policy advice items. It can be observed that key advice formulated in the peer review context was subsequently underlined and reinforced through the Semester, with further analysis in the Commission Staff Working Documents leading in many cases to concrete Country Specific Recommendations. This naturally developed link explains why, according to the Commission assessment, policy advice items which were also highlighted in the European Semester outputs tend to have a slightly higher achievement rate.

More generally, a key aspect in assessing whether or not policy advice has been properly addressed lies in the difficult issue of adequate implementation. This will become more and more relevant as laws are adopted swiftly in order to comply with legislative deadlines, often leaving instrumental details to be further developed in implementing measures, which will ultimately determine the actual effectiveness of the reform in the long run.

Finally, regarding the country-specific elements underpinning the above-mentioned considerations, the factsheets included here offer the Commission's take on the state of play in each Member State when it comes to implementing the specific EPC policy advice. They provide a key opportunity to observe meaningful progress with often far-reaching implications on the budget process, while also revealing remaining gaps to be addressed. In the light of the ongoing dynamism witnessed in reinforcing national fiscal frameworks, this snapshot may however be soon superseded by the sweeping reforms being introduced or planned across the EU.

Commission services country factsheets for the horizontal

EPC Peer Review of Fiscal Frameworks (October 2013)

Fiscal governance in Austria – 2013 update

Further to the 2011/12 cycle of the Peer Review, the Economic Policy Committee was to revisit the issued policy advice and take stock of the progress achieved by the Member States.

EPC policy advice

The set-up of the Austrian fiscal framework has been conducive to enhancing budgetary discipline and avoiding procyclical policies. However, it has not enabled Austrian authorities to achieve one of the government's fiscal strategy goals, i.e. a balanced budget over the business cycle. In this context, national authorities should introduce the following measures:

- *Align legislative, administrative, revenue-raising and spending responsibilities across the different levels of government, in particular in the area of healthcare.*
- *Ensure that the Austrian framework has a bearing on sub-national government levels, by extending the medium-term budgetary framework to them and enforcing the corrective mechanisms of the Austrian Stability Pact if need be.*

The following factsheet from the Commission services assesses the progress to date in implementing the policy advice adopted by the EPC in 2011/12, and provides some updated information on the latest developments in relation to Austria's fiscal framework.

I. ASSESSMENT OF PROGRESS TOWARDS THE 2011 POLICY ADVICE

The reform of the Austrian Internal Stability Pact (AISP), which entered into force in 2012, has strengthened Austria's fiscal framework. The new AISP aims to ensure stronger fiscal discipline following an output target approach based on the introduction of multiple fiscal rules covering also subnational governments. Nevertheless specific weaknesses characterising Austria's fiscal framework, in particular those related to federal fiscal relations, have not been directly addressed by this reform.

The set of fiscal rules encompassed in the AISP broadly mirrors those introduced at the European level in the framework of the reform of the economic governance. The reform of the AISP has to various degrees addressed the two main policy recommendations given to Austria in the context of the previous peer review of national fiscal frameworks.

a) Align legislative, administrative, revenue-raising and spending responsibilities across the different levels of government, in particular in the area of healthcare.

Assessment of progress made: Partially implemented

The new AISP has the potential to enhance the effectiveness of the fiscal framework. However, it will depend on whether the new fiscal rules will provide incentives to address the inefficiencies related to organisational complexity, lack of transparency and overlapping responsibilities among the different layers of government. These issues, including the numerous inconsistencies between funding and spending powers, are not directly tackled by the reform of the AISP. The output target approach has been followed in the healthcare sector through the introduction of an expenditure benchmark for healthcare expenditure equal to the average nominal GDP growth until 2016, while from 2016 onwards healthcare expenditure growth should not exceed a threshold of 3.6%. In order to achieve these targets a consistent overhaul of the healthcare system is needed. The agreed healthcare reform aims to pursue this objective. However, detailed measures will have to be specified in the coming months.

b) Ensure that the Austrian framework has a bearing on sub-national government levels, by extending the medium-term budgetary framework to them and enforcing the corrective mechanisms of the Austrian Stability Pact if need be.

Assessment of progress made: Implemented

The new edition of the AISP contains several fiscal rules. Headline deficit targets have been set for the three layers of government for the years 2012-2016. From 2017 onwards, a budget balance rule in accordance with TSCG rules will kick in whereby the lower limit for the structural deficit of general

government will be set at 0.45% of GDP (0.35% for central government; 0.1% for *Länder* and municipalities). The new expenditure rule introduced in the SGP at EU level under the revised Regulation 1466/97 applies to all sub-sectors of general government. Similarly, a debt rule applies to all general government sub-sectors following EU specifications. The new system of fiscal rules covering also subnational levels of government has broadly addressed the policy advice issued to Austria. In particular, the application of the expenditure benchmark at subnational levels strengthens the medium-term budgetary framework by introducing an annual cap for expenditure growth. This benchmark is aimed to cap the total aggregate of sub-sectorial expenditure, while *ex-ante* specific targets in nominal terms for the main categories of subnational expenditure are not envisaged. However, the AISP contains also a provision whereby all three levels of government are obliged to submit their medium-term budgetary plans (in a relatively detailed form regarding the state and local government) to the Coordination Committee (a body administering the Pact) by 31 August each year. These are legally binding according to the AISP, but the stringency and effectiveness of this rule should be closely monitored in the future.

The AISP also introduces stronger enforcement mechanism requiring the government to submit a corrective plan if it has deviated from the target. In case the plan does not deliver the expected outcome, the Conciliation Committee (composed of representatives from all levels of government, without voting rights for the concerned layer) could impose a fine.

II. ADDITIONAL INFORMATION ON PROGRESS UNRELATED TO THE POLICY ADVICE

On 1 January 2013 the second stage of the budgetary reform entered into force. This stage consists of the introduction of performance budgeting, the reform of the budget structure and the modernisation of the public accounting system. The performance budgeting introduces an output-based approach where specific output and outcome targets to be achieved with an underlying budget are made clear and transparent. It aims at enhancing the accountability of the line ministers and at communicating the results achieved by the public administration to the wider public. In addition to performance budgeting, the reform also simplifies the number of single appropriations by replacing them with a reduced number of binding global budgets. Furthermore, accrual-based accounting is introduced to flank the cash-based accounting system.

In July 2013, the Austrian parliament adopted a law on the basis of which the Government Debt Committee was transformed into the Fiscal Council. The law explicitly conferred on the renamed body responsibilities for independent fiscal institutions provided for in the Fiscal Compact, the Directive on budgetary frameworks and the Two Pack. In particular, it endowed the Fiscal Council with the task of monitoring the conditions which would warrant the triggering of the correction mechanism and with issuing recommendations aimed at activating, prolonging or terminating the correction mechanism.

Fiscal governance in Belgium – 2013 update

Further to the 2011/12 cycle of the Peer Review, the Economic Policy Committee was to revisit the issued policy advice and take stock of progress achieved by the Member States.

EPC policy advice

Following a significant and largely successful debt reduction strategy during the 1990s, in which a tight framework of fiscal rules played a non-negligible role, Belgium has relaxed the stringency of its fiscal setting in the past decade. Moreover, deficits and debt are again on the rise as a result of the crisis, though less than in most other Member States. In this context, national authorities should introduce the following measures:

- *In order to supplement the objectives defined in terms of budget balance, revive and possibly tighten (including at the regional and local levels) the system of expenditure and revenue rules, which was instrumental in markedly improving Belgium's public finances in the 1990s. In particular, the authorities should embed the spending ceilings from the MTBF in a multi-annual expenditure rule with the broadest possible coverage in line with best practices.*
- *Taking into account the size of the fiscal challenge Belgium is facing, including its debt ratio and the pressures arising from population ageing, develop multi-year fiscal planning coordinated between all layers of government.*
- *Given the increasing fiscal autonomy of the regions, revive and strengthen the kind of 'internal stability pact' that was in place between the different government layers in the 1990s, allowing greater fiscal coordination.*

The following factsheet from Commission services assesses the progress to date in implementing the policy advice adopted by the EPC in 2011/12 and provides some updated information on the latest developments in relation to Belgium's fiscal framework.

I. ASSESSMENT OF PROGRESS TOWARDS THE 2011 POLICY ADVICE

Currently, Belgium is going through a further round of institutional reforms (the so-called "sixth reform of the state"), which attributes additional spending competences to the sub-federal level from 2014 onwards. The financial flows between the different layers of government, contained in the Special Finance Law, will also be revised, granting more tax autonomy (e.g. on personal income tax) to the regions.

a) In order to supplement the objectives defined in terms of budget balance, revive and possibly tighten (including at the regional and local levels) the system of expenditure and revenue rules, which was instrumental in markedly improving Belgium's public finances in the 1990s. In particular, the authorities should embed the spending ceilings from the MTBF in a multi-annual expenditure rule with the broadest possible coverage in line with best practices.

Assessment of progress made: Partially implemented. No general, multi-annual expenditure rule has been implemented.

The expenditure rule for growth of health care expenditure in the Social Security subsector has been tightened in the December 2011 coalition agreement. The growth ceiling in real terms has been reduced from the legal ceiling of +4.5% to +2% in 2012-2013 and +3% in 2014. The coalition agreement mentions that the growth ceiling for subsequent years will be stipulated in a law, but so far this has not yet been done.

Regional authorities took some initiatives to reinforce the balanced budget rule for local authorities, especially by revising the medium term budgetary framework for local authorities. In Flanders, the new rules should result in a balanced multi-annual budget over the local government's term (so as to take into account the local authorities' investment cycle). In Wallonia, ceilings are imposed for investment expenditures.

b) Taking into account the size of the fiscal challenge Belgium is facing, including its debt ratio and the pressures arising from population ageing, develop multi-year fiscal planning coordinated between all layers of government.

Assessment of progress made: Partially implemented.

A multi-year fiscal trajectory to restore a balanced budget has been outlined in the 2011 federal coalition agreement and subsequent Stability Programmes of Belgium.

In July 2013, the different governments agreed on the burden sharing of the budgetary effort in 2013 and 2014 between federal (Entity I) and sub-federal level (Entity II), an element which was lacking in the 2012 and 2013 Stability Programme of Belgium.

Entity II (comprising regions, communities and local authorities) committed to reach together a surplus of +0.1% of GDP by 2014. However, no internal burden sharing of this target has been explicitly agreed. The official notification states that this does not mean that one or more regions or communities should reach a surplus, implicitly counting on a surplus of the local authorities.

From 2014 to 2016, regions and communities will further contribute to the fiscal consolidation by a lump-sum reduction in transfers of revenues from the federal level. This mechanism has been anchored in the draft of the revised Finance Law. While regions and communities have committed to a balanced budget by 2014, it is not yet sure that they will offset the reduced transfers in their 2015-2016 fiscal plans.

Lastly, the on-going state reform will shift part of the budgetary pressure from ageing to the sub-federal level, which should also contribute to a more balanced burden sharing between federal and sub-federal level.

c) Given the increasing fiscal autonomy of the regions, revive and strengthen the kind of 'internal stability pact' that was in place between the different government layers in the 1990s, allowing greater fiscal coordination.

Assessment of progress made: Not implemented. Although an ad-hoc burden sharing has been agreed (cf. above) for 2013-2014, no formal cooperation agreement or binding arrangement has been concluded. The agreements reached have only a political character and seem to be insufficient to act as an effective MTBF.

While from 2014 onwards, regions and communities will contribute to the fiscal consolidation by a lump-sum reduction in transfers of revenues from the federal level, regions and communities did not explicitly commit to offset these reduced transfers in their own budgets.

Belgium is currently going through another round of institutional reforms (the 'sixth reform of the state'). This will bring the share of the sub-federal levels to 45% of total government expenditure as of 2014. In addition, regions will be responsible for around 25% of personal income taxes. This evolution further increases the need for greater fiscal coordination recommended in 2011. A cooperation agreement with binding arrangements is expected to be part of the institutional reform framework to be concluded before the end of 2013.

II. ADDITIONAL INFORMATION ON PROGRESS UNRELATED TO THE POLICY ADVICE

Belgium has not yet fully transposed Directive 2011/85 on national budgetary frameworks. An administrative working group bringing together the different ministries and sub-federal entities has finished its preparatory work.

Belgium did not yet ratify the TSCG and progress on its implementation seems to be limited so far.

In the context of the excessive deficit procedure against it, Belgium shall submit a report by 31 December 2013 on the intended implementation of the first recommendation issued under the European Semester regarding the adoption of explicit coordination arrangements to ensure that budgetary targets are binding at federal level and sub-federal levels within a medium-term planning perspective.

Fiscal governance in Bulgaria – 2013 update

Further to the 2011/12 cycle of the Peer Review, the Economic Policy Committee was to revisit the issued policy advice and take stock of progress achieved by the Member States.

EPC policy advice

After taking major steps to improve its institutional fiscal framework through fiscal governance reforms aimed at strengthening control over budgetary aggregates, the focus could shift to finalising the adoption of the new initiatives and proceeding with the necessary fine-tuning of the functioning of the new institutional fiscal framework. Going forward, efforts could be geared towards further strengthening the binding character and the contents of the medium-term budgetary framework, improving the budget process and the quality of the reporting and control systems.

In this context, the national authorities should introduce the following measures:

- *Require that the macroeconomic forecasts made by the authorities are accompanied by a statement on the consistency or the differences with the forecasts from the European Commission. In case of non-compliance, reconsider creating an independent fiscal council with adequate funding.*
- *Further improve the content, transparency and binding character of the medium-term budgetary framework by embedding in it binding fiscal rules and by including information on off-budget items that could represent a potential contingent liability for the budget — such as the losses and arrears of state-owned enterprises or commitments under procurement contracts.*
- *Strengthen reporting on accrual basis, including improving the quality and timeliness of reporting by state-owned enterprises and sub-national governments as well as their cash and treasury management practices.*

The following factsheet from Commission services assesses the progress to date in implementing the policy advice adopted by the EPC in 2011/12 and provides some updated information on the latest developments in relation to Bulgaria's fiscal framework.

I. ASSESSMENT OF PROGRESS TOWARDS THE 2011 POLICY ADVICE

In early 2013, the Bulgarian Parliament adopted a new organic Law on Public Finances (to enter into force in January 2014). It regulates the general framework of public finances and is also intended to transpose the provisions of the Fiscal Compact (which has not been ratified by Bulgaria to date). The new law has strengthened the fiscal framework overall. The change in government in Q2 2013 appears to have resulted in some adjustments to overall fiscal policy (notably a weaker fiscal deficit target for 2013-2014, albeit in a weaker economic setting). There is currently no indication that the fiscal framework as amended by the new law was altered. However, the change of government has somewhat delayed the design and implementation of some associated secondary legislation. This includes the setting up of an independent fiscal monitoring institution and the definition of an automatic corrective mechanism in case of significant deviation from the MTO.

a) Require that the macroeconomic forecasts made by the authorities are accompanied by a statement on the consistency or the differences with the forecasts from the European Commission.

Assessment of progress made: Implemented.

The new Law on Public Finances requires the comparison of the spring and autumn macroeconomic forecasts produced by the Ministry of Finance with those of the European Commission. Major discrepancies have to be publicly justified. In practice, the April 2013 Convergence Programme contained a consistency check with European Commission figures.

b) In case of non-compliance, reconsider creating an independent fiscal council with adequate funding.

Assessment of progress made: Partially implemented.

Independent forecast assessment is not secured to date as the fiscal monitoring institution has not been identified/established yet. However, the Law on Public Finances requires the Government to submit to Parliament a proposal on the establishment of an independent fiscal monitoring body; the deadline for submission which was set 6 months after the promulgation of the law has however expired. According to preliminary plans of the government, the future Fiscal Council could be hosted by the Parliament.

c) Further improve the content, transparency and binding character of the medium-term budgetary framework by embedding in it binding fiscal rules and by including information on off-budget items that could represent a potential contingent liability for the budget — such as the losses and arrears of state-owned enterprises or commitments under procurement contracts.

Assessment of progress made: Partially implemented.

The new Law on Public Finances has strengthened the content, transparency and binding character of the multi-annual fiscal framework. In practice, compliance during execution will have to be checked. The law details the content of the rolling three-year budget planning, which is submitted to the Parliament together with the annual budget plan. In particular, it includes multi-annual expenditure ceilings for the next three years and numerical fiscal rules targeting nominal and structural deficit, expenditure growth and GDP ratio and debt. In terms of transparency, monthly budget execution data with a breakdown by sub-sector are published on the website of the Ministry of Finance. A monthly government debt management bulletin is also published. The law also provides for the publication of macroeconomic forecasts, of their underlying assumptions and of an explanation of potential major discrepancies with the European Commission's forecasts. As regards the "binding character" of the framework, Article 78 states that the budgets are drawn up in "strict compliance with the approved expenditure ceilings". The impact remains to be seen in practice. The past practice has been that the medium term budget ceilings were indicative and were revised annually according to changes in macroeconomic outlook and policy preferences. The new law does not spell out specific conditions which could trigger revisions to budget ceilings of spending units nor corrective actions in case ceilings are breached. Thus, it may remain somewhat discretionary.

Regarding contingent liabilities, the law provides for the publication of information on government guarantees by the Ministry of Finance and entitles it to request information to local governments on projected budgetary impact of municipal corporations, public-private partnerships and other local off-budget items. While the law does not require the publication of contingent liabilities into the medium term budgetary document, in practice government guarantees were indicated in the 2013 Convergence Programme. However, a broader reporting of contingent liabilities including participation in the capital of corporations for the general government sector was not included nor provided for.

d) Strengthen reporting on accrual basis, including improving the quality and timeliness of reporting by state owned enterprises and sub-national governments as well as their cash and treasury management practices

Assessment of progress made: Implemented. Progress has been made regarding municipal reporting and accounting requirements. The Law on Public Finances strengthens requirements at the municipal level by aligning public finance accounting and statistics with the Eurostat methodology.

II. ADDITIONAL INFORMATION ON PROGRESS UNRELATED TO THE POLICY ADVICE

Bulgaria has overall maintained strict fiscal discipline. The fiscal targets over 2011-2012 were even outperformed.

The new Law on Public Finances has further strengthened the fiscal framework and maintains the already previously existing strict numerical fiscal rules. The previously existing numerical rules were supplemented by additional ones related to the Stability and Growth Pact: a medium-term budget ceiling of 0.5% of GDP for the structural deficit (1% in case debt is under 40% of GDP, which is currently the case), as well as a limit to expenditure growth below the forecast GDP growth, and an annual adjustment path of 5% in case public debt exceeds 60% of GDP.

Fiscal governance in Cyprus – 2013 update

Further to the 2011/12 cycle of the Peer Review, the Economic Policy Committee was to revisit the issued policy advice and take stock of the progress achieved by the Member States.

EPC policy advice

Cyprus currently has neither a set of fiscal rules nor a Medium-Term Budgetary Framework. Cyprus also does not have an independent fiscal institution. In this context, national authorities should introduce the following measures:

a) Accelerate the phasing-in of a binding medium-term budgetary framework, as well as Programme and Performance Budgeting (PPB);

b) Implement an enforceable multiannual budgetary framework with a binding statutory basis and corrective mechanisms in case of non-compliance;

c) Establish an independent fiscal institution, or widen the mandate and strengthen the scope and competences of existing institutions, such as the office of the Auditor General.

The following factsheet from the Commission services assesses the progress to date in implementing the policy advice adopted by the EPC in 2011/12 and provides some updated information on the latest developments in relation to Cyprus's fiscal framework.

I. ASSESSMENT OF PROGRESS TOWARDS THE 2011 POLICY ADVICE

Having started from a weak base in 2011, Cyprus is making progress in the strengthening of its fiscal framework over the last year against the background of the implementation of the EC-ECB-IMF adjustment programme. A significant step forward is expected when a comprehensive Fiscal Responsibility law (FRBSL) will enter into force at the end of the year.

a) Accelerate the phasing-in of a binding medium-term budgetary framework, as well as Programme and Performance Budgeting (PPB).

Assessment of progress made: Implemented

Adhering to the EPC policy advice in May 2011 and in compliance with the financial assistance programme conditionality, Cyprus took a number of steps towards a radical reform to modernize its public financial management (PFM) system. A Law on the Medium-Term Budgetary Framework and Fiscal rules (MTBF Law) was adopted in December 2012. It contained provisions in relation to the MTO, the formalisation of preparatory steps for the annual budget and the involvement of line ministers in the process and the introduction of an expenditure rule and a correction mechanism. If the deviation from the specified path towards attaining the MTO exceeds 0.5pp of GDP, the Minister of Finance would then have to prepare and submit within one month to the Council of Ministers a supplementary budget, amended budget, or any other bill setting out in detail the necessary steps to correct the deviation.

The MTBF law also leads to the production and adoption of a Fiscal Strategy Statement (FSS) on 29 May 2013 that first anchored the principles of multi-annual fiscal planning in the annual budget cycle.

The FSS presents the general background for fiscal policy, the macroeconomic and budgetary scenario foreseen in the financial assistance programme, and recent EU reform of its fiscal governance. Budgetary objectives for the period 2012 are reported and objectives for the period 2014-2016 are set, including targets for the primary balance, current revenue and primary expenditure. A description of future policy actions is provided in the main sectors followed by a summary of guidelines in relation to the preparation of the 2014 budget.

Currently, work is underway for the adoption of an integrated umbrella legislation covering budgetary processes on a broad front, the Fiscal Responsibility and Budget System Law (FRBSL). Rescinding the MTBF law, the FRBSL would: (i) flesh out a number of provisions already introduced in the MTBF, (ii) allow for the fulfilment of recent EU requirements arising from EU Regulation ('Two-pack') 473/2013 and the Fiscal Compact and (iii) tackle other areas such as rules for local government and state-owned enterprises. Its adoption is planned in December 2013.

Against the background of a challenging fiscal environment and overriding policy priorities, there has been no progress on programme budgeting. The draft FRBSL legislation, when implemented, would provide a base for progress in that area, for instance by providing a framework for multi-annual fiscal programming and rules for the evaluation of projects.

b) Implement an enforceable multiannual budgetary framework with a binding statutory basis and corrective mechanisms in case of non-compliance.

Assessment of progress made: Implemented

The 2012 Budget Law was the first budget law that reflected the basic principles of a MTBF, even before a legislative framework was adopted. Likewise, and in compliance with the financial assistance programme conditionality, the 2013 Budget Law introduced a multiannual expenditure rule providing nominal rolling expenditure ceilings for line ministries of the central government for the period 2013-2015. These ceilings are consistent with the overall fiscal targets agreed under the financial adjustment programme. The 2013-2015 expenditure ceilings will be updated for the period 2014-2016 and will accompany the 2014 Budget Law. In the context of monitoring compliance with the annual fiscal targets' programme conditionality, the execution and the preparation of budgetary plans are closely and systematically reviewed by programme partners. Provisions for corrective mechanisms in case of non-compliance are foreseen in the MTBF (and future FRBSL) legislation, as noted in preceding paragraph.

c) Establish an independent fiscal institution, or widen the mandate and strengthen the scope and competences of existing institutions, such as the office of the Auditor General.

Assessment of progress made: Not implemented

The draft FRBSL encompasses provisions grounding the Fiscal Council into law. As provided for in the draft legislation, the Fiscal Council will be an independent entity in structural terms, with a leadership composed of three members with attached staff. Amongst its main responsibilities are the *ex-ante* assessment of the macroeconomic forecasts prepared by the government with a view to endorsing them, the monitoring of compliance with numerical rules incorporated the medium-term budgetary objective in the budgetary process, and the provision of *ex-ante* and *ex-post* public assessment of the fiscal policy. Draft implementing text pertaining to the Fiscal Council staff has been prepared, along with a Memorandum of Understanding between the Fiscal Council and the Ministry of Finance regarding the exchange of statistical information. The adoption of the FRBSL in December 2013 will allow for the establishment of the Fiscal Council as of January 2014.

II. ADDITIONAL INFORMATION ON PROGRESS UNRELATED TO THE POLICY ADVICE

Currently, work is underway for the adoption of integrated umbrella legislation, the Fiscal Responsibility and Budget System Law, which is an over-arching framework for fiscal policy-making. Provisions regarding fiscal rules, budgetary position rule, adjustment path, debt rule, correction mechanism, and a corrective plan and escape clauses are embedded in draft FRBSL. The FRBSL will be applicable to the entire general government sector. As per policy advice in financial assistance programme's documentation, the FRBSL will be adopted by December 2013.

Fiscal governance in the Czech Republic – 2013 update

Further to the 2011/12 cycle of the Peer Review, the Economic Policy Committee was to revisit the issued policy advice and take stock of the progress achieved by the Member States.

EPC policy advice

The 2004 reform represented a considerable improvement in the framework for fiscal policy with the introduction of a medium-term budgetary framework together with an expenditure rule. However, expenditure ceilings have been revised upwards several times: levels other than the central government are insufficiently constrained and the transparency of some elements of the overall set-up for fiscal policy could be improved. In this context, national authorities should introduce the following measures:

- *Consider introducing an independent fiscal council to support the preparation, evaluation and monitoring of fiscal policies.*
- *Improve enforceability of the expenditure rule by establishing a system by which good performance is rewarded and failings are clearly sanctioned. Enhance transparency by making a clear link between annual expenditure ceilings and state budget expenditure.*
- *Improve coordination between all levels of government in the budgetary process and involve sub-national governments in medium-term budgetary planning. Consider introducing some form of a fiscal debt rule for the local and regional levels.*

The following factsheet from the Commission services assesses the progress to date in implementing the policy advice adopted by the EPC in 2011/12 and provides some updated information on the latest developments in relation to the Czech Republic's fiscal framework.

I. ASSESSMENT OF PROGRESS TOWARDS THE 2011 POLICY ADVICE

As assessed in the 2011 review, the Czech fiscal framework was considerably improved in 2004, with the introduction of the medium-term budgetary framework and an expenditure rule. However, expenditure ceilings have been revised upwards several times, levels other than the central government are insufficiently integrated in the expenditure rule (and even at central level the links are not fully clear) and the transparency of some elements of the overall set-up of fiscal policy could be strengthened. In this context, the national authorities were invited to introduce the following measures:

a) Consider introducing an independent fiscal council to support the preparation, evaluation and monitoring of fiscal policies.

Assessment of progress made: Not implemented

The Czech authorities have proposed to establish an independent fiscal institution - the National Fiscal Council (NFC) - as part of a constitutional reform of the fiscal framework prepared by the Government and submitted to Parliament in autumn 2012. The functions, funding, methods of nomination and dismissal of the Council´s members and other elements related to the functioning of the NFC were included in the proposals of the Government. The NFC was, among other things, supposed to monitor compliance with numerical fiscal rules and to report on this to the Chamber of Deputies. However, the proposals endorsed by the Government have not been adopted by the Parliament and the Chamber of Deputies was dissolved in August 2013 (early elections are anticipated for the end of October). Given this, it is unclear whether, or in what form, the proposals will be adopted.

b) Improve enforceability of the expenditure rule by establishing a system by which good performance is rewarded and failings are clearly sanctioned. Enhance transparency by making a clear link between annual expenditure ceilings and state budget expenditure.

Assessment of progress made:

Enforceability of the expenditure rule - **Not implemented**
Enhanced transparency - **Partially implemented**

The expenditure rule for the central government and for the social security funds does not provide for any system of rewards and sanctions in case of (non)-compliance. The Government has adopted steps towards promoting the enforceability of the medium-term expenditure frameworks (MTEF) and to make them consistent with the expenditure rule. Principles to ensure this consistency and improve the enforceability of the expenditure rule are enshrined in a constitutional reform of the fiscal framework which however has not been approved by the Parliament, and the future outlook remains uncertain.

When it comes to transparency issues, the revision of the budgetary rules (Act No. 218/2000 coll.) effective from January 2013 adjusted the fiscal rule for the central government. The revision abolished the previous methodology used for fiscal targeting and introduced targets in the ESA95 methodology. As regards the need to ensure a clear link between multi-annual expenditure ceilings and state budget expenditure, the enforceability of the MTEF deserves further attention as indicated above.

c) Improve coordination between all levels of government in the budgetary process and involve sub-national governments in medium-term budgetary planning. Consider introducing some form of a fiscal debt rule for the local and regional levels.

Assessment of progress made:

Coordination between all levels of government **- Not implemented**

Fiscal debt rule for the local and regional levels **- Not implemented**

On 12 June 2013 the Government approved a legal basis (i.e. the implementing act on fiscal responsibility rules) for a coordination mechanism called "budgetary strategy for the government sector". The strategy should become part of the annual update of the Convergence Programme which is approved by the Government and presented to the Parliament. The strategy should contain overall expenditures of the government sector and define financial relations of the state budget vis-à-vis the local governments, vis-à-vis the government sector institutions and vis-à-vis the health insurance funds. However, this approach is rather minimalistic, as it is limited to defining the links between the state budget and the budgets not directly controlled by the Government.

When it comes to a public debt rule for the local and regional levels, on 10 October 2012 the Government adopted a rule specifying that the level of debt of the regional and local units shall not exceed 60% of the average of their total revenues for the last 4 years. The rule contains an automatic corrective mechanism and sanctions in case of non-compliance. However, neither the "budgetary strategy for the government sector" nor the public debt rule for the local and regional levels have been approved by the Parliament and their future will become clear only with the new Government in office.

II. ADDITIONAL INFORMATION ON PROGRESS UNRELATED TO THE POLICY ADVICE

The Czech Republic is not a signatory party of the TSCG. The transposition of the Directive on budgetary frameworks is affected by the political developments after the Chamber of Deputies was dissolved on 28 August with the early elections set for the end of October. As a consequence, the adoption of the improvements to the fiscal framework has been postponed. This also holds for the other legislative proposals ensuring compliance with the Directive. Taking this into account, it seems very likely that the transposition of the Directive will face a delay in many areas. In particular, this will apply to the areas of fiscal and statistical data, as the required data provision by some general government institutions will be available only with a revision of the Accounting Act. Delays also occur with the deferred reform of the Supreme Audit Office which envisaged extending its audit competences across the vast majority of general government institutions. As for the requirements of the Directive adopted so far, the availability of the cash-based fiscal data on a monthly basis for the six state funds has reportedly been ensured and improvements have been undertaken in the area of forecasting. In its publicly available quarterly macroeconomic projections, the Treasury carries out an *ex-ante* comparison of the latest national forecast with those of both domestic and international institutions (i.e. CNB, COM, OECD, IMF), providing an explanation of differences. In the same publication, it also provides an *ex-post* comparative assessment using common statistical methods.

Fiscal governance in Germany – 2013 update

Further to the 2011/12 cycle of the Peer Review, the Economic Policy Committee was to revisit the issued policy advice and take stock of the progress achieved by the Member States.

EPC policy advice

The new constitutional debt brake has the potential to effectively curb deficits and to further strengthen the German fiscal framework. However, while detailed provisions in the German Constitution and related implementation rules suggest good prospects for effective application of the debt brake at the federal level, effective and consistent implementation at the Länder *level appears less certain. Only some* Länder *have enshrined balanced budget rules in their constitutions, and provisions for their implementation have not yet been specified or vary across states. In this context, national authorities should introduce the following measure:*

- *Further strengthen the monitoring and enforcement of the debt brake at state level, in particular by ensuring consistent rules and provisions for their implementation across all* Länder*, adequate monitoring procedures and effective sanctions in case of non-compliance.*

The following factsheet from the Commission services assesses the progress to date in implementing the policy advice adopted by the EPC in 2011/12 and provides some updated information on the latest developments in relation to Germany's fiscal framework.

I. ASSESSMENT OF PROGRESS TOWARDS THE 2011 POLICY ADVICE

2011 policy advice: Further strengthen the monitoring and enforcement of the debt brake at state level, in particular by ensuring consistent rules and provisions for their implementation across all Länder*, adequate monitoring procedures and effective sanctions in case of non-compliance.*

Assessment of progress made: Partially implemented

In 2009, Germany introduced a new constitutional balanced budget rule ('debt brake'), which stipulates that both the federation and the *Länder* should have structurally balanced budgets from 2016 and 2020, respectively. Specific legal provisions appear to be required to ensure an effective application of the debt brake in the annual budgetary procedure. Such detailed provisions have been laid down for the federal budget in the federal constitution and in implementing rules. This has not been done to the same extent at *Länder* level, which is the sole responsibility of the *Länder* themselves. Hence, the 2011 policy advice aimed at strengthening the enforcement of the debt brake at *Länder* level.

The policy advice has been partially implemented and additional efforts appear to be required. So far, out of sixteen *Länder*, six have enshrined reinforced balanced budget rules in their constitutions and five in their budget laws[9]. Only Rhineland-Palatinate, Lower Saxony and Schleswig-Holstein have laid down implementing rules. Lower Saxony and Schleswig-Holstein have defined decreasing annual borrowing ceilings for the transition period until 2020. Rhineland-Palatinate and Schleswig-Holstein have specified provisions for preventing recourse to financial transactions, correcting the deficit for the impact of the business cycle, applying exemption clauses for natural disasters and other emergencies, and using a control account which records deviations in budget execution from the authorised level of borrowing and ensures that the cumulated effect on government debt is recouped in the following years.

II. ADDITIONAL INFORMATION ON PROGRESS UNRELATED TO THE POLICY ADVICE

In addition to the constitutional debt brake, in 2013 the federal government adopted a law transposing the Treaty on Stability, Coordination and Governance in the EMU. Accordingly, it sets the ceiling for the general government structural deficit at Germany's current medium-term budgetary objective of 0.5% of GDP. Compliance with the national deficit ceiling will be monitored by the existing Stability Council, which consists of the federal and *Länder* ministers of finance and the federal minister of economics. The Stability Council will be equipped with an independent advisory board that publishes statements on

[9] Hamburg, Hessen, Lower Saxony, Mecklenburg-Western Pomerania, Rhineland-Palatinate and Schleswig-Holstein have enshrined debt brakes in their respective constitutions and Baden-Württemberg, Bavaria, Saxony, Saxony-Anhalt and Thuringia in their budget laws. Berlin, Brandenburg, Bremen, North Rhine-Westphalia and Saarland have not enshrined reinforced balanced budget rules in *Länder* legislation.

compliance with the deficit ceiling and recommendations for corrective action in the event of non-compliance[10]. The law also covers the sanctions that may be imposed on the federal government and the *Länder* under the reformed preventive arm of the Stability and Growth Pact.

[10] The advisory board will consist of representatives from the Bundesbank, the Council of Economic Experts (*Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung*), and the institutes that prepare the joint economic forecast, as well as experts appointed by the federal and *Länder* governments, the associations of local authorities and the social security institutions.

Fiscal governance in Denmark – 2013 update

Further to the 2011/12 cycle of the Peer Review, the Economic Policy Committee was to revisit the issued policy advice and take stock of the progress achieved by the Member States.

> ***EPC policy advice***
>
> *The track record of Denmark's fiscal framework has been rather positive. Denmark's medium-term budgetary framework (MTBF) and the introduction of the balanced structural budget rule embedded in the MTBF have helped to reduce public debt and to address the need for sustainability, enhancing reforms early on. In addition, multi-annual public consumption targets ensure that new spending initiatives must be balanced by cost reductions elsewhere in order not to jeopardise the MTBF's overall ceilings. However, Denmark has also a history of substantial expenditure overruns at the regional and local government levels. In this context, national authorities should introduce the following measures:*
>
> - *Specify annual expenditure ceilings that comply with the structural balance objective set out in the multi-annual plan in order to improve the link with the MTBF.*
> - *Improve reporting on budget execution at local level, providing accruals — together with cash-based information on a quarterly or monthly basis.*
> - *Widen expenditure targets, so that they are not limited to public consumption expenditure but cover the main part of non-cyclical public expenditures.*

The following factsheet from the Commission services assesses progress made in implementing the policy advice adopted by the EPC in 2011/12 and provides some updated information on the latest developments in relation to Denmark's fiscal framework.

I. ASSESSMENT OF PROGRESS TOWARDS THE 2011 POLICY ADVICE

The track record of Denmark's fiscal framework has been rather positive, and it ranks relatively favourably among the Member States, based on the overall fiscal rule index[11]. The general rule for budgetary policy in Denmark is achieving a structural general government balance or surplus in the medium to long term, as specified in the medium-term budgetary framework (MTBF). The Danish Budget Law, which was adopted in June 2012 and came into force in February 2013, introduces legally binding ceilings on public expenditure (at central, regional and municipal level). These contribute to achieving budget balance in accordance with Denmark's obligations under the Fiscal Compact.

a) Specify annual expenditure targets that comply with the deficit objective set out in the multi-annual plan in order to improve the link with the MTBF

Assessment of progress made: Implemented

Denmark is applying a medium-term budgetary framework (MTBF) to all levels of government. According to the Danish Budget Law, the budgetary position of the general government shall be balanced or in surplus. The budget balance rule is deemed to be respected if the structural balance of the general government is at the MTO as defined in the revised SGP, with a lower limit of a structural deficit of 0.5 per cent of GDP, unless exceptional circumstances are present.

The Danish MTBF is not based on constitutional or legal acts, but it is a political commitment to achieve fiscal sustainability over the long term. Nevertheless, the multiannual plans have parliamentary support and serve as an anchor for fiscal policy planning in the annual budget process.

The Danish Budget Law introduced multiannual binding expenditure ceilings for all three government levels. In accordance with the Budget Law, expenditure ceilings for 2014-17 for central and local government (regions and municipalities) were adopted by the Parliament in June 2013. Starting from 2014, in year t (e.g. 2014), expenditure ceilings for the new t+4 (e.g. 2018) will be adopted at the same time as the budget for t+1 (e.g. 2015) is adopted. The expenditure ceilings are nominal spending limits that have to respect the Danish MTBF. The ceilings are designed to underpin the fulfilment of the Danish MTO and the

[11] Based on the Commission's fiscal governance database.

Danish budget balance rule. The Budget Law implements the budget balance rule of the fiscal compact in a binding ordinary Danish law.

b) Improve reporting on budget execution at local level, providing accruals – together with cash-based information on a quarterly or monthly basis.

Assessment of progress made: Partially implemented

From 1 January 2014 Denmark will publish primary accounts (cash-based accounting system) for local government on a quarterly basis. The Agency for the Modernisation of Public Administration (*Moderniseringsstyrelsen*), a body under the Ministry of Finance, is responsible for the collection and publication of the relevant data, which will not be seasonally adjusted.

Statistics Denmark only publishes accrual-based quarterly data for the entire public sector, and not for the local government level alone.

c) Widen expenditure targets, so that they are not limited to public consumption expenditure but cover the main part of public expenditures.

Assessment of progress made: Implemented

Denmark has a history of substantial expenditure overruns, in particular at regional and local level. To improve control over local government expenditures and taxation level, permanent legislative acts containing sanction mechanisms have been approved by the Parliament over the last few years since 2010. No expenditure overruns have occurred in 2011 and 2012.

Under the new Danish Budget Law, the Parliament sets expenditure ceilings at central, regional and municipal level. The ceilings always cover the next four years. The adopted expenditure ceilings are not limited to public consumption expenditure but cover approximately ¾ of public expenditures. Unemployment benefits (as expenditures very sensitive to the business cycle) and interest rate expenditures are not included.

In previous medium-term plans, it was usually assumed that planned expenditure could be financed in the future through unspecified measures, which often proved difficult to implement. The government has introduced a precautionary principle according to which new expenditures will not be approved unless there is majority support in Parliament for specific initiatives to ensure funding. This is an important step towards a stricter expenditure policy.

II. ADDITIONAL INFORMATION ON PROGRESS UNRELATED TO THE POLICY ADVICE

Denmark does not currently appear to face short-term, medium-term or long-term fiscal sustainability challenges. The ratification of the TSCG was approved by the Danish Parliament on 31 May, 2012. The provisions of the TSCG have been transposed in the new Danish Budget Law, which was passed by the Danish Parliament on 12 June, 2012. The provisions came into force on 1 February, 2013 as a part of national law.

Fiscal governance in Estonia – 2013 update

Further to the 2011/12 cycle of the Peer Review, the Economic Policy Committee was to revisit the issued policy advice and take stock of progress achieved by the Member States.

EPC policy advice

While the strength of the fiscal governance framework lies in the long-standing commitment to the budget balance rule, the rule itself is not formalised in legislation and has proved to be insufficient in preventing the procyclical fiscal loosening in years of high growth. The medium-term framework is in place but would need strengthening or augmenting by additional rule(s) to ensure sustainable fiscal policy over the cycle. In this context, national authorities should introduce the following measures:

- *Formalise the current budget balance rule in legislation, as currently envisaged by the authorities. The new law should take into account Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States and include targeting a balanced or surplus position over the cycle.*
- *In order to prevent excessive expenditure growth in good economic times, the binding nature of expenditure ceilings in the medium-term budgetary framework should be strengthened and augmented by multi-annual expenditure rules; the framework would benefit from a strengthening of the monitoring system of the strategic targets, including elements of public accountability.*

The following factsheet from Commission services assesses the progress to date in implementing the policy advice adopted by the EPC in 2011/12 and provides some updated information on the latest developments in relation to Estonia's fiscal framework.

I. ASSESSMENT OF PROGRESS TOWARDS THE 2011 POLICY ADVICE

The strength of the fiscal governance framework of Estonia has been the long-standing commitment to the (nominal) budget balance rule, although the rule itself is not formalised in legislation. The process of strengthening the fiscal framework is ongoing in the context of the transposition of the Fiscal Compact into national legislation and is expected to be completed by 1 January 2014.

a) Formalise the current budget balance rule in legislation, as currently envisaged by the authorities. The new law should take into account Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States and include targeting a balanced or surplus position over the cycle.

Assessment of progress made: Not implemented. However, the assessment can be revised to "implemented" after adoption of the draft State Budget Act (SBA) before the end of 2013, which is the main tool used for the transposition of the Fiscal Compact. Currently the new SBA is in the final stage of consultation, it should be submitted to the Government for adoption in October and it is envisaged to take effect on 1 January 2014.

The new SBA sets out general requirements for structural fiscal balance of the whole general government. Annual state budgets have to be compiled in a way that the general government structural position is at least in balance. The Government can deviate from the budget rule only if correction mechanism has been triggered or in exceptional circumstances referred to in the Stability and Growth Pact (i.e. factors beyond Government control, economic recession and economic growth below potential GDP growth for a long time).

Although the annual state budget is the main tool which ensures compliance with the structural balanced-budget rule, there are specific regulations in place or planned to be added to legislation for non-central government entities and for other general government sector which supports the achievement of fiscal balance. Among others, these restrictions include debt rules and balanced current budget requirements.

b) In order to prevent excessive expenditure growth in good economic times, the binding nature of expenditure ceilings in the medium-term budgetary framework should be strengthened and augmented by multi-annual expenditure rules; the framework would benefit from a strengthening of the monitoring system of the strategic targets, including elements of public accountability.

Assessment of progress made: Not implemented.

There are no changes in legislation related to strengthening the binding nature of expenditure ceilings in the medium term budgetary framework and/or to introducing multi-annual expenditure rules. Although the new State Budget Act (SBA) stipulates that expenditure ceilings will be set in place in the medium-term state budget strategy for the next four years, there are no provisions for how to strengthen the binding nature of those ceilings. Similar to the current situation, expenditure ceilings set in the budget strategy are the starting point for next year's state budget, but they can be revised during the state budget preparation process. Expenditure limits can be revised in the following year's update of the budget strategy.

II. ADDITIONAL INFORMATION ON PROGRESS UNRELATED TO THE POLICY ADVICE

The transposition process of the TSCG is ongoing in Estonia and the new State Budget Act is envisaged to be adopted before 1 January 2014. In addition to the above-mentioned structural balanced-budget rule, the new SBA will introduce a correction mechanism following a deviation from the MTO, a compensation mechanism for historical structural deficits and will create an independent fiscal monitoring body.

If there is a significant deviation from the MTO of a structural surplus, a correction mechanism will be triggered and consolidation measures should be implemented by the government in such a way that the general government structural position improves by at least 0.5% of GDP annually until the MTO has been reached again. Overall, the correction mechanism can be triggered by a significant deviation from the structural budget balance (the MTO) identified *ex post* or *ex ante* either by national authorities or at the EU level.

In addition, the SBA establishes a compensation mechanism for historical structural deficits. If the structural deficit was larger than 0.5% of GDP, it should be compensated immediately after reaching a structural balance. During the compensation period the structural surplus should be at least 0.5% of GDP per year until the historical deficit is fully compensated. Even though there would not be a specific timeline for achieving the compensatory structural surpluses, it acts to avoid unduly pro-cyclical policies.

The tasks of the independent Fiscal Council are planned to be designated to the National Central Bank, Bank of Estonia (*Eesti Pank*), which will act as the main fiscal supervisory body in charge of monitoring implementation of the SBA. These monitoring tasks will be fixed in the Eesti Pank Act. According to the draft Act, the Bank of Estonia is responsible for assessing the validity of economic forecasts underlying fiscal strategies and state budgets, appropriateness of fiscal targets and adjustment path towards them, existence of exceptional circumstances, and implementation of a structural budget balance rule. All these assessments will be made available on the website of the Bank of Estonia. Although Bank of Estonia's assessments are not legally binding, the Government is supposed to follow them or to explain publicly the non-compliance.

Fiscal governance in Greece – 2013 update

Further to the 2011/12 cycle of the Peer Review, the Economic Policy Committee was to revisit the issued policy advice and take stock of the progress achieved by the Member States.

EPC policy advice

Greece faces a difficult but critical task in the strengthening of its fiscal framework which, before recent reforms, was lagging behind the EU average by a considerable margin. In the context of the implementation of the EC-ECB-IMF adjustment programme, national authorities should introduce the following measures:

a) In order to reinforce the binding character of the targets considered in the new MTBF, introduce mechanisms to enforce ceilings for the central government and social security funds building on those set up for the general government;

b) Resume and enhance the operation of the independent fiscal council entrusted with technical tasks related to fiscal policy-making (e.g. provision of forecast for the budget preparation, monitoring fiscal developments against budgetary targets and fiscal rules, etc…);

c) Strengthen expenditure monitoring mechanisms for local governments and social security funds;

d) Review the current budgetary procedures to further strengthen the Ministry of Finance vis-à-vis line ministries;

e) Introduce a revenue rule for the general government, according to which the allocation of higher-than-expected revenues should be specified ex ante in the budget.

The following factsheet from the Commission services assesses the progress to date in implementing the policy advice adopted by the EPC in 2011/12 and provides some updated information on the latest developments in relation to Greece's fiscal framework.

I. ASSESSMENT OF PROGRESS TOWARDS THE 2011 POLICY ADVICE

Greece made significant progress in strengthening its fiscal framework over the last year within the context of the implementation of the EC-ECB-IMF economic adjustment programme. The process will be further strengthened when all the recent developments will have been integrated into the organic budget law in the last part of the year. Key recommendations include:

a) In order to reinforce the binding character of the targets considered in the new MTBF, introduce mechanisms to enforce ceilings for the central government and social security funds building on those set up for the general government.

Assessment of progress made: Implemented

Since November 2012 Greece has made satisfactory progress in implementing a set of ceilings for the balances of many sub-sectors of the central and general government (Extra Budgetary Funds, State Owned Enterprises and Local Governments), enforced through sector-specific corrective mechanisms aiming at securing the achievement of targets. Binding ceilings were set for the balance of the aforementioned subsectors with the update of the Medium Term Fiscal Strategy (MTFS) in February 2013. Following the setting of overall target per each sector, monthly targets have been set for each entity in order to ensure the consistency with the overall target. The budget execution is monitored every quarter against the targets, and corrective mechanisms are triggered in case of deviations of more than 10% from the quarterly financial targets. Corrective mechanisms start by addressing the specific entity whose budget execution is off-track and asking for adopting corrective measures. In case of inertia, operating expenditures or grants from the State are cut by an amount matching that of the slippages, as long as the deviation is not corrected. Deviations for entities that do not receive funding or support of any kind from the State budget are sanctioned through cuts in the amount of borrowing and suspension or removal of the Board.

All these safeguards for the delivery of fiscal commitments will be fully integrated in the corrective mechanisms required by the Fiscal Compact within the context of the upcoming reform of the Organic Budget Law (envisaged for adoption by October 2013).

Binding ceilings were also introduced in the healthcare sector with the last update of the MTFS in February 2013 concerning pharmaceutical spending and illness benefits (diagnostics and private hospitals mainly). These two areas represent the main part of the healthcare sector, excluding wages to doctors and other

personnel. Ceilings are enforced through structural measures aimed at reducing the underlying expenditure trend, and through a "claw back" mechanism according to which the healthcare provider for Greece (EOPYY) does not reimburse billed goods and services exceeding the aforementioned ceilings.

b) Resume and enhance the operation of the independent fiscal council entrusted with technical tasks related to fiscal policy-making (e.g. provision of forecast for the budget preparation, monitoring fiscal developments against budgetary targets and fiscal rules, etc…).

Assessment of progress made: Partially implemented

The Parliamentary Budget Office was established in 2010 but initiated its activities in summer 2011. Its Board collectively resigned immediately after the publication of its first quarterly report, following criticism by the Ministry of Finance.

The office was resumed in December 2012 and the Board is now in office. Two quarterly reports have been published although the Office is still understaffed.

The current regulation of the PBO is still to be assessed in terms of meeting the independency requirements laid out in the Common principles on national fiscal correction mechanisms (COM 2012/342). It does not include a specification of tasks.

A draft of a new regulation has been prepared to fulfil the Memorandum of Understanding (MoU) requirement of strengthening the reputation of the existing Parliamentary Budget Office, independence and technical competence towards a fully-fledged fiscal council the Parliamentary Budget Office by December 2013.

c) Strengthen expenditure monitoring mechanisms for local governments and social security funds.

Assessment of progress made: Implemented

For local governments (LGs), the pre-existing balanced budget rule was strengthened through the creation of the Observatory body, which assesses *ex-ante* the credibility of the fiscal projections underlying the budgets of LGs. On the sequence of the process, the Observatory can recommend changes to the budget of LGs, if projections submitted are not robust. Once annual budgets are assessed, monthly targets are also identified. Monthly budget execution is evaluated against these targets and, when permanent and significant deviations from the monthly targets occur, the LG concerned is forced to adopt corrective action. Case of non-compliance may ultimately lead to the freeze of state transfers.

While for Extra Budgetary Funds (EBFs) and State Owned Enterprises (SOEs) the corrective mechanisms aforementioned are fully operational, the mechanism for the LGs will become operational in the context of the preparation of the 2014 budgets.

A crucial reform on the monitoring of social security system was completed by June 2013. Two electronic systems, namely "HELIOS" and "ARIADNE", have been legislated and fully activated. The information system "HELIOS" is a centralised social security monitoring system that gradually replaces the 93 existing sectoral systems and provides statistical data about the number of pensioners, the amount of each and every pension, as well as the total expenditure paid. Monthly reports are made public. At the same time central e-services are designed, such as the connection with the tax authority in order to pre-fill tax forms with pension income. "ARIADNE", which is a system that directly records the major demographic changes (birth, marriage, divorce, death), is already linked with "HELIOS" in order to suspend pensions, when needed.

d) Review the current budgetary procedures to further strengthen the Ministry of Finance vis-à-vis line ministries.

Assessment of progress made: Partially implemented

The current budgetary procedures will be changed within the revisions of the Organic budget law to be implemented in 2014, with the aim at strengthening the role of Ministry of finance. Pending the delivery of the wider ranging reform, the Ministry of Finance has strengthened its role in the budget execution introducing sanctions for entities which do not report their data to the General Accounting Office.

The aforementioned corrective mechanisms also helped strengthening the role of Ministry of Finance, by creating proper incentive mechanisms for public entities to keep the budgetary execution on track.

e) Introduce a revenue rule for the general government, according to which the allocation of higher-than-expected revenues should be specified ex-ante *in the budget.*

Assessment of progress made: Not implemented

Greece committed to introduce such rule within the changes to the Organic budget law whose deadline is scheduled for end-October 2013. The current budgetary procedures will be changed within the revisions of the Organic Budget Law which will be carried out next year.

II. ADDITIONAL INFORMATION

The current MoU includes commitments to change the Greek Organic budget law by end October 2013 to:

i. Introduce the necessary legislation to transpose the Fiscal Compact provisions, with a view to introducing a structural balanced-budget rule with automatic correction mechanisms;

ii. Introduce the three-years binding expenditure ceilings on a permanent basis, as part of the rolling MTFS for line ministries and the health care sector;

iii. Establish binding annual balanced budget targets for local governments;

iv. Identify performance targets for SOEs;

v. Introduce provisions to freeze *ex-ante* 10% of discretionary appropriations per budget line, as part of the MTFS. The frozen appropriations would be released in the second half of the year, conditional upon meeting the fiscal targets. The first application should concern the 2014 budget.

vi. Introduce a revenue rule for the general government, according to which at least 30% of windfall revenues will be devoted to debt repayment while up to 70% could be used the following year by the Government to support temporary policies aimed at boosting growth and social cohesion automatically, conditional on the achievement of the fiscal targets.

Fiscal governance in Spain – 2013 update

Further to the 2011/12 cycle of the Peer Review, the Economic Policy Committee was to revisit the issued policy advice and take stock of the progress achieved by the Member States.

EPC policy advice

Although the prevailing fiscal framework has been instrumental in promoting multi-annual fiscal planning and showed an overall good track record in a highly decentralised country, to some extent the significant deterioration of budget deficits at the central, regional and local government level can be explained by the fact that the fiscal framework did not sufficiently take into account the cyclical position of the economy. In addition, the fiscal framework was not sufficiently binding for regional and local governments. These issues are currently being addressed, as evidenced by the recent introduction of an expenditure rule at central and local level and a balanced budget constitutional amendment.

In this context, national authorities should introduce the following measures:

- *Adopt, as foreseen before the end of June 2012, the organic law to implement the new constitutional balanced budget rule, including the mechanisms needed to ensure compliance and implementing corrective action in case of deviation at all levels of government, to define the methodology for calculating the structural deficit, ideally following the methodology agreed at EU level, and clearly define a limited number of escape clauses.*
- *Strictly apply existing deficit and debt control mechanisms at sub-national government levels, ensuring that commitments are delivered; further improve reporting on budget execution at sub-national level; and adopt, as envisaged, binding expenditure rules at regional level.*

The following factsheet from the Commission services assesses the progress to date in implementing the policy advice adopted by the EPC in 2011/12 and provides some updated information on the latest developments in relation to Spain's fiscal framework.

I. ASSESSMENT OF PROGRESS TOWARDS THE 2011 POLICY ADVICE

a) Policy advice #1: Adopt, as foreseen before the end of June 2012, the organic law to implement the new constitutional balanced budget rule, including i) the mechanisms needed to ensure compliance and implementing corrective action in case of deviation at all levels of government, ii) to define the methodology for calculating the structural deficit, ideally following the methodology agreed at EU level, and iii) clearly define a limited number of escape clauses.

Assessment of progress made: Implemented.

Art. 135 of the Spanish Constitution, which subjects all public administrations to the principle of budgetary stability, is implemented by Organic Law 2/2012 (as amended) on Budgetary Stability and Financial Sustainability (BSOL). The law is in force as of 1 May 2012.

The Budgetary Stability Organic law:

i) Provides for **preventive, corrective and enforcement mechanisms** needed to ensure compliance and implementing corrective action in case of deviation at all levels of government. These consist of the following:
   - *Public non-compliance risk warnings*, if the central government identifies a risk of non-compliance with the fiscal stability target, public debt target or spending rule of regions. The warned administration has one month in which to take the necessary risk prevention measures, which must be communicated to the Ministry of Finance (Art. 19 of BSOL).
   - *Automatic corrective measures*, such that all debt operations of the non-complying region require the authorisation of the State[12] (Art. 20 of BSOL).

[12] This is unless the Autonomous Community has submitted an economic/financial plan that is deemed suitable by the Fiscal and Finance Policy Council, in which case, short-term credit operations that are not considered to be external financing will not require State authorisation; Art. 20.1 of BSOL.

- *Submission and implementation of Economic and Financial Plans* (EFP) by the non-compliant administration to meet the fiscal targets or the spending rule within the year (Art. 21 and 23 of BSOL).
- *Quarterly follow up reports* by the Ministry of Finance on the implementation of the measures contained in the EFPs (Art. 24 of BSOL).
- *Enforcement/compulsory measures*[13] in the event of two negative and consecutive quarterly reports (Art. 25 and 26 of BSOL).

ii) Refers to secondary legislation to define the **methodology for calculating the structural deficit**. Ministerial Decision ECC/2741/2012, of 20 December, describes a methodology for the calculation of the forecasts for income and expenditure trends and the reference growth rate of the Spanish economy, in response to the law's mandate.

iii) Provides for a limited number of **escape clauses**: According to Art. 11 of the BSOL, "the State and the Autonomous Communities may exceptionally incur a structural deficit in the event of natural disasters, severe economic recession or extraordinary emergencies which, in the judgement of an absolute majority of the members of the Congress of Deputies, are beyond the control of the Public Administrations and seriously impair their financial situation or their economic or social sustainability".[14]

The provisions of the BSOL are largely compatible with the circumstances in Art. 3.3b or in Art. 5.1 of Regulation 1466/97. First, severe economic recession is to be defined in accordance with European regulations (Art. 11.3). Second, the structural deficit is calculated by the method used by the European Commission in the context of the regulations on fiscal stability (Art. 11.6).

However, there are two differences in the definition of cases leading to the activation of the escape clauses:

- Under the BSOL, such clause would be triggered in the event of natural disasters, whereas Regulation 1466/1997 does not provide for this; nevertheless, it could be argued that a natural disaster is a type of unusual event outside the control of the member state, as referred to in the above-mentioned Regulation.
- Moreover, the Parliament decides whether "the unusual event outside the control of the member state" seriously impairs their financial situation *or their economic and social sustainability*. The latter is not provided for in Art. 5.1 of Regulation 1466/97 and creates the risk of turning this escape clause into a loophole.

b) Policy advice #2: i) Strictly apply existing deficit and debt control mechanisms at sub-national government levels, ensuring that commitments are delivered; ii) further improve reporting on budget execution at sub-national level; and iii) adopt, as envisaged, binding expenditure rules at regional level.

Assessment of progress made: Partially implemented.

The Budgetary Stability Organic Law introduces binding fiscal rules, including expenditure ceilings for regions and local governments, and provides for corrective mechanisms and sanctions in the event of non-compliance with fiscal targets. However, these have only been applied in part. Nevertheless, reporting on budget execution at sub-national level has improved considerably, following the publication of monthly data in cash and ESA terms.

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[13] Enforcement measures consist of the following:

a) freezing of credits to guarantee compliance with the target set; in addition, the regulatory powers granted to the Autonomous Communities in connection with devolved taxes could be exercised by the State;
b) lodging of an interest-bearing deposit in the Bank of Spain equivalent to 0.2 per cent of its nominal Gross Domestic Product, which will bear no interest if the economic and financial plan / rebalancing plan has not been submitted or approved or the measures have not been implemented within 3 months of the lodging of the deposit;
c) appointment of a commission of experts (if the abovementioned measures are not adopted or are inadequate), under the direction of the Ministry of Finance to submit a proposal of (adjustment) measures, which will be binding upon the non-complying administration;
d) if the above fails to deliver results, the Government will order the President of the Autonomous Community to see that the decision to freeze credits is adopted, the mandatory deposit laid is lodged or the measures proposed by the commission of experts are implemented;
e) if the above fails, the Government will take the measures necessary to compel implementation by the Autonomous Community.

[14] Art. 11.5 goes on to say that Social Security Administrations may exceptionally incur a structural deficit subject to the purposes and conditions laid down in the Social Security Reserve Fund regulations. In such an event the maximum allowable structural deficit for the central administration shall be reduced by the amount of the Social Security deficit (Art. 11.5). Local corporations must maintain a situation of budgetary equilibrium or surplus (Art. 11.4), meaning that no escape clause is provided for them.

i) The application of deficit and debt control mechanisms at sub-national government levels from May 2012 to date has been as follows (refer to the reply of recommendation 1.i. for a description of preventive, corrective and enforcement mechanisms in the BSOL):

- There was no need to issue non-compliance risk warning. In 2012, the process started with the approval by the Financial and Fiscal Policy Council in May 2012 of the 2012-2014 Economic and Financial Plans for all 17 regions. In other words, the process has started directly with the application of corrective measures, as no region complied in 2011 with the fiscal target.
- There have been two (quarterly) assessments of the 2012-2014 EFPs to date. These were published in December 2012 and in May 2013, respectively. The first concluded that seven regions were unlikely to meet the 2012 deficit target.[15] The second informed that six regions had missed such target, one of it, by a small amount.[16]
- As per Art. 21 of the BSOL, five non-compliant regions submitted an EFP for 2013. These plans were approved by the Financial and Fiscal Policy Council of 31 July 2013.
- The 2013 EFPs follow two negative assessments reports made by the Ministry of Finance. As per Art. 24 of BSOL, this leads to the application of the enforcement measures provided for in Art. 25 of BSOL by the non-compliant administration.[17]
- The implementation of this provision has been mixed: while some regions have reported freezes in budgetary appropriations in their 2013 EFPs,[18] none of them have lodged the interest bearing deposit in the Bank of Spain of 0.2% of nominal regional GDP, considering that they were conditional on the liquidity mechanisms provided by the central government.

ii) Reporting on budget execution at sub-national level: transparency of budget execution, especially by regional and local governments, has improved considerably with the publication of more timely, systematic and higher-frequency data. To illustrate:

- Publication of monthly budgetary execution data in cash terms started in July 2012.
- Since March 2013, the Ministry of Finance publishes budgetary execution data for regions and social security on a monthly and national accounts basis (starting with data for January 2013).
- More systematic information on the regions budget laws has also become available on the Ministry of Finance website.[19]

iii) Adoption of binding expenditure rules at regional level: Art. 12 of the BSOL provides for a spending rule,[20] to be observed by all general government subsectors. The expenditure rule is the benchmark used by the central administration, regions and local corporations when drawing up their respective Budgets (Art. 12.3). In other words, the expenditure benchmark is taken into account *ex-ante* in budgetary planning.

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[15] These regions are the following: Andalucía, Baleares, Canarias, Castilla la Mancha, Valencia, Extremadura and Murcia. The assessments concluded that Catalonia could meet the 2012 fiscal targets depending on the degree of execution of the planned sales of real estate assets.

[16] These regions are: Andalucía, Baleares, Castilla la Mancha, Valencia, Murcia and Catalonia. Castilla la Mancha missed the target by a small margin (0.06 percentage points).

[17] According to Art. 25.1 of BSOL, the enforcement measures consist of: a) the freezing of credits to guarantee compliance with the target set. In addition, where it is necessary to fulfil fiscal consolidation commitments with the European Union, pursuant to Article 19 of the Autonomous Communities (Financing) Act, Organic Law 8/1980 of 22 September 1980, the regulatory powers vouchsafed to the Autonomous Communities in connection with devolved taxes shall be exercised by the State. b) Lodge an interest-bearing deposit in the Bank of Spain equivalent to 0.2 per cent of its nominal GDP. The deposit shall be cancelled when the measures guaranteeing compliance with the targets are implemented.

[18] Valencia and Murcia's 2013 EFPs report freezes of €230 and €106.7 million for 2013, respectively. Baleares and Andalucía have not adopted such freezes (it has been argued that the measures reported in Baleares' 2013 EFP are enough to meet the 2013 fiscal target and that there was no need to freeze budgetary appropriations in addition to those measures). Catalonia has extended its 2012 expenditure budget for 2013 (i.e., the Catalan government will execute 86% of last years' expenditure budget until the 2013 regional budget is approved). Hence, no freezes have been applied either, as these are embedded in the extension of the 2012 regional budget.

[19] See: http://www.minhap.gob.es/Documentacion/Publico/PortalVarios/FinanciacionTerritorial/Autonomica/Resumen Ejecutivo Presupuestos/Resumen ejecutivo PRESUPUESTOS CC.AA. 2013.pdf.

[20] The spending rule is defined as follows:

The variation in the eligible expenditure of the Central Administration, Autonomous Communities and Local Corporations may not exceed the reference rate of medium-term growth of the Spanish economy's Gross Domestic Product (calculated by the Ministry of Economy, following the method used by the European Commission).

However, where there is a structural imbalance in the public accounts or a public debt in excess of the target set, the growth of eligible public expenditure will be adjusted to follow the lines laid down in the respective economic/financial and rebalancing plans referred to in Articles 21 and 22 of the BSOL.

When regulatory changes entailing permanent increases in revenue are approved, the level of eligible expenditure resulting from application of the rule in the years when such increases in revenue occur may be raised accordingly. Conversely, when regulatory changes entailing decreases in revenue are approved, the level of eligible expenditure resulting from application of the rule in the years when such decreases in revenue occur must be reduced accordingly.

All revenue in excess of forecasts will be devoted entirely to reducing the level of public debt.

Note, however, that the expenditure benchmark provided for in the BSOL does not have an identical specification as in Art. 5.1 of Regulation 1466/1997:

- The BSOL spending rule does not depend on whether Spain is at the MTO or not. The Spanish law allows (upward) adjustments in the level of eligible expenditure when there are regulatory changes adopted entailing permanent increases in revenue, as well as decreases in revenue if the level of eligible expenditure is reduced accordingly, without linking this to Spain's relative position *vis-a-vis* the MTO.
- Art. 12 of BSOL excludes from eligible expenditure debt servicing (vs. interest expense in Regulation 1466/97) as well as transfers to Autonomous Communities and local Corporations tied to financing systems (no reference in Regulation 1466/97), as this is considered an internal consolidation operation.

The next step would consist in the application of existing deficit and debt control mechanisms at sub-national government levels:

- The Ministry of Finance plans to publish the third assessments of regions' EFP in November (covering information until Q2 2013 on the execution of measures in the regions' 2013 budgets).
- The fourth assessment of the regions EFP will be published following the publication of budgetary execution data for Q3 2013.

II. ADDITIONAL INFORMATION ON PROGRESS UNRELATED TO THE POLICY ADVICE

Draft organic law providing for the creation of an independent fiscal council:
On 27 June 2013, the Council of Ministers sent to Parliament a draft organic law providing for the creation of an independent fiscal council,[21] where it will follow a fast track procedure. The Government expects this law to be adopted in Parliament in November 2013.

The draft law provides that the AIRF will be appended to the Ministry of Finance (Art. 7.3). The draft law specifies that this is without prejudice to the Authority's autonomy and functional independence.

The AIRF is entrusted with the task of guaranteeing compliance with the budgetary stability principle provided for by Art. 135 of the Spanish Constitution.

The AIRF is also entrusted with the drawing up of reports falling into the following few categories (Arts. 14-22):

i) assessment of macro forecasts used in the annual budget laws and in the stability programme;
ii) assessment of the Stability Programme;
iii) assessment (before 15 July of each year) on the degree of compliance with fiscal targets of all general government sub-entities;
iv) proposal of definition of regions' fiscal targets;
v) assessment of the quality of regions' economic and financial plans;
vi) evaluation of the draft budget bills of the various levels of general government.

Moreover, the AIRF will issue opinions on the following matters:

i) budgetary execution;
ii) long term financial sustainability and
iii) any other matter provided for by law.

Lastly, the AIRF will produce studies commissioned by the Government, the Financial and Fiscal Policy Council, the National Committee for Local Administration and the Social Security Financial Committee (Art. 5.3).

Unlike the opinions, the AIRF's reports are subject to the "comply or explain principle", whereby if the addressee of the report decides not to follow the recommendations of the AIRF, he/she will have to explain why (and attach the explanation to the relevant file).

Remaining shortcomings of the draft organic law[22] include: i) the very short term of office of the president (3 years); ii) the organisational location of the Council (linked to the Ministry of Finance); iii) the administrative status of the President (currently lower than secretary of state level). However, the independence of the AIRF is reinforced with legal provisions that are unique to it (i.e., provisions that are not found in the legislation of other independent bodies in Spain). As an example, these include the

[21] *Autoridad Independiente de Responsabilidad Fiscal* –AIRF.
[22] Existing version as of end-September 2013.

Parliament's capacity to veto the nomination of the AIRF's President and the specific tax levied on all administrations, to underpin the AIRF's financial autonomy.

Amendment of the BSOL to reduce arrears in commercial public sector debt

On 20 September 2013, the Council of Ministers sent to Parliament a draft organic law amending the Budgetary Stability Organic Law, so as to eliminate arrears in public sector commercial debt. The draft law is likely to get parliamentary approval before year-end.

- For that to happen, all public sector entities will publish their own average payment period. Should it be above the thresholds provided for in the law, preventive and then corrective measures will be activated, consisting of freezes in budgetary appropriations and other fiscal measures and State authorisations of the debt operations of the non-complying administration.
- If these measures fail to reduce the average payment period of the administration concerned, the Ministry of Finance will pay the commercial debt directly to the creditor and at the same time, withhold the amounts due to the non-compliant administration under the existing financing system.

Overall, the draft law aims at strengthening the monitoring powers of the Ministry of Finance over the cash and arrears' situation of the various public administrations, so that arrears do not undermine the financial sustainability of the administration concerned.

Fiscal governance in Finland – 2013 update

Further to the 2011/12 cycle of the Peer Review, the Economic Policy Committee was to revisit the issued policy advice and take stock of the progress achieved by the Member States.

EPC policy advice
The strength of Finland's fiscal framework lies in the long-standing commitment to agreeing the growth of central government expenditure at the beginning of a new parliamentary term. In this context, national authorities should introduce the following measures:
- *In addition to expenditure ceilings, formalise a budget balance rule in legislation, complementing the expenditure rule and providing a robust correction mechanism in case of unwarranted cyclical developments.*
- *Considering the long-term cost pressures for municipalities arising from population ageing, reinforce the rules and incentives for municipalities to balance their finances.*

The following factsheet from the Commission services assesses the progress to date in implementing the policy advice adopted by the EPC in 2011/12 and provides some updated information on the latest developments in relation to Finland's fiscal framework.

I. ASSESSMENT OF PROGRESS TOWARDS THE 2011 POLICY ADVICE

The main modifications to the fiscal framework in Finland arise from the ratification of the TSCG and the on-going municipal reform.

a) In addition to expenditure ceilings, formalise a budget balance rule in legislation, complementing the expenditure rule and providing a robust correction mechanism in case of unwarranted cyclical developments.

Assessment of progress made: Partially implemented

Finland has adopted the legislation to implement the TSCG. According to the law, the government sets the medium-term objective for the structural balance of the public finances in accordance with the Treaty. The law is not constitutional and can be revised as all other legislation.

The minimum pace of structural adjustment is specified at 0.5 percentage point. The measures to reach this shall be decided by the government the same year, or the following year at the latest. The independent body (State Audit Office, *Valtiontalouden tarkastusvirasto*) will give its opinion on the adequacy of these measures.

The law states that measures to correct the deviation from the MTO can be temporarily omitted if the Council has specifically concluded that exceptional conditions, as stated in the TSCG, prevail in Finland. The escape clause is valid until the Council decides that such exceptional circumstances no longer prevail in Finland.

b) Considering the long-term cost pressures for municipalities arising from population ageing, reinforce the rules and incentives for municipalities to balance their finances.

Assessment of progress made: Partially implemented

In addition to the adoption of the budgetary rule and in line with the provisions of the TSCG, the adopted law gives the government a mandate to propose secondary legislation which would also allow it to set fiscal targets for the sub-sectors of the government, including municipalities.

The Government has announced plans to enforce the balanced budget rule in the context of the new structural reform programme. Municipalities will be partially relieved from existing duties and they are forced to make additional savings or increase their revenues to balance the budget. The aim is to help close Finland's long-term sustainability gap.

II. ADDITIONAL INFORMATION ON PROGRESS UNRELATED TO THE POLICY ADVICE

Spending limit decisions are taken in late March each year, based on the Multi-Annual Fiscal framework adopted in the beginning of the Government's term. However, neither balanced budget requirements nor limits to annual deficits are set by the rule. The framework includes built-in automatic stabilisers, as some expenditure falls outside the scope of the limits.

Social security funds and municipalities currently operate outside the system of expenditure limits, except for the fact that government transfers to the municipalities are subject to central government expenditure limits. Municipalities are subject to a rule that requires a balanced budget over a four-year period but are free to decide on expenditure growth that can be financed by increasing local taxes. A civil service working group has been established to analyse ways of improving the macroeconomic steering of local governments, including setting spending limits for local governments.

Fiscal governance in France – 2013 update

Further to the 2011/12 cycle of the Peer Review, the Economic Policy Committee was to revisit the issued policy advice and take stock of the progress achieved by the Member States.

EPC policy advice
With the establishment of real multi-annual planning of public finances and the strengthening of fiscal rules, France's fiscal framework has improved significantly over the past few years. In this context, national authorities should introduce the following measures:
● Make multi-annual planning legally binding and of higher legal status compared to annual budgets while reinforcing the current coordination mechanism across general government sub-sectors.
● Build the consolidation strategy on realistic macroeconomic assumptions, through independent growth forecasts, and continue removing outdated and inefficient tax expenditures.

The following factsheet from the Commission services assesses the progress to date in implementing the policy advice adopted by the EPC in 2011/12 and provides some updated information on the latest developments in relation to France's fiscal framework.

I. ASSESSMENT OF PROGRESS TOWARDS THE 2011 POLICY ADVICE

The main changes that have affected France's fiscal framework since the 2011/12 Peer Review relate to the transposition of the Treaty on Stability, Coordination and Governance into national law. This has affected both the way multi-annual planning operates (policy advice #1) and the macroeconomic assumptions that underpin (multi-) annual budgets (policy advice #2).

a) Make multi-annual planning legally binding and of higher legal status compared to annual budgets while reinforcing the current coordination mechanism across general government sub-sectors.

Assessment of progress made: Partially implemented

While the concept of multi-annual planning already existed in France, the transposition of the TSCG into national law reinforced this. The main novelty was the creation of a fiscal council – the High Council for Public Finances – tasked with assessing *ex-ante* consistency of draft annual (or supplementary) budgets with a pre-defined multi-year adjustment path and reporting *ex-post* on a possible significant deviation from that path, which would then trigger a correction mechanism automatically. While the new provisions are aimed at preventing and correcting possible deviations from the initial path, multi-annual planning laws do not supersede as such annual budgets any more than before. In that respect, the credibility of the new legislation will still have to be built as it moves from concept to implementation. In particular:

• , The *ex-ante* warnings the High Council for Public Finances is to issue on draft annual (supplementary) budgets have taken the form of a risk assessment rather than a positive versus negative opinion, with a conclusion on the plausibility of the forecasts, including the underlying macroeconomic scenario (see below). They are taken into account by the Constitutional Court when assessing the sincerity of those budgets. The creation of a fiscal council is a clear novelty in the French budgetary framework institutional set-up and is likely to contribute to increasing the plausibility and credibility of fiscal targets. In that respect, the High Council has found the macroeconomic scenario underpinning the draft budget for 2014 plausible, an assessment also confirmed by the Commission 2013 Autumn Forecast, which was not always the case in previous years. On the other hand, the targeted reduction of the structural deficit for next year has been considered optimistic by the High Council.

• In case a significant deviation is expected, it cannot be formally excluded that the authorities will revisit the multi-annual adjustment path to avoid the correction mechanism being activated. Yet with the existence of the High Council (which has to issue a public opinion on every single new budget law), such a policy action would be associated with reputational costs and would go against the spirit of multi-annual planning.

• Although there are legal indications about the size and timeframe of the correction in case the correction mechanism has been activated, the current legislation does not explicitly prohibit deviations from those indications but instead says that such deviations need to be justified. In particular, it remains unclear whether these are limited to cases of exceptional circumstances as referred to in article 3 TSCG. .

The follow-up to the opinion the fiscal council has issued on the 2014 draft budget and the correction mechanism being likely activated already in 2014 will provide evidence as to the real impact of the new legislation.

Regarding coordination mechanisms across general government sub-sectors, limited progress has been made to effectively involve non-state-controlled sub-sectors (notably local governments as well as supplementary pension schemes for private sector workers and the unemployment benefit system, both run by social partners) to the overall budgetary strategy, Regarding local governments, efforts to curb grants from the central government have been made and these will be cut by around 0.1% of GDP annually in 2014 and 2015. However, this will not necessarily translate into a similar reduction in local spending insofar as local authorities have at the same time been entitled to temporarily raise stamp duties on the sale of immovable property in 2014-15. More generally, a 'confidence and responsibility' pact between the central government and local authorities has been agreed on, but a genuine governance framework for local authorities remains to be built according to a recent report from the Court of Auditors. Regarding supplementary pension schemes, social partners reached an agreement earlier this year which will partly reduce deficits and will thus have an impact on the general government balance. However, this cannot be seen as improving the coordination mechanism between those schemes and the state.

b) Build the consolidation strategy on realistic macroeconomic assumptions, through independent growth forecasts, and continue removing outdated and inefficient tax expenditures.

Assessment of progress made: Partially implemented

Regarding growth forecasts, the newly created fiscal council is notably in charge of delivering an opinion on the macroeconomic assumptions underpinning draft (multi-) annual budgets, supplementary budgets and stability programmes. As already mentioned, this opinion is incorporated in a legal framework in which the Constitutional Court uses them to assess the sincerity of draft budgets. The opinions which have been issued so far seem to have made a difference towards realistic macroeconomic assumptions. In particular, the macroeconomic scenario underpinning the draft budget for 2014 appears realistic (see above).

Regarding tax expenditures, the on-going consolidation strategy has largely relied on reducing and/or abolishing some tax and social security exemptions ('*niches fiscales et sociales*'). In the area of personal income taxation, the ceiling on the cumulated amount of tax exemptions that taxpayers can claim for a specific year has been gradually lowered, and some exemptions (e.g. on overtime) have been abolished. As far as corporate income tax is concerned, while the statutory rate has remained unchanged, the possibilities for carrying over losses and practicing tax optimisation have been limited. A further cut in corporate income tax exemptions is effective from 2013, mainly through gradually limiting the deduction of interest payments (first to 85% and then to 75%) and of long-term capital gains (the taxable portion has been increased from 10% to 12% and will now be assessed on gross instead of net capital gains). A number of exemptions on social contributions have also been (partly) abolished. As regards indirect taxation, the standard VAT rate applies to the so-called triple-play services as from 2011, and a number of goods and services are now taxed at 7% (instead of 5.5% until last year). The standard and intermediate rates will be raised from 2014, to 20% and 10% from 19.6% and 7%, respectively, as part of a further shift from labour to consumption on taxation. Overall, the amount of foregone revenue from tax and social security exemptions is expected to decrease by some 8% between 2010 and 2013 based on government data.[23] Nevertheless, the total remains still very high at above EUR 100 billion or 5% of GDP according to the same data and up to twice as much that amount when using a broader definition of tax expenditures.[24] Moreover, the trend will be clearly reversed next year with the introduction of a tax credit on payroll below 2.5 times the minimum wage (*crédit d'impôt pour la compétitivité et l'emploi*) although this will reduce the cost of labour for companies, in line with the country specific recommendations addressed to France under the European Semester.

II. ADDITIONAL INFORMATION ON PROGRESS UNRELATED TO THE POLICY ADVICE

France ratified the TSCG following a law adopted on 22 October 2012. Article 3 TCSG was transposed through an organic law, which has superior force compared to ordinary laws in the French legal order. The law was adopted on 17 December 2012, pursuant to which a multi-year public finance planning law,

[23] See draft state and social security budgets for 2012 and 2013 (*Projet de loi de finances, Evaluation des voies et moyens, tome II – Dépenses fiscales; Projet de loi de financement de la sécurité sociale, Annexe 5 – Présentation des mesures d'exonérations de cotisations et contributions et de leurs compensations*).

[24] Court of Auditors, *Rapport public annuel 2011*, February 2011.

covering 2012-17, was adopted on 31 December 2012. According to the authorities, such legal basis ensures that the rules concerned are guaranteed to be fully respected and adhered to throughout the national budgetary process. Apart from the changes in the institutional set-up described above (namely the creation of a fiscal council tasked with *ex-ante* warnings and activating a correction mechanism in case of a deviation observed – see above), multi-annual planning laws contain structural (on top of headline) balance targets and the medium-term objective is now explicitly referred to as such into national law.

Council Directive 2011/85/EU on requirements for budgetary frameworks of the Member States entered into force in December 2011. Member States are required to transpose a number of essential standards by 31 December 2013. The 2012 Commission Interim Progress Report informed on the state of play of the transposition at the time of reporting by Member States (i.e. September 2012). Regarding accounting, statistics and transparency provisions, while France makes monthly data for the state government bodies available in cash basis, fiscal data for social security funds and local governments is not available yet. In the area of macroeconomic and budgetary forecasting, the creation of a fiscal council is a novelty in the French institutional set-up which should contribute to France meeting the requirements of the Directive, in particular when it comes to macroeconomic and budgetary forecasts for fiscal planning being subject to regular, unbiased and comprehensive evaluation based on objective criteria, including ex post evaluation. Numerical fiscal rules have also been reinforced, namely with the introduction of a budget balance rule, on top of already existing rules applying to state government and healthcare expenditure but also to local authorities (balance budget rule). In the area of coordination mechanisms across general government sub-sectors, limited progress has been made to effectively involve non-state-controlled sub-sectors to the overall budgetary strategy (see above).

Fiscal governance in Hungary – 2013 update

Further to the 2011/12 cycle of the Peer Review, the Economic Policy Committee was to revisit the issued policy advice and take stock of the progress achieved by the Member States.

EPC policy advice

Almost all aspects of Hungary's fiscal framework have improved significantly since 2008. The adoption of the new Constitution in April 2011, which includes a separate chapter on public finances, will need to be followed by further legislation. In this context, national authorities should introduce the following measures:

- *Based on the strong commitment to a sound fiscal framework, determine as soon as possible the operational aspects of the key elements. These should include the exact workings of temporary numerical rules (both at the central and local level) in effect as long the debt ratio is above the 50 % threshold and the broadened governing arrangements of the Fiscal Council.*
- *Building on the progress achieved since 2008, embed the constitutional debt brake into a comprehensive fiscal governance framework covering, in particular, multi-annual fiscal planning, real-time budgetary monitoring, the transparency of public finances and stringent procedural and accounting rules.*

The following factsheet from the Commission services assesses the progress to date in implementing the policy advice adopted by the EPC in 2011/12 and provides some updated information on the latest developments in relation to Hungary's fiscal framework.

I. ASSESSMENT OF PROGRESS TOWARDS THE 2011 POLICY ADVICE

In the framework of the first BoP operation, Hungary started to comprehensively reinforce its fiscal framework from late 2008, including new procedural and accounting rules, the multi-annual nature of the numerical rules as well as the establishment of an independent Fiscal Council (FC), supported by a 30-strong analytical staff. Starting from late 2010, fiscal governance was fundamentally revamped by the new government, which has weakened some aspects of the efficiency of its operation (notably, replacing the forward looking real debt rule with a pro-cyclical debt ceiling and dismantling the autonomous analytical capacity of the FC, but at the same time endowing it with a veto right over the budget) while strengthening others (inter alia, providing a strong Constitutional basis for the new set-up). The EPC advice was formulated right after the adoption of the new Constitution in April 2011, including a separate chapter on public finances, which would have to be followed up by further legislative steps.

a) Based on the strong commitment to a sound fiscal framework, determine as *soon as possible the operational aspects of the key elements. These should include the exact workings of temporary numerical rules (both at the central and local level) in effect as long the debt ratio is above the 50% threshold and the broadened governing arrangements of the Fiscal Council.*

Assessment of progress made:

Numerical fiscal rules at central and local level – **Implemented**
Governing arrangements of the Fiscal Council – **Partially implemented**

The current debt growth rule[25] has a number of design flaws (narrow focus on annual cycle, lenient escape clause, insufficient monitoring and correction mechanism in case of deviation[26]), and it will be in effect only from 2016. Plans in this area[27] envisage some important improvements. The introduction of a structural balance rule to define the adjustment path to the MTO coupled with a correction mechanism in the event of deviations is considered. A new rule came into force from 2012, which constrains the debt

[25] The operational aspects of the key constitutional provisions were defined in subsequent laws (cardinal law on Economic Stability and the new Public Finance Act) in December 2011.

[26] See the 2012 European Semester Staff Working Document for a detailed discussion (on p. 14-15): http://ec.europa.eu/europe2020/pdf/nd/swd2012_hungary_en.pdf

[27] Based on information provided in October 2012 for the Commission's Interim Progress Report on the transposition of the budgetary frameworks Directive. All the necessary legislative amendments are to be submitted to Parliament during the ongoing autumn session.

accumulation by municipalities by means of an *ex-ante* central authorisation of local governments' loan agreements[28].

Also due to the peer pressure under the European Semester and EDP, the Fiscal Council (FC) received some reinforcement in September 2012 both in terms of optional tasks and resources. Notably, a small dedicated analytical team was set up within the Office of the Parliament and informal expert networks are being established. However, further improvements are still needed to ensure that the FC's analytical underpinnings are commensurate with its unprecedented and constitutionally enshrined strong veto competence over the annual budget bill, in particular the mandatory assignment to issue macro-fiscal baseline projections and assessments on major fiscal policy proposals as well as a systematic *ex-post* monitoring of compliance with numerical fiscal rules. The advocated broadening of the mandatory mandate would be conducive to ensuring that the FC's work and decisions is based on detailed and quantified calculations and not on a qualitative risk assessments (as has been the case so far).

b) Building on the progress achieved since 2008, embed the constitutional debt brake into a comprehensive fiscal governance framework, covering, in particular, multiannual fiscal planning, real-time budgetary monitoring, the transparency of public finances as well as stringent procedural and accounting rules.

Assessment of progress made:

MTBF – **Not implemented**
Budgetary procedures (monitoring, transparency, procedural and accounting rules) – **Partially implemented**

The Hungarian medium-term budgetary framework (MTBF) remained purely indicative (as basically the old system, which had no tangible results, was reconfirmed at the end of 2011). Legislative plans for the 2013 autumn session of Parliament (as reported earlier) envisage that a possible new structural balance rule may be embedded into a more binding MTBF.

As regards other proposed elements, the revamped Public Finance Act of December 2011 formulates information requirements to budgetary planning with a view to enhancing the transparency of the budgetary process. Remaining gaps are expected to be addressed by the transposition of Council Directive 2011/85/EU on requirements for budgetary frameworks, such as ensuring the public availability of budgetary planning documents and providing comprehensive information on PPPs and other contingent liabilities. Further improvements could target the regular update of the official budgetary forecasts and, building on the progress achieved recently with the regulation on *ex-ante* impact assessment, the systematic real-time publication of the officially projected budgetary impacts of the draft laws. Enhancing the real-time monitoring of budgetary execution would perhaps be best resolved by the enhancement of the watchdog function of the FC.

II. ADDITIONAL INFORMATION ON PROGRESS UNRELATED TO THE POLICY ADVICE

As the EPC policy advice to Hungary had been rather encompassing, virtually covering all aspects of the fiscal governance framework, there are no significant unrelated developments to be mentioned.

[28] The new procedure proved to be an effective tool in its first year operation. Specifically, in total an aggregate amount of 0.2% of GDP was authorised, of which 80% was renegotiation of already existing loans.

Fiscal governance in Ireland – 2013 update

Further to the 2011/12 cycle of the Peer Review, the Economic Policy Committee was to revisit the issued policy advice and take stock of progress achieved by the Member States.

EPC policy advice

Ireland's fiscal framework did not restrain high expenditure growth in the year prior to the crisis, which contributed to the significant deterioration of the fiscal position in the downturn. Comprehensive reforms of the medium-term budgetary framework addressing former weaknesses have been implemented and establishing these on a statutory basis is well advanced. These reforms will support the ongoing fiscal consolidation process over the coming years. In the context of the implementation of the EC-ECB-IMF adjustment programme, national authorities should pursue the introduction of the following measures:

a) Establish the fiscal council on a statutory basis to provide an independent assessment of the government's budgetary position and forecasts and to monitor compliance with fiscal rules.

b) Establish a statutory basis for the already introduced medium-term expenditure framework with binding multi-annual ceilings on expenditure for every major subcomponent (including both current and capital spending), ensuring that the coverage is sufficiently broad-based to allow for effective management of overall fiscal targets.

c) Ensure that the fiscal rules deliver an appropriate fiscal stance at each stage of the economic cycle, and are effective in ensuring compliance with the economic governance framework at EU level.

d) Continue to improve budgetary reporting.

The following factsheet from Commission services assesses the progress to date in implementing the policy advice adopted by the EPC in 2011/12 and provides some updated information on the latest developments in relation to Ireland's fiscal framework.

I. ASSESSMENT OF PROGRESS TOWARDS THE 2011 POLICY ADVICE

Significant steps have been made to improve the Irish fiscal framework and the quality, timeliness and comprehensiveness of provision of data. The main areas of progress concern the passage of the Fiscal Responsibility Act (FRA), the establishment of an Irish Fiscal Advisory Council (IFAC), the introduction of a medium-term expenditure framework (MTEF) and enhanced reporting and fiscal statistics. However, further efforts have to be made to enhance the quality of fiscal statistics, reduce their fragmentation and improve consistency across general government entities. Moreover, the expenditure ceiling framework continues to fall short of the letter and spirit of EU requirements and recommendations (as per the EPC policy advice, the budgetary frameworks Directive, and the EU-IMF economic adjustment programme) in terms of its binding nature and robustness.

a) Establish the fiscal council on a statutory basis to provide an independent assessment of the government's budgetary position and forecasts and to monitor compliance with fiscal rules.

Assessment of progress made: **Implemented**.

The Fiscal Responsibility Act 2012 (FRA) establishes the Irish Fiscal Advisory Council (IFAC) on a statutory basis. The FRA provides the IFAC with the task of assessing and monitoring the forecast of the Department of Finance (DoF), assessing the compliance with the budgetary rule and appropriateness of the Government's fiscal stance. The Ministers and Secretaries (Amendment) Act 2013 further complements the IFAC's competences with the role of independently endorsing the macroeconomic forecasts underlying the budgetary plans. A Memorandum of Understanding (MOU) containing practical arrangements and information sharing rules between the IFAC and the DoF has been published. To facilitate this process and

to comply with the two pack requirement of setting out the forecasting methodology, the DoF will set out its forecast methodology by way of a periodically updated working paper which will be publicly disclosed.

Moreover, the FRA requires the independence of the IFAC and outlines the criteria of a stand-alone entity, appointment on the basis of experience and competence, freedom from political/external interference, predefined committed financial resources as a source of funding, access to information to perform the assigned tasks.

b) Establish a statutory basis for the already introduced medium-term expenditure framework with binding multi-annual ceilings on expenditure for every major subcomponent (including both current and capital spending), ensuring that the coverage is sufficiently broad-based to allow for effective management of overall fiscal targets.

Assessment of progress made: **Partially implemented**.

While significant progress has been made to ensure greater accountability in the budgetary process and to introduce an effective multi-annual framework, the Irish Medium-term Expenditure Framework should be further improved.

The Comprehensive Expenditure Report 2012-2014 (CER) published in December 2011 introduced “Ministerial expenditure ceilings” on an administrative basis, i.e. three-year allocations of current expenditure to each Minister/Department, which the Ministers and Secretaries (Amendment) Act 2013 (MSAA2013) puts on a statutory footing. The Act empowers the Government to set out an overall Government expenditure ceiling for aggregate expenditure for each of the following three years (on the basis of a proposal from the Minister for Finance), and to apportion the aggregate ceilings into Ministerial expenditure ceilings (on the basis of a proposal from the Minister for Public Expenditure and Reform). The subsequent annual expenditure plans have to respect the pre-defined Government expenditure ceiling for that year. Operational details of the Expenditure framework were further clarified in the administrative circular published in October 2013, including over-arching conditions of the national and EU budgetary rules, including EU expenditure benchmark, and circumstances for revisions of the expenditure ceilings.

These reforms undertaken since the Peer Review exercise partially address the policy advice, except for the following elements that are still missing to ensure full effectiveness:

(i) copper-fasten the binding nature of the ceilings and spell out limited revision circumstances in ordinary law. Whereas ceilings should be binding, the MSAA2013 allows for discretionary changes to the Government expenditure ceiling and the administrative circular does not restrict the Government's decisions any further than the requirements of European and national fiscal rules. Therefore, the binding nature of the government expenditure ceiling should be strengthened by embedding the adjustment criteria in ordinary law rather than in an administrative circular, which is not legally binding and gives leeway for discretionary changes to the ceiling.

(ii) ensure consistency with the EU expenditure benchmark. The Government expenditure ceiling covers a somewhat different aggregate[29] than the EU expenditure benchmark. This could impede its effectiveness as a fiscal rule, given also a need to promote compliance with SGP rules.
(iii) fully lay out correction and sanction mechanisms. The consequences for non-compliance with Ministerial and Government ceilings are thus far not well defined, and in particular not in the Act itself.

c) Ensure that the fiscal rules deliver an appropriate fiscal stance at each stage of the economic cycle, and are effective in ensuring compliance with the economic governance framework at EU level.

Assessment of progress made: **Implemented**.

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[29] Specifically, “government expenditure” in the context of the abovementioned MSAA2013 is defined as the expenditure voted by the Dáil each year and excludes: (a) debt service costs; (b) non-voted expenditure financed directly from the "central fund" (judges' pay, and the budgets of the Houses of Oireachtas and the IFAC); and (c) expenditure by local governments and non-market public corporations. In contrast, the EU expenditure benchmark is set for general government sector excluding interest expenditure, non-discretionary changes in unemployment benefit expenditure and discretionary expenditure increase fully offset by discretionary revenue-increasing measures.

The FRA fully implements budgetary and debt rules, i.e articles 3 and 4 of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG).

The budgetary rule requires that the budgetary position of General Government must be either:

(i) in balance or in surplus and that this will be satisfied if the annual structural balance is at the medium-term budgetary objective (MTO); or

(ii) the annual structural balance of General Government is complying with the adjustment path toward the MTO as set in accordance with the SGP; unless a failure to achieve the MTO or remain on the adjustment path towards it is permitted if exceptional circumstances, as defined under the SGP, apply.

If there is a failure to comply with the budgetary rule and the deviation from the MTO or the adjustment path is more than 0.5% of GDP and exceptional circumstances do not apply, then the Government will be required to implement a correction mechanism. Under the correction mechanism, if the Commission addresses a warning to the State or the Government considers that there is a failure to comply with the budgetary rule, the Government shall, within 2 months, prepare and lay before the parliament a plan specifying what is required to ensure compliance with the budgetary rule. The plan should be consistent with the SGP rules and recommendations made under the SGP.

The FRA also provides for the implementation of the debt rule in line with the requirements of the SGP. The debt rule requires that General Government debt in excess of 60% of GDP must be reduced by one twentieth of the excess over this limit each year. In Ireland's case, the debt rule will apply in full three years after it has exited its current EDP in 2015.

Moreover, as a part of the mandate under the FRA, the IFAC, in relation to each budget and stability programme, provides an assessment of whether the Government's fiscal stance is conducive to prudent economic and budgetary management and a fiscal assessment report is published twice per year.

d) Continue to improve budgetary reporting.

Assessment of progress made: **Partially implemented**.
The provision of fiscal data has been improved and efforts in this area continue. However, it appears that a significant scope for improvement remains.

As of March 2013, the CSO (Central Statistics Office) is in charge of the EDP reporting and, as of April 2013, publishes quarterly government finance statistics publications.

A memorandum of understanding on data exchange between the competent authorities has been set up to ensure more reliable and transparent public finance data. An alternative presentation of the Exchequer Returns, has been published since November 2012, aiming at enhancing budgetary reporting and transparency by showing voted expenditure (current and capital, including spending from departments, the Social Insurance Fund, and the National Training Fund) and all revenue (current and capital, including separately the monthly outturn for Appropriations-in–Aid) *on a gross basis*.

The Irish Government requested the IMF to conduct a Fiscal Transparency Assessment (FTA) which was published in July 2013. The FTA highlighted that fiscal disclosure in Ireland remains somewhat fragmented and diffuse. The report therefore recommended a series of actions over five years to: (i) expand the institutional coverage of budgets, statistics, and accounts; (ii) recognize all assets, liabilities, and associated fiscal flows in fiscal reports; (iii) modernize and harmonize accounting standards across the public sector; (iv) accelerate the timetable for submission and approval of the annual budget and financial statements; and (v) improve the analysis forecast changes, long-term trends, and fiscal risks[30].

The FTA highlighted several weaknesses in the Irish fiscal reporting system. In particular, cash-based budget execution reports are published monthly but cover only the Exchequer and use a classification which does not correspond to the ESA 95 rules. Fiscal statistics cover all general government entities, but still exclude public corporations and multiple and inconsistent charts of accounts are used by different general government entities.

[30] See http://www.imf.org/external/np/sec/pr/2013/pr13258.htm

Further progress also needs to be made in terms of local government management[31].

In Ireland, the only sub-sector outside central government and social security is the local government sub-sector which represents a small percentage of overall general government (ca. 10%), and the management of local government finances is relatively centralised. However, it appears that some aspects of the coordination between central and local government could be improved, in particular as regards the quality and consistency of data across the local entities, revenue collection performance, bad debt provisions, and procurement procedures, as signalled by the Local Government Audit Service in its reports[32].

II. ADDITIONAL INFORMATION ON PROGRESS UNRELATED TO THE POLICY ADVICE

Significant steps have been taken to fully comply with the Two-pack regulations.

The IFAC has been mandated to endorse the macroeconomic forecast of the budgets (Two-pack requirement) and to facilitate information access and sharing a memorandum of understanding between the IFAC and the DoF has been signed and is publicly disclosed.

To fulfil the requirement of setting out the forecasting methodology, the DoF will publish a signed working paper on their forecast methodology which will be also part of the budget documentation.

The requirement of a comprehensive audit of public finance for countries under macroeconomic adjustment programme has been satisfied by the existing audit arrangements and special reports analysing policy and market failures leading to the Irish financial crisis.

[31] On this issue the conclusions of the thematic peer review on coordination arrangements conducted in May 2013 would be relevant for tackling the challenges met by Ireland.

[32] http://www.environ.ie/en/LocalGovernment/LocalGovernmentAuditService/PublicationsDocuments/FileDownLoad,32617,en.pdf

Fiscal governance in Italy – 2013 update

Further to the 2011/12 cycle of the Peer Review, the Economic Policy Committee was to revisit the issued policy advice and take stock of progress achieved by the Member States.

EPC policy advice

While Italy's fiscal framework has significantly improved in the last few years, notably as a result of the reform of the budgetary process that introduced a three-year horizon for budgetary planning, the introduction of comprehensive numerical rules and better coordination across government layers would help to rein in expenditure growth and achieve the needed fiscal consolidation. In this context, national authorities should introduce the following measures:

- *Adopt a more binding budgetary framework by introducing enforceable multi-annual expenditure ceilings for all government layers. Expenditure growth over time should be kept below prudent projections of nominal GDP growth.*

- *In view of the ongoing implementation of fiscal federalism, quickly specify and implement the mechanisms foreseen in the 2009 reform to ensure timely monitoring of budgetary developments against targets across all institutional sub-sectors, and the contribution of each of them to the achievement of the general government targets.*

The following factsheet from Commission services assesses the progress to date in implementing the policy advice adopted by the EPC in 2011/12 and provides some updated information on the latest developments in relation to Italy's fiscal framework.

I. ASSESSMENT OF PROGRESS TOWARDS THE 2011 POLICY ADVICE

a) Adopt a more binding budgetary framework by introducing enforceable multi-annual expenditure ceilings for all government layers. Expenditure growth over time should be kept below prudent projections of nominal GDP growth.

Assessment of progress made: Partially implemented

Like other euro-area countries, Italy is subject to the EU reinforced budgetary governance, including the expenditure rule under the SGP's preventive arm (expenditure benchmark). Compliance with the rule requires spending plans that are consistent with long-term trends in nominal GDP growth. The rule, effective across the EU as of 2013, has been automatically incorporated in the new constitutional fiscal framework that applies as from 1 January 2014. Although defined consistently with EU requirements, the rule only applies to the general government (with no further specification on its enforcement across sub-sectors), and in particular does not reinforce the existing system of spending controls at the sub-national level. Mechanisms to ensure that sub-national administrations achieve balanced budgets, at the sub-sector level and within each region, will become binding in 2016.

b) In view of the ongoing implementation of fiscal federalism, quickly specify and implement the mechanisms foreseen in the 2009 reform to ensure timely monitoring of budgetary developments against targets across all institutional sub-sectors, and the contribution of each of them to the achievement of the general government targets.

Assessment of progress made: Not implemented.

Although several legislative decrees were adopted to implement the 2009 reform[33], fiscal federalism has been virtually put on hold in the last two years, when higher priority was given to reinforcing the overall framework through the constitutional balanced budget rule. The latter has better specified the powers of the central government in coordinating the public finances and ensuring that the general government complies with the budgetary rules (EU and domestic). The harmonisation of accounting practices launched in 2009 is

[33] https://www.portalefederalismofiscale.gov.it/portale/it/web/guest/ap_iterdecreti.

progressing slowly: its implementation is not likely to be completed for another two years, although pilot experiments are being done and incentives were given in 2013 to administrations volunteering to experiment with harmonised accounting.

Two other cornerstones of the fiscal federalism process have seen very little progress: (i) the decentralisation of taxing powers to enhance local fiscal autonomy has been pursued through higher local revenue shares in centrally-set taxes and the allocation to municipalities, as from 2014, of the proceeds of the recurrent tax on immovable property; (ii) the use of "standard needs" and standard unit costs to compute the financing needs of local authorities as a basis for setting the budgetary targets in the domestic stability pact, still appears a distant prospect.

Progress in the process of transferring part of State property to Regions and local governments, aimed at supporting financial autonomy of local governments, has been accelerated by a recent decree-law [34].

II. ADDITIONAL INFORMATION ON PROGRESS UNRELATED TO THE POLICY ADVICE

A balanced budget rule was introduced in the Italian Constitution in April 2012, followed in December by legislation specifying the modalities of application of the rule. The new rule stipulates that a general government budget balance in structural terms will have to be ensured as from 2014, while giving two more years to subnational governments to comply with it. It includes a correction mechanism to rectify temporary deviations, and an independent fiscal council, attached to Parliament, to validate official macroeconomic and fiscal projections.

Beforehand, Italy had already introduced legislation to align its MTBF to the requirements of the Six-Pack,[35] and launched two rounds of spending reviews to reduce the cost of procurement of goods and services and other unproductive expenditure. Although systematic reviews have not become a permanent feature of the budgetary process, it should be acknowledged that progress has been made in reining in public expenditure, notably through a four-year freeze in wages and recruitment, a pension reform that accelerated the transition to a notional defined contribution (NDC) system, and better control of health expenditure and intermediate consumption, also thanks to a tighter enforcement of the rules of the domestic stability and health pacts and improved healthcare accounting procedures[36].

[34] Decree-Law No. 69/2013, converted into Law No. 98/2013.

[35] Law 39 of 2011, modifying law 196/2009 aligned the multi-annual budgetary process, i.e. calendar and contents of the planning documents, to the requirements of the European Semester. Since 2008 Italy also produces 3-year budgets, although they are revised annually.

[36] In both 2011 and 2012, health expenditure decreased in nominal terms from the previous years.

Fiscal governance in Lithuania – 2013 update

Further to the 2011/12 cycle of the Peer Review, the Economic Policy Committee was to revisit the issued policy advice and take stock of the progress achieved by the Member States.

EPC policy advice

While Lithuania's fiscal framework benefits from the existence of annual numerical fiscal rules, the existing medium-term framework is less developed and may help explain the frequent expenditure slippages registered in the past. In this context, national authorities should enhance the medium-term budgetary framework, by introducing more stringent forward-looking elements and mechanisms to avoid procyclicality by introducing the following measures:

- *Strengthen transparency (e.g. timely reporting of central government and social security expenditure and ensuring comparability of budgetary indicators on cash and accrual basis).*
- *Reinforce expenditure discipline through enforceable ceilings in the medium-term budgetary framework.*
- *Improve the monitoring of the budget execution throughout the year.*

The following factsheet from the Commission services assesses the progress to date in implementing the policy advice adopted by the EPC in 2011/12 and provides some updated information on the latest developments in relation to Lithuania's fiscal framework.

I. ASSESSMENT OF PROGRESS TOWARDS THE 2011 POLICY ADVICE

In 2007 Lithuania adopted the law on fiscal discipline, which is based on provisions of the Stability and Growth Pact. It links an expenditure ceiling to revenues and has exerted some disciplinary role on the expenditure side in the budget planning. However, despite the law and against an improving economic outlook, slippages in adhering to original budget plans continued to occur. It seems that this could be related to difficulties of the government to contain expenditure increases throughout the year. Currently, a draft legislative package including a constitutional law on sustainability of general government sector finances in accordance with the Fiscal Compact is being discussed by the government.

a) Strengthen transparency (e.g. timely reporting of central government and social security expenditure and ensuring comparability of budgetary indicators on cash and accrual basis).

Assessment of progress made: Implemented

There has been some progress with adjusting the national classification of public accounts to the ESA95 standards. Data on cash basis is available on the websites of the Ministries of Finance and the Social Insurance Fund. Data on accrual basis arrives with some time lag.

b) Reinforce expenditure discipline through enforceable ceilings in the medium-term budgetary framework.

Assessment of progress made: Partially implemented

Lithuania's medium-term budgetary framework specifies revenues and expenditure of the national budget for three years; however, it lacks binding targets and a clear connection between the medium-term targets and the annual budgets as witnessed by repeated upward revisions of multiyear general government deficit targets despite improving economic outlook. The 2007 law on fiscal discipline sets as objectives a balanced budget in the medium term and long-term sustainability, but falls short of establishing a binding medium-term expenditure framework. Its enforcement mechanism remains weak. On the positive side, escape clauses in the law on fiscal discipline, which delayed its application during the crisis years, can no longer be applied due to improving economic outlook. Thus, the law has been applied for budget planning on expenditure side since the 2013 budget.

In addition, amendments of the National Budget law to implement Council Directive 2011/85/EU on requirements for budgetary frameworks of the Member States targeting a balanced or surplus position over the cycle are coming into full force for the 2014 budget planning and execution process. These amendments

increase government's accountability for the implementation of multiannual fiscal targets, while it remains to be seen whether they will result in enhanced budget discipline.

Next steps: finalise and adopt legislative package of constitutional law on sustainability of general government sector finances thereby enforcing multiyear fiscal discipline in accordance with the requirements of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union.

c) Improve the monitoring of the budget execution throughout the year.

Assessment of progress made: Partially implemented

Local government deficits continue to be recorded in post-crisis recovery years despite tight borrowing limits (the balanced budget rule for municipalities was abolished in 2011). Data on an accrual basis of the expenditure of local governments and subsectors of the government is available only after the end of the fiscal year. This limits the possibility to react to potential expenditure overruns during the year.

Next steps would be for Lithuania to strengthen the monitoring of expenditures on accrual basis throughout the year.

II. ADDITIONAL INFORMATION ON PROGRESS UNRELATED TO THE POLICY ADVICE

The government has drafted a constitutional law on sustainability of general government finances and accompanying amendments to related laws with a view to implementing the requirements of the Fiscal Compact. These legislative acts are still under revision by the executive branch and are planned to be submitted for parliamentary approval by the end of this year. The above-mentioned law on fiscal discipline establishing a limit on annual increase in budget expenditures is to be amended to comply with the new legislative package. It is anticipated that the National Audit Office would be endowed with the functions of an independent fiscal council. Its legal independence will be strengthened. The national central bank is to support National Audit Office by providing macro-economic expertise.

Fiscal governance in Luxembourg – 2013 update

Further to the 2011/12 cycle of the Peer Review, the Economic Policy Committee was to revisit the issued policy advice and take stock of the progress achieved by the Member States.

EPC policy advice

Luxembourg's public finances are healthy. However, the estimated increase in pension and healthcare expenditure due to an ageing population is among the highest in the EU. Luxembourg is currently one of only a few Member States without a medium-term budgetary framework underpinning the budget law or the Stability Programme. In this context, national authorities should introduce the following measure:

• Adopt a medium-term budgetary framework with multi-annual expenditure ceilings. The expenditure rule should cover all government sub-sectors and should take into account the increasing costs of ageing.

The following factsheet from the Commission services assesses the progress to date in implementing the policy advice adopted by the EPC in 2011/12, and provides some updated information on the latest developments in relation to Luxembourg's fiscal framework.

I. ASSESSMENT OF PROGRESS TOWARDS THE 2011 POLICY ADVICE

Luxembourg's public finances recorded a surplus of 2.4% of GDP on average over the period 2000-2008. However since 2009, following the outbreak of the financial crisis, the general government balance has regularly posted a deficit. For the current year a deficit is also expected. The need for an overhaul of the fiscal and budgetary framework has become more evident. Luxembourg ratified the TSCG (including the Fiscal Compact).

> *Policy advice: Adopt a medium-term budgetary framework with multi-annual expenditure ceilings. The expenditure rule should cover all government sub-sectors and should take into account the increasing costs of ageing.*

Assessment of progress made: Partially implemented

With regard to the institutionalisation of the medium-term budgetary framework (MTBF) into primary law, the government has prepared a draft bill[37], which was submitted to Parliament in July 2013. Its adoption was delayed by the resignation of the Government in July and the new timing is not known to date. At this stage, the draft bill provisions are expected to enter into force on 1 January 2014.

According to the draft bill, the new Multiannual Finance Programme Law (MFPL) would cover the same time horizon as the forthcoming update of the Stability Programme. It would be adopted annually on a rolling basis, and would constitute the basis for the annual budget. It would detail plans to achieve the Medium-Term Budgetary Objective (MTO) at the level of the general government. To that end, the MFPL would provide annual forecasts for the public debt and balance (in nominal and structural terms) broken down by major subsector, i.e. the central government, the social security and the local government sector. Moreover, the draft bill stipulates that for each major budget line, projections of expenditures and revenues would be annexed to the MFPL. The expected contribution of envisaged policies to the achievement of multi annual budgetary targets and the comparison with a no-change policy baseline would also be annexed.

The draft bill introduces multi-annual ceilings in the MFPL that would cover the central government sector only. There is no specification in the draft bill regarding the consequences if ceilings are exceeded.

The draft bill does not introduce a national expenditure rule that would guide the setting of multi-annual expenditure targets. In particular, it does not contain an explicit reference to the expenditure benchmark as defined in Regulation 1466/97. However, it contains provisions for the adjustment path to the MTO to be respected.

[37] Projet de loi relative à la coordination et à la gouvernance des finances publiques

Apart from that, the Luxembourg authorities have prepared a draft bill[38] on the implementation of changes to the budgetary procedure at the level of the local government, which introduces a new budgetary tool for local governments, the Multiannual Financing Plan. Local authorities would have to project their financial plan over a mid-term horizon of at least three years. This would also provide a basis for the elaboration of the annual budget of local governments. However, the draft bill refrains from synchronizing the calendar of the budgetary procedure of the local authorities with that of the central government, which implies that figures for local government would not be reported in the general government budget.

II. ADDITIONAL INFORMATION ON PROGRESS UNRELATED TO THE POLICY ADVICE

On 27 February 2013, the Parliament endorsed the inter-governmental Treaty on Stability, Coordination and Governance in the Economic and Monetary Union. The scope of the draft bill referred to above is broader than the introduction of the MTBF, as it is intended to transpose the provisions of Council Directive 2011/85/EU on requirements for the budgetary frameworks of the Member States and of the Fiscal Compact. In particular, the draft bill introduces the MTO and plans the establishment of independent fiscal monitoring within the Central Bank. In the 2013 European Semester, Luxembourg was advised to adopt a medium-term budgetary framework and to put in place an independent monitoring of fiscal rules.

[38] Draft bill n. 6479 tabled in front of the Parliament on 18.9.2012. The draft bill has not been adopted yet.

Fiscal governance in Latvia – 2013 update

Further to the 2011/12 cycle of the Peer Review, the Economic Policy Committee was to revisit the issued policy advice and take stock of progress achieved by the Member States.

EPC policy advice

While the national fiscal governance framework provides some basis for an effective mechanism to implement counter-cyclical fiscal policy, both past and recent developments suggest that the current framework cannot prevent pro-cyclical policies, thus there is a need to strengthen the existing framework. Numerical fiscal rules and the medium-term framework remain underdeveloped, which explains the frequent mid-year budgetary revisions registered in the past and recurring again in 2012. In this context, national authorities should introduce the following measures, in a way that is consistent with agreements achieved during the EC/IMF Balance-of-Payments support program:

- *Adopt a new Fiscal Responsibility Law –possibly supported by amendments to the Constitution– to provide a credible and enforceable framework for limiting expenditure growth in good economic times and ensure its effective implementation from 2013. The law should take into account the EU Directive on minimum requirements for national budgetary frameworks and include targeting a balanced or surplus position over the cycle;*
- *Complement the budget balance rule envisaged in the draft Fiscal Responsibility Law with additional rule(s) to ensure that any revenue in excess of what was previously projected is used to reduce the government's debt and that expenditure remains within set limits;*
- *Ensure the effective implementation of the envisaged switch to binding multi-year expenditure targets from the 2013 budgetary cycle and set up a mechanism for monitoring compliance with the set targets, including elements to ensure public accountability. The timing of the annual medium-term budgetary framework cycle should be aligned with the EU surveillance cycle;*
- *Reinforce the annual budgetary process by implementing a top-down approach in the formulation of expenditure targets (based on the medium-term budgetary framework).*

The following factsheet from Commission services assesses the progress to date in implementing the policy advice adopted by the EPC in 2011/12 and provides some updated information on the latest developments in relation to Latvia's fiscal framework.

I. ASSESSMENT OF PROGRESS TOWARDS THE 2011 POLICY ADVICE

a) Adopt a new Fiscal Responsibility Law – possibly supported by amendments to the Constitution – to provide a credible and enforceable framework for limiting expenditure growth in good economic times and ensure its effective implementation from 2013. The law should take into account the EU Directive on requirements for national budgetary frameworks and include targeting a balanced or surplus position over the cycle.

Assessment of progress made: Implemented

The Fiscal Discipline Law (FDL) was adopted by Parliament on 31 January 2013 and entered into force on 6 March 2013. Some provisions will enter into force gradually; notably provisions related to the establishing of the Fiscal Council will enter into force from 1 January 2014.

The draft law was considerably revised in the course of 2012 in order to reflect developments in the EU governance framework, in particular the entry into force of the "Six-pack" and the adoption of the Directive on requirements for national budgetary frameworks.

The FDL is centred on targeting the general government deficit of 0.5% of GDP in structural terms, which corresponds to the definition of "balanced or in surplus position" according to the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union. The escape clauses from this rule are limited to natural disasters, emergencies and natural and social processes if their impact exceeds 0.1% of GDP; elimination of a threat to national security; and severe economic downturn.

This balance rule is supplemented by the expenditure growth rule, which stipulates that when formulating fiscal targets in multi-annual budget framework laws, provisions of the revised preventive arm of the SGP[39] related to expenditure growth need to be respected. The FDL also specifies that general government debt cannot exceed 60% of GDP.

Draft amendments to the Constitution were proposed to Parliament in late 2011, together with the draft FDL, in order to back the FDL with provisions of higher legal standing; the wording of the draft amendments was adapted to the legal style in which the Constitution is written. However, these amendments have not been adopted to date. At the same time, ratification of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union in May 2012, which similarly required higher parliamentary majority than regular legislative process, implicitly took over this role of the "higher standing" legal instrument to back the FDL.

The process of formulating the 2014 draft budget is already based on the new law.

b) Complement the budget balance rule envisaged in the draft Fiscal Responsibility Law with additional rule(s) to ensure that any revenue in excess of what was previously projected is used to reduce the government's debt and that expenditure remains within set limits.

Assessment of progress made: Implemented

According to the Article 19 of the FDL, revenue in excess of planned expenditure shall be transferred to the Long-Term Stabilisation Reserve[40] or used to reduce the government debt. This provision does not apply to certain categories of revenue and expenditure, notably those related to the implementation of EU structural funds and own revenue. The provision also does not apply to the special budget (which is financed by social security contributions and used to finance social expenditure, notably pensions), where the excess is accumulated on a separate account in the State Treasury.

The expenditure levels in multi-annual and annual budget laws are derived on the basis of budgetary targets, which are set in structural terms. Once expenditure limits for the central government have been set in the annual budget law, they cannot be changed without budgetary amendments, thus better intra-year revenue outcome cannot automatically lead to increasing expenditure of the state budget.

In addition, the FDL introduces the debt brake rule, which implies that accumulated ex post deviations from fiscal targets, once their value is negative and exceeds 0.5% of GDP in absolute terms, would necessitate upward correction of the fiscal target in the outermost year of a medium-term budget framework law; no such correction is performed in case of positive deviations.

c) Ensure the effective implementation of the envisaged switch to binding multi-year expenditure targets from the 2013 budgetary cycle and set up a mechanism for monitoring compliance with the set targets, including elements to ensure public accountability. The timing of the annual medium-term budgetary framework cycle should be aligned with the EU surveillance cycle.

Assessment of progress made: Partially implemented

Given that the FDL was adopted in January 2013, i.e. later than originally envisaged, it was not formally applied to the 2013 budgetary cycle, even though the main elements of the new law were already tested during the 2013 budgetary process.

The principles of the FDL, notably binding multi-year expenditure targets, are being applied from the 2014 budgetary cycle. In future, expenditure targets for the first and second year of each medium-term budget framework law (MTBFL) will be inherited from the second and third year of the previous edition of the MTBFL. These expenditure targets will be subject to certain exceptions: in particular expenditure related to the social insurance budget ("special budget"), expenditure related to the implementation of EU funds and expenditure related to own revenue are determined according to different procedures; nevertheless they are taken into account when (re-)calculating expenditure thresholds for the state budget, so that the overall

[39] amended Council Regulation 1466/97 of 7 July 1997

[40] This reserve is established in accordance with the Long-Term Stabilisation Reserve Law, to be used as an instrument of counter-cyclical fiscal policy.

fiscal target is respected. However, the expenditure thresholds can be adjusted in case of revisions to the macroeconomic forecasts, if updated calculations for expenditure ceiling deviate from a previous MTBFL's version by more than 0.1% of GDP in either direction.

According to the Law on Budget and Financial Management, draft MTBFLs covering next three years should be submitted to Parliament annually by 15 May. However, according to transitional provisions of that law, this timing will not be applied in 2013, 2014 and 2015. In these years preparation of MTBFLs will be aligned in time with the annual budgetary process, i.e. it will take place in autumn.

The monitoring of compliance with the set targets will be performed by the Fiscal Council, which is to be established according to the FDL from 1 January 2014. The Council will perform verification of application of the budget rule and the expenditure rule and provide opinions on certain aspects of the implementation of the FDL. The Council shall prepare regular and ad hoc (irregularity) reports, which shall be made public.

d) Reinforce the annual budgetary process by implementing a top-down approach in the formulation of expenditure targets (based on the medium-term budgetary framework).

Assessment of progress made: Implemented

The 2014 draft budget is the first annual budget document prepared fully in accordance with the FDL, where the budgetary process starts from setting the top-down budgetary target. This target – deficit of 0.9% of GDP – has already been presented in the 2013 Convergence Programme of Latvia adopted in April 2013. The top-down target is used as a basis when setting expenditure level for the state budget, after taking into account revenue forecasts, budgetary forecasts for local governments and non-budgetary units reclassified inside general government, as well as other parameters.

II. ADDITIONAL INFORMATION ON PROGRESS UNRELATED TO THE POLICY ADVICE

The main development which does not directly relate to the EPC policy advice concerns the establishment of the Fiscal Council. According to the FDL, the Fiscal Council shall be established from 1 January 2014. The Council will consist of six members, of which three are nominated jointly by the president of the Bank of Latvia and the minister of finance and three are nominated by at least ten members of Parliament.

In addition to formal monitoring of compliance of the fiscal policy with the FDL as described above, the Council will provide independent opinions regarding more complicated economic policy matters like cyclical position of the economy, permissible deviation from the balance rule in case of severe economic downturn, application of provisions related to fiscal risks etc. The Council can co-operate with other institutions and persons both domestically and internationally and involve experts as deemed necessary.

Fiscal governance in Malta – 2013 update

Further to the 2011/12 cycle of the Peer Review, the Economic Policy Committee was to revisit the issued policy advice and take stock of the progress achieved by the Member States.

EPC policy advice

In the context of a non-binding medium-term budgetary framework (MTBF), a lack of numerical fiscal rules, persistent expenditure overruns and a tendency to use favourable medium-term macroeconomic assumptions, national authorities should introduce the following measures:

- *Strengthen the MTBF and its legislative base to make it binding and more detailed, thereby enforcing a longer fiscal planning horizon, including the introduction of legally anchored numerical rules to restrain expenditure dynamics.*
- *Strengthen the budgetary process through: (i) more cautious fiscal planning, based on prudent macroeconomic assumptions; (ii) stricter monitoring of the individual components of the budget; and (iii) the introduction of predefined, strict corrective mechanisms in case of emerging slippages.*

The following factsheet from the Commission services assesses the progress to date in implementing the policy advice adopted by the EPC in 2011/12 and provides some updated information on the latest developments in relation to Malta's fiscal framework.

I. ASSESSMENT OF PROGRESS TOWARDS THE 2011 POLICY ADVICE

Owing to the small size of the economy, the fiscal framework is centralised and very flexible which, however, creates risks for expenditure overruns and the achievement of a sound fiscal position in a timely manner. The absence of a binding fiscal framework also undermines the credibility of the government's fiscal strategy and implies a short fiscal planning horizon.

a) Strengthen the MTBF and its legislative base to make it binding and more detailed, thereby enforcing a longer fiscal planning horizon, including through the introduction of legally-anchored numerical rules to restrain expenditure dynamics.

Assessment of progress made: Not implemented

Every year around end-October the Budget Speech by the Minister of Finance in Parliament outlines the policy orientations in the forthcoming budget and sets out three-year fiscal targets for deficit and debt ratios. However, only the first year of these multi-annual targets is approved by Parliament and is thus binding. There are no rules in place to restrain expenditure and the use of supplementary estimates[41] to approve additional budgetary allocations throughout the year is a common occurrence.

The government announced in its Economic Partnership Programme (EPP), submitted to the Commission on 1 October 2013, the intention to introduce a rolling three-year framework that would specify expenditure commitments and include specific provisions to prevent overruns. Any slippages would be funded through a new Contingency Reserve Fund (CRF), amounting to no more than 0.8% of GDP. The authority to grant access to the CRF would lie with the Prime Minister, on a recommendation by the Minister of Finance. The minimum size of the CRF is to be restored at the beginning of each three-year cycle. Use of Supplementary Estimates would still be allowed, but only on recommendation of the new Fiscal Council (see Section II) and under the conditions to be stipulated in the upcoming Fiscal Responsibility Act. Thus, the CRF would serve as the first line of defence in case of an expenditure overrun, and a Supplementary Estimate would be resorted to only in case the CRF is exhausted.

In addition, the government plans to introduce numerical fiscal rules. The introduction of a balanced budget rule in the Constitution with a transition phase to ensure convergence towards the medium-term objective at a sufficient pace, as stipulated in Regulation 1466/97, is envisaged.

[41] A Supplementary Estimate, legislated through a supplementary appropriation bill, is defined by the Constitution of Malta as an additional budgetary allocation that is necessary to cover spending in areas where the originally approved allocations need to be increased or have already been exceeded.

b) Strengthen the budgetary process through (i) more careful fiscal planning, based on prudent macroeconomic assumptions, (ii) stricter monitoring over the individual components of the budget and (iii) the introduction of pre-defined, strict corrective mechanisms in case of emerging slippages.

Assessment of progress made: Not implemented

There are still no corrective mechanisms in place to correct expenditure slippages, and there is a tendency for fiscal planning to overestimate the revenue outturn.

In its EPP, the government announced plans to improve further the budget monitoring and evaluation functions with a view to ensuring increased compliance with budget objectives and targets and avoid revenue shortfalls and slippages in expenditure targets. The Ministry of Finance is to produce revenue and expenditure forecasts, taking into account seasonal patterns, in monthly terms (on a cash basis) as well as in quarterly terms (in accrual terms).

In addition, as explained above, corrective mechanisms in case of emerging slippages are indeed planned.

Overall, the policy advice issued in 2011 has not yet been implemented. The planned measures are relevant and would significantly strengthen the medium-term fiscal framework. Nevertheless, concrete details are yet to be made public, which prevents a full assessment of the reform at this stage. The measures are to be presented in parliament by the end of the year, but no implementation dates have been set, which leaves significant implementation risks.

II. ADDITIONAL INFORMATION ON PROGRESS UNRELATED TO THE POLICY ADVICE

Malta has not yet transposed Directive 2011/85/EU on budgetary frameworks. In addition, a structural budget balance rule, as provided for in the Treaty on Stability, Coordination and Governance in the EMU, has not yet been introduced in legislation.

The reform of the fiscal framework is planned to be complemented with empowering the National Audit Office and the Auditor General to act as an independent Fiscal Council. The government would be obliged to comply with the recommendations of the Fiscal Council or explain its objections. The scope of the new authority, however, is yet to be specified in detail. Nevertheless, even without a clear mandate, the National Audit Office and the Auditor General have already been appointed to perform the duties of a Fiscal Council.

Fiscal governance in the Netherlands – 2013 update

Further to the 2011/12 cycle of the Peer Review, the Economic Policy Committee was to revisit the issued policy advice and take stock of the progress achieved by the Member States.

EPC policy advice

The overall performance of the Dutch medium-term budgetary framework has been very strong since its implementation in 1994. Checks and balances are well designed and reinforced by the independence of the CPB. However, whilst overall the recent modifications to the framework are to be welcomed, a number of new elements may limit the ability to conduct discretionary policy in warranted cases. In addition, the local government balance has proven to be volatile over time thus contributing to excessive deficits. In this context, national authorities should introduce the following measures:

- *Remove cyclically-sensitive unemployment outlays from the expenditure ceilings to avoid procyclicality and allow for full free working of the automatic stabilisers.*
- *Improve monitoring of local governments by integrating them into the central government's treasury system.*

The following factsheet from the Commission services assesses the progress to date in implementing the policy advice adopted by the EPC in 2011/12 and provides some updated information on the latest developments in relation to the Netherlands' fiscal framework.

I. ASSESSMENT OF PROGRESS TOWARDS THE 2011 POLICY ADVICE

The Netherlands has a well-developed fiscal framework. The main characteristics of the multiannual trend-based fiscal framework currently in place in the Netherlands are: (i) the use of real expenditure ceilings, which are determined *ex ante* and apply to the entire term of office of the government; (ii) automatic stabilisation of revenues; and (iii) the use of independently derived macroeconomic assumptions. When a new government is formed, medium-term budgetary targets are set by determining the way in which general government expenditure should evolve and the tax burden for each year until the last year of the government's term.

Also to strengthen its fiscal framework, the Netherlands has signed and ratified the TSCG and is expected to adopt a law on the sustainability of public finances (*Wet houdbare overheidsfinanciën*) integrating the Fiscal Compact in its national legislation. In the 2011/12 cycle of the Peer Review, the Economic Policy Committee issued the following policy advice:

a) Remove cyclically-sensitive unemployment outlays from the expenditure ceilings to avoid procyclicality and allow for full free working of the automatic stabilisers.

Assessment of progress made: Not implemented.

According to the coalition agreement, automatic stabilisers are free to operate within each of the separate expenditure ceilings as long as the country's overall fiscal position remains in accordance with European fiscal rules. Interest payments are kept outside the overall expenditure ceiling, whereas other expenditure that is sensitive to cyclical trends, notably unemployment and social assistance benefits, is kept within the expenditure ceiling framework. This impedes the working of automatic stabilisers in an economic downturn.

b) Improve monitoring of local governments by integrating them into the central government's treasury system.

Assessment of progress made: Partially implemented.

The current fiscal framework does not cover local government. In this respect, the Netherlands is currently transposing the EU fiscal rules into national legislation. This will entail giving the medium-term budgetary framework a legal basis (law on the sustainability of public finances) and laying out provisions and coordination mechanisms for local government finances. The law on the sustainability of public finances also includes a multiannual macro norm for local government (municipalities, provinces and water authorities) as a whole. The local governments have to stick to a joint deficit of max 0.5% of GDP. This norm is agreed to decrease to 0.4% in 2016 and 0.3% in 2017. These numbers are not part of the law but

are agreed upon by the central and the subnational governments. These numbers are going to be evaluated in 2015 to check if subnational governments can achieve the macro norm. The law clearly states that all subnational governments, social security funds, waterboards and other entities (public television station, *Staatsbosbeheer*, etc.) are required to take their part in achieving budgetary targets and that they can be subject to deposits and fines in case budgetary overruns in the form of a cut of the Municipality Fund or the Provincial Fund. It remains to be seen whether subnational governments will be able to comply with these provisions, especially in light of the substantial decentralisation and consolidation efforts the central government has assigned to them.

II. ADDITIONAL INFORMATION ON PROGRESS UNRELATED TO THE POLICY ADVICE

The economic crisis of the recent years has exposed weaknesses in the fiscal framework and successive governments have increasingly adjusted the budget outside the procedures laid down in the framework. Successive governments have amended their medium term budgetary plans with sizeable consolidation measures, partly because initial expenditure ceilings had been based on growth paths which turned out to be overly optimistic. The large number of ad-hoc adjustments to the medium term budgetary plans has not yet resulted in an adjustment of the budgetary process. Clear rules on when and how to adjust the medium term budgetary plans in the case of sizeable revisions in the economic outlook would decrease uncertainty for economic actors stemming from long-lasting negotiations and continued uncertainty regarding additional consolidation packages.

Fiscal governance in Poland – 2013 update

Further to the 2011/12 cycle of the Peer Review, the Economic Policy Committee was to revisit the issued policy advice and take stock of progress achieved by the Member States.

EPC policy advice
Poland has substantially strengthened its fiscal framework over the past years, with reforms in the field of fiscal rules, medium-term programming and performance budgeting. In this context, Polish authorities should keep up the momentum and further improve the fiscal framework design and functioning by introducing the following measures:
- *Enhance the enforceability and transparency of the fiscal rules by adjusting the definitions used in national accounting to ESA 95 standards and ensuring sufficiently broad coverage.*
- *Strengthen medium-term planning by enhancing its connection with annual budget preparation, and by fostering the mechanisms of coordination between government tiers.*
- *Complete the design of the new permanent expenditure rule to make it sufficiently comprehensive, transparent, binding and to support more countercyclical fiscal policy responses.*
- *Improve intra-annual monitoring of budget execution.*

The following factsheet from Commission services assesses the progress to date in implementing the policy advice adopted by the EPC in 2011/12 and provides information on the latest developments in relation to Poland's fiscal framework.

I. ASSESSMENT OF PROGRESS TOWARDS THE 2011 POLICY ADVICE

The Polish government made progress in addressing the EPC policy advice as demonstrated by the on-going work on the new permanent stabilising expenditure rule. However, many weaknesses in the fiscal framework remain, in particular the discrepancy between the national standards and ESA as well as the vulnerability of fiscal rules to frequent changes which risks undermining their credibility and effectiveness. Moreover, a continuing weakness in Poland's fiscal framework is the lack of a fiscal council responsible for enforcing fiscal discipline.

a) Enhance the enforceability and transparency of the fiscal rules by adjusting the definitions used in national accounting to ESA 95 standards and ensuring sufficiently broad coverage

Assessment of progress made: Partially implemented

The differences between the national rules and ESA-95 remain. In particular, the Polish authorities continue using the national definition of the public sector when judging if the sanctions for breaching public debt thresholds (55% and 60% of GDP, until recently also 50%) should be applied. At the end of 2012, public debt according to the national definition was nearly 3% of GDP lower than that based on ESA95 mainly because of the exclusion of the debt of the National Road Fund.

However, on the positive side, the new draft stabilising expenditure rule (SER) (described below at point c)) when setting the expenditure level, covers almost the whole general government sector, excluding only units which are not legally able to generate significant deficits and expenditures fully financed from the EU funds. Moreover, the correction mechanism foreseen by the rule is based on the result of the whole GG sector. In this sense, the rule appears to be consistent with ESA95.

b) Strengthen medium-term planning by enhancing its connection with annual budget preparation and by fostering the mechanisms of coordination between government tiers.

Assessment of progress made: Partially implemented

Regarding the connection between medium-term planning and annual budget:

- The deadline for the preparation of an update to the Multi-Annual State Financial Plan by the Council of Ministers was changed as of 2013. It is now consistent with the European Semester and

the amended Council Regulation (EC) No 1466/97/EC. The new deadline is 30 April, while the old one was two months after the publication of the state budget.

- The new bill on SER envisages that the Multi-Annual State Financial Plan will consist of the Convergence Programme and the annex that sets goals together with their implementation measures. The Convergence Programme will contain, in particular, key objectives of social and economic policy, planned actions and their impact on the level of revenues and expenditures of general government sector, including long-term sustainability of public finance, the initial level of expenditure according to SER and the preliminary estimates of macroeconomic variables together with assumptions needed to calculate them.

- The new bill also removes the provision of the Public Finance Law according to which the draft budget for a given year cannot include a deficit higher than the deficit set for this year in the Multi-Annual State Financial Plan.

Regarding the coordination between government tiers:

- The planned SER (described below at point c) sets a general level of expenditure of the public sector. The expected level of expenditure of local governments (and some other entities) is deducted from the overall expenditure level. The expected level of expenditure by this sub-sector will be forecast taking into account all the rules that apply to the local government units. The remaining part of the amount - the limit - would be binding on the rest of the public finances sector. It means that if local government expenditure is forecast to increase faster than the dynamics implied by SER for the whole public sector, then the rest of the GG sector would have to compensate for this dynamic by adjusting its spending level accordingly. Furthermore, if the GG deficit turns out to be excessively high due to the local government sub-sector, the deviations from MTO are accumulated and when the sum exceeds 6%, the correction component is added to the SER formula.
- Originally the government planned to complement SER with a legally binding limit for the deficit of the local government sub-sector. However, it dropped this plan arguing in the 2013 update of the Convergence Programme that the current rules are sufficient to limit fiscal imbalances in this sub-sector. This is reflected in a continuing decrease in aggregate deficit of local governments over the recent years. From 2014 onwards local government units will be subject to individual debt constraints reflecting their economic capacity to pay off liabilities.
- In order to reinforce budgetary discipline of local governments, two other elements were adopted. Firstly, the government introduced a uniform type of long-term financial forecast for all local governments. Secondly, the right to monitor the situation of local governments will be conferred on Regional Financial Chambers and in the case of threat to the delivery of public duties, they would require a preparation of a remedial programme by the local government in question.

c) Complete the design of the new permanent expenditure rule to make it sufficiently comprehensive, transparent, binding and to support more countercyclical fiscal policy responses.

Assessment of progress made: Partially implemented

According to the draft law of 24 September 2013, approved by the government and submitted to the Parliament:

- The rule would set the level of expenditure of the public finance sector (as defined by the Polish law) and the government funds managed by the BGK (a state-owned bank), e.g. including the National Road Fund – which, together, encompass almost the whole Polish GG sector – excluding the expenditure financed with non-returnable EU funds as well as expenditure of those units which are obliged by law to balance their budgets.
- The formula that determines the level of expenditure for the year t+1 consists of five steps: (1) the level of expenditure for the year t (corrected with updated values of inflation), is multiplied by (2) forecasted inflation in year t+1 and by (3) an eight-year average real GDP growth rate (for the period from t-6 to t+1). The level of expenditure is further reduced by (4) a correction component, in case of public debt above 50/55% thresholds or GG deficit above 3%, as well as in case of accumulated deviations of GG balance from the MTO (in nominal terms). Finally, the level of expenditure is changed by (5) the forecasted value of discretionary measures on the revenue side.

- The level of expenditure computed in this way is then adjusted for the expected level of expenditure of local governments, the entities referred to in Article 139(2) of the Public Finance Act and the National Health Fund. The remaining part - the so-called limit - will be divided between the remaining entities of the GG sector and will be binding on them.
- Escape clauses allowing for the determination of arbitrary expenditure limits disregarding the SER formula are provided only in the event of martial law or a state of emergency, or a natural disaster throughout the territory of Poland.
- The Ministry of Finance will monitor and calculate the deviation from the rule. The report on the implementation of the budget act is presented to the Parliament and the Supreme Audit Office by 31 May of each year. The bill on SER does not foresee any particular independent monitoring of the compliance with the rule, but according to the Polish legal order, the Supreme Audit Office presents to the Parliament annual reports on the execution of the budget act and implementation of statutes and other legal regulations governing the budgetary process, which would include the SER.

On the whole, the new stabilising expenditure rule seems to address well the EPC advice given to Poland. In particular, the SER seems to:

- Promote compliance with the reference values on deficit and debt set in accordance with the TFEU (with a caveat mentioned below);
- Set a multiannual time horizon which is superior to a rule that only sets a target for one year from the point of view of avoiding pro-cyclicality;

However, the effectiveness of SER might be weakened by the absence of the following elements: (1) independent *ex-ante* monitoring of compliance with the rule (e.g. independent estimates of input variables like the impact of discretionary revenue measures) (2) automatic correction mechanism in the event of actual expenditure exceeding the level set by the rule[42].

d) Improve intra-annual monitoring of budget execution.

Assessment of progress made: Partially implemented

According to the 2013 update of the Convergence Programme, the Polish authorities are working to improve the scope and frequency of data collection in units of general government in order to meet the requirements of Council Directive 2011/85/UE of 8 November 2011. The following fiscal data will be published on the website of the Ministry of Finance: monthly – concerning the central government sub-sector and social security funds sub-sector (with a one-month delay) and quarterly – concerning the local government sub-sector (with a one-quarter delay). A reconciliation table showing the methodology of transition between data from public accounting and the statistics of general government, in accordance with ESA 95, will also be available on the website. The Central Statistical Office will publish data concerning: contingent liabilities with potentially significant impact on the budget, including those relating to non-performing loans, liabilities of public enterprises, public-private partnership agreements considered off-balance sheet, guarantees granted by the sector as a whole and all sub-sectors, as well as the shares of general government in the capital of private and public companies (if the amounts are economically significant).

II. ADDITIONAL INFORMATION ON PROGRESS UNRELATED TO THE POLICY ADVICE

Other changes to the fiscal framework since 2011:

- In 2014, the existing limits on the level of debt and the level of debt servicing costs of local governments will be replaced by individual debt constraints reflecting the economic capacity of particular units to pay off liabilities. The new limit will depend on the ability of the unit to generate adequate surpluses in the current budget and income from the sale of property. The debt

[42] SER contains a correction component which is part of the formula for setting the expenditure level. It applies in case of accumulated deviations of GG balance from the MTO (in nominal terms). Moreover, Polish law contains general sanction mechanisms such as a possibility to charge the Minister of Finance before the Tribunal of State or the political responsibility of the government before the Parliament. However, these elements do not provide for an automatic correction mechanism in the event of actual expenditure exceeding the level set by the rule.

constraint, calculated on the values from the previous three years, is aimed to safeguard local government units against excessive accumulation of payments due to debt servicing relative to their economic capacities.

- At the end of 2012 the authorities introduced additional method of recalculating of public debt for the purposes of stating the breach of the 50/55% debt/GDP thresholds from the Public Finance Act. The specific correction mechanisms provided by the Public Finance Act apply only if the public debt breaches them as calculated according to both methods (the standard definition and the new method). The recalculation is done in the following way: (1) the PLN value of foreign denominated debt is computed taking into account the average exchange rate from a given year (standard definition: from the last day of the year); (2) the value of debt is diminished by the value of liquid assets held by the government destined to service debt in the next year. This change raises several concerns: (1) it might weaken the effectiveness of the existing debt/GDP thresholds as they are breached only if public debt is above them as calculated by both methods; (2) by effectively adding another definition of the public debt, it makes the fiscal framework less transparent; (3) the second change (deducting liquid assets) increases the scope for the authorities to alter the value of public debt.
- The specific correction mechanism for breaching of the 50% debt/GDP threshold (according to which the ratio of deficit to revenues in a given year cannot be higher than in the previous year) was suspended in 2013 by the 2013 budget amendment. The draft law on permanent expenditure rule permanently removes this provision.
- Finally, the draft law on SER removes the provision of the Public Finance Act (in force since 2011), which prohibits the Council of Ministers from adopting certain draft acts while Poland is subject to EDP: (1) containing exemptions, reliefs and deductions whose financial outcome may be a reduction in the revenues of public finance sector and (2) causing an increase in state budget expenditure which is not covered by the temporary expenditure rule currently in force (CPI+1).

Fiscal governance in Portugal – 2013 update

Further to the 2011/12 cycle of the Peer Review, the Economic Policy Committee was to revisit the issued policy advice and take stock of the progress achieved by the Member States.

EPC policy advice

Portugal has made clear progress towards strengthening its budgetary framework, starting from a low base. Overall, the recent Budgetary Framework Law addresses relevant weaknesses of the budgetary process, however there are still elements that can be further improved. In the context of the EC-ECB-IMF adjustment programme, national authorities should introduce the following measures:

a) The local and regional financing framework should be made consistent with the principles and rules adopted in the Budgetary Framework Law.

b) Strict conditions for the correction of deviations from the budget balance rule should be clearly specified, including the rules for the application of these mechanisms which should at least fulfil the requirements of the reinforced EU fiscal framework and the fiscal compact.

c) The budgetary process should be reinforced, building on improvements already made regarding transparency. Relevant information should be made public, including inter alia forecasts and a complete assessment of fiscal risks, whether of an intra-budgetary or extra-budgetary nature. The methodology used should be clearly specified, together with the results and alternative scenarios.

d) The Ministry of Finance should continue to reinforce controls at all stages of the budgetary process.

The following factsheet from the Commission services assesses the progress to date in implementing the policy advice adopted by the EPC in 2011/12 and provides some updated information on the latest developments in relation to Portugal's fiscal framework.

I. ASSESSMENT OF PROGRESS TOWARDS THE 2011 POLICY ADVICE

Portugal has stepped up its efforts to improve fiscal governance since 2011. This field is closely monitored in the context of the programme. The Budget Framework Law (BFL) was amended with the objective to transpose the Fiscal Compact (ratified by the Parliament on 13 April 2012[43]) and Council Directive 2011/85/EU. Regional and Local Finance Laws were also reviewed. Additional reforms to enhance the budgetary process, including a simpler and more targeted BFL, are expected to be submitted to Parliament by Q1 2014. The ongoing public administration reform is also expected to translate into better public financial management.

a) The local and regional financing framework should be made consistent with the principles and rules adopted in the Budget Framework Law.

Assessment of progress made: Implemented

In early August 2013, the Portuguese Parliament approved the revised Local and Regional Finance Laws, which considerably improve the subnational fiscal framework. They will enter into force in January 2014. Their provisions are now consistent with the principles of the BFL and include a number of new articles for sound fiscal and financial management. The subnational annual budgets are now enshrined in multiannual plans and regional and local governments are bound by balance and indebtedness rules. The scope of application has been enlarged to all relevant public entities in the perimeter of local and regional governments as per the European System of National Accounts and the regime of data provision to support revenue projections at subnational level is also defined.

In addition, the laws set enhanced control mechanisms through more stringent reporting requirements and larger auditing and enforcement powers of the central tax administration over the whole territory. The laws envisage the establishment of two Financial Policy Councils to support coordination between the central and subnational governments, gathering representatives from the central government and, respectively,

[43] Diário da República, 1.ª série — N.º 127 — 3 July 2012

from the regional/local governments[44]. Finally, the laws define the necessary conditions for subnational governments to request central economic and financial support.

The recent reform of the legal regime of local State-Owned Enterprises and improved supervision over regional Public-Private Partnerships will also add to better fiscal management at subnational level.

The implementation of the Regional and Local Finance Laws will be monitored in the context of the programme.

b) Strict conditions for the correction of deviations from the budget balance rule should be clearly specified, including the rules for the application of these mechanisms which should at least fulfil the requirements of the reinforced EU fiscal framework and the fiscal compact.

Assessment of progress made: Implemented

The BFL was amended in June 2013[45] with the objective to transpose the Fiscal Compact and Council Directive 2011/85/EU. It will be further refined by Q1 2014. Among other things, the revised law provides a clearer framework for the convergence towards the Medium Term Objective (MTO), for the identification of a significant deviation and its correction.

The MTO as well as the path of convergence towards the MTO – including the minimum annual structural effort of 0.5% - are defined in the BFL by reference to the Stability and Growth Pact (SGP). The compliance of the numerical definition of the MTO limits with the Fiscal Compact will be improved with the forthcoming revision of the BFL. The structural budget balance cannot be lower than the MTO. According to the law, once a deviation has been identified following an opinion from the national Fiscal Council[46] (CFP) or the Council of the EU, an *ex-post* mechanism based on a corrective plan and a numerical corrective rule is triggered. Concretely, the corrective plan has to be submitted to Parliament within a month after identification of the deviation with the objective to restore the original fiscal path. The size and timeline of the correction are numerically determined by specific rules, which also take into account the effect of the impact of the deviation on debt dynamics. The role of the CFP in the identification of the deviation as well as in the identification and implementation of the correction path needs to be better specified in the revision of the BFL. The rolling multiannual budget which is updated annually for the next four years has to be consistent with these rules. It includes expenditure ceilings that are binding for the first two years at an aggregated level and indicative afterwards. Deviation from these ceilings has to be justified by the Government in front of the Parliament.

As for the next steps, in the context of the adjustment programme:

- A dedicated technical group will publish a report by the end of 2013, notably reviewing the structure of the law, the operationalisation of the provisions in the law and ensuring full compliance with EU legislation (Fiscal Compact, Two-Pack, Six-Pack). The draft law will be submitted to Parliament by Q1 2014.
- In parallel to the review of the BFL, a draft action plan will by prepared by Q1 2014 to secure the implementation of the BFL.

c) The budgetary process should be reinforced building on improvements already made regarding transparency. Relevant information should be made public, including inter alia forecasts and a complete assessment of fiscal risks, whether of an intra-budgetary or extra-budgetary nature. The methodology used should be clearly specified, together with the results and alternative scenarios.

Assessment of progress made: Partially implemented

The transparency of the budgetary process has improved. Although there is no corresponding legal provision, detailed budget execution data on cash basis is published every month in the website of the Directorate in charge of the budget, providing a comprehensive breakdown by sub-sector of the

[44] The Regional Fiscal Policy Council notably aims ensuring compliance with the provisions of the Regional Finance Law, evaluating the regional budgetary policy to ensure consistency with national fiscal objectives and the EU framework and evaluating financing needs and indebtedness.The Local Fiscal Policy Council promotes the exchange of information between the central and local administration to improve budgetary practices at local level.

[45] Lei 37/2013 - Diário da República, 1.ª série - N.º 113 - 14 June 2013

[46] Conselho das Finanças Públicas *(CFP)*

performance of the main fiscal aggregates. The Budget Law includes underlying macroeconomic and budgetary forecasts as well as forecasts by other organisations, notably the European Commission. The deviations respect to these projections must be publicly justified. The projections are tested against various macroeconomic shocks and other potential risks.

The Fiscal Council (CFP) plays an important role in budget transparency, as the publication of its opinions –e.g. on compliance with fiscal rules, macroeconomic and budgetary forecasts, financial position of local governments and autonomous regions– is provided for in its grounding law. In practice, to date, opinions on budgetary execution and annual/multiannual budget preparation were already published.

Moreover, a complete assessment of fiscal risks covering both intra-budget and extra-budget elements is now published every year as part of the budget – for the first time for the 2013 budget. This is currently a requirement of the programme and is expected to be enshrined in the revised BFL.

d) The Ministry of Finance should continue to reinforce controls at all stages of the budgetary process.

Assessment of progress made: Partially implemented

Recent changes into the Public Financial Management system have allowed for better control of the Ministry of Finance in the budgetary process. A detailed Public Finance Management action plan for the period 2013-2015 was published with the 2013 budget[47]. The action plan aims at improving the legislative framework and legislative procedures, improving the institutional capacity and reorganising the management of the public administration.

In particular, in 2012 the Ministry of Finance applied a new model that increases the responsibility of line ministries for the execution of their budgets under stringent supervision by the Ministry of Finance. Under this scope, the role of budget coordinators in line ministries and their interactions with the Ministry of Finance were reinforced.

Moreover, the Commitment Control Law approved in 2012 that links commitments to available funds also allows for better control of the budget execution. The implementation of the law is regularly monitored in the context of the programme. Starting in 2013, available funds from general revenues are set by the Ministry of Finance and transferred to the ministries according to budget outturns, thus allowing for better control of expenditure. Previously there were constant monthly transfers simply by dividing the budget appropriation through the year.

Notwithstanding these efforts, challenges remain for budgetary control as the budget remains extremely fragmented, with about 450 budget entities and more than 40,000 appropriation lines. The role of budget coordinators needs to be better defined, ensuring that the coordinators have the adequate skills and the necessary powers to exert the necessary control at all stages of the budgetary process.

Alternative ways to reinforce budget control are being explored by the technical group in charge of the revision of the BFL.

II. ADDITIONAL INFORMATION ON PROGRESS UNRELATED TO THE POLICY ADVICE

The revised version of the BFL to be submitted to Parliament in Q1 2014 is likely to impact all building blocks of fiscal governance. A report by the technical unit in charge of the review of the law describing the envisaged structure of the law will be prepared by the end of 2013. In the context of the adjustment programme, it is anticipated that some technical assistance missions by the International Monetary Fund and the European Commission will advise in the reform.

Several initiatives are already underway. In particular, the quality of accounting information has been improved with the introduction in almost all central government agencies of the Official Plan of Public Accounting (POCP) that uses accrual basis of recording. Moreover, in order to reduce budget fragmentation new organisational models are being tested in the Ministry of Finance and the Ministry of Foreign Affairs. These models could be later implemented in other ministries.

[47] http://www.dgo.pt/politicaorcamental/Paginas/OEpagina.aspx?Ano=2013&TipoOE=Orçamento+Estado+Aprovado&TipoDocumentos=Lei / Mapas Lei / Relatório

Fiscal governance in Romania – 2013 update

Further to the 2011/12 cycle of the Peer Review, the Economic Policy Committee was to revisit the issued policy advice and take stock of the progress achieved by the Member States.

EPC policy advice

Romania has taken major steps to improve its institutional fiscal framework through the fiscal governance reforms implemented recently. The focus should now shift from adopting new initiatives to fine-tuning the functioning of the new institutional fiscal framework with special focus on the Fiscal Council, the content of the medium-term budgetary framework (MTBF) and further improving the budget process in a way that is consistent with the EC IMF balance-of-payments assistance programme. In this context, national authorities should introduce the following measures:

- *Ensure adequate resources for the functioning of the Fiscal Council.*
- *Further improve the content of the MTBF by including information on the off-budget items that represent a potential contingent liability for the budget such as the losses and arrears of state-owned enterprises. Introduce the use of ESA 95 accounting in the MTBF as swiftly as possible.*
- *Further strengthen the budget planning and management process by improving the capital budgeting process.*

The following factsheet from the Commission services assesses the progress to date in implementing the policy advice adopted by the EPC in 2011/12 and provides some updated information on the latest developments in relation to Romania's fiscal framework.

I. ASSESSMENT OF PROGRESS TOWARDS THE 2011 POLICY ADVICE

Romania has introduced important changes in its fiscal framework in 2010 and has since worked on further refining and improving them. The country also ratified the TSCG, including the Fiscal Compact. A third two-year balance-of-payments (BoP) programme (and a second precautionary one) is scheduled to start in October/November 2013. Conditionality also targets improvements in fiscal governance and will be closely monitored via quarterly mission reports (bi-annual formal reviews).

a) Ensure adequate resources for the functioning of the Fiscal Council.

Assessment of progress made: Implemented

The Fiscal Council is a young institution in Romania, created in 2010 with the entry into force of the Fiscal Responsibility Law. Its mandate includes the assessment of macroeconomic and budgetary forecasts, of the compliance with numerical fiscal rules in budget preparation and performance and of the impact of draft measures. In its first two years of existence, the Council fulfilled its mandate, even if its technical secretariat was under-staffed. The secretariat was entitled to up to 10 people according to the law, but at the time of its creation, Romania was struggling to put an end to its excessive deficit and had enacted, as part of the austerity package, a measure limiting public sector hiring across the board (the 1-in-7 rule). This also affected the Fiscal Council, which could not fill its positions. At the beginning of 2013, the government granted a derogation from the 1-in-7 rule to the Fiscal Council, which started to gradually fill its positions. Currently, the 1-in-7 rule was replaced by a 1-in-1 rule: the Council has already managed to fill 8 out of the 10 positions and the recruitment process is underway for the rest[48]. Moreover, access to information and to funding through the budget of the Romanian Academy, to which the Fiscal Council is attached, is secured in the Fiscal Responsibility Law.

The completion of the recruitment process should allow the Fiscal Council to strengthen its role in the assessment of fiscal policy in Romania, especially with a view to becoming a strong internal anchor by the time of the finalisation of the precautionary BoP programme in September 2015. The Commission and the IMF will support the Council and monitor developments in this area until then (including through specific conditionality in the new program).

[48] The composition of the technical secretariat, as well as the notice for the competition for a further position are published on the Fiscal Council's website: http://www.consiliulfiscal.ro/

To prevent the possible return of an up-beat bias in the authorities' revenue forecasts when the international assistance is no longer available in 2015, current conditionality anticipates a stronger role for the Fiscal Council in preparing and publishing its own revenue forecast and the exact cash deficit target (in line with the required ESA target and the necessary structural adjustment) ahead of the budgetary process.

b) Further improve the content of the MTBF by including information on the off-budget items that represent a potential contingent liability for the budget such as the losses and arrears of state-owned enterprises. Introduce the use of ESA 95 accounting in the MTBF as swiftly as possible.

Assessment of progress made: Partially implemented

Although the content of the MTBF has improved overall since 2011, the critical elements mentioned in the policy advice are still not fully included, some of them for objective reasons.

With the exception of reporting the ESA general government deficit, alongside the cash deficit, the full introduction of the ESA 95 accounting in the MTBF was not possible, given that the fiscal reporting system which would enable the authorities to move to a real-time ESA accounting is not finalised. There were some delays in previous years related to the procurement process, but it now seems to be on a right track to be finalised, with IMF technical assistance. This would allow the Ministry of Finance to move to ESA accounting starting with the 2015 budget. An important milestone of this project is the pilot rollout of the web application at one central and one local government unit by end-January 2014.

Regarding the items which represent a contingent liability to the budget, some details were included in the 2013 Fiscal Strategy, such as measures to deal with arrears, but a consistent and comprehensive numerical reporting of such fiscal risks is still lacking. The internal reporting of SOE data to the Ministry of Finance has improved significantly in the last two years, also in view of conditionality under the previous programme. However, information on SOEs impact on the budget was not published in the Fiscal Strategy (the MTBF) or Convergence Programme.

The requirement to further improve the content of the Fiscal Strategy (including via an assessment of fiscal risks), to regularly publish arrears data as well as the completion of the project allowing the government to move to real-time ESA accounting are part of the conditionality for the new BoP programme for Romania. This will entail close monitoring of the developments in these areas and an increased likelihood for results to materialise by the end of the programme in 2015.

c) Further strengthen the budget planning and management process by improving the capital budgeting process

Assessment of progress made: Partially implemented

The capital budgeting process has been improved since 2011, but more work is needed in this area.

Since 2011, Romania has succeeded in switching the composition of its funding of capital investments away from domestic funding and more towards EU funds. A capital budgeting unit was set-up within the Ministry of Finance which regularly updates a database of capital projects and produces quarterly reports to the government. However, a true prioritisation strategy was lacking by mid-2013, at the end of the previous programme[49] and there was no clear alignment of yearly capital investment budget with the medium-term budgeting process. More recent initiatives and commitment by Romania show however that the country is working towards further eliminating these shortcomings.

Under the new programme, the authorities have to further improve capital budgeting and the alignment of investment planning with medium-term budget planning. The role of the Ministry of Finance in guiding prioritisation and selection of investment should be strengthened. The authorities are already taking clear steps in this direction. In September, the authorities adopted a government ordinance which lays down the prioritisation criteria and the process for project prioritisation. As a next step, the authorities have to apply these criteria and approve the list of resulting projects via government memorandum by mid-October 2013.

[49] See paragraph 27 of the "overall assessment of the two balance-of-payments assistance projects for Romania, 2009-2013", available at: http://ec.europa.eu/economy_finance/publications/occasional_paper/2013/op156_en.htm

II. ADDITIONAL INFORMATION ON PROGRESS UNRELATED TO THE POLICY ADVICE

Romania is currently working to update its fiscal framework in line with the Fiscal Compact requirements and has also committed to several other improvements, some of them connected with previous EPC advice regarding the content of the MTBF and regarding the capital budgeting process, as part of the new 2-year precautionary BOP assistance programme starting in October/November 2013.

Fiscal governance in Sweden – 2013 update

Further to the 2011/12 cycle of the Peer Review, the Economic Policy Committee was to revisit the issued policy advice and take stock of the progress achieved by the Member States.

EPC policy advice

Although the Swedish fiscal framework has worked very well, further clarification could be given to the relative weights the government attached to the indicators used to assess fulfilment of the surplus target. This uncertainty raises the risk of an 'opportunistic' interpretation of these indicators. In this context, national authorities should introduce the following measure:

- *State more clearly the relative weight attached to each indicator in the assessment of the fulfilment of the surplus target.*

The following factsheet from the Commission services assesses the progress to date in implementing the policy advice adopted by the EPC in 2011/12 and provides some updated information on the latest developments in relation to Sweden's fiscal framework.

I. ASSESSMENT OF PROGRESS TOWARDS THE 2011 POLICY ADVICE

The Swedish fiscal framework was gradually put in place in the second half of the 1990s. The framework is centred on four components, three main rules and one fiscal institution: (i) a surplus target, (ii) a nominal expenditure ceiling, (iii) a balanced-budget rule for local governments and (iv) a Fiscal Policy Council.

The fiscal framework in place has contributed to the fiscal discipline leading to a sharp reduction of the government debt since the 1990s (from 73.3% of GDP in 1996 to 39.4% in Q1-2013). It has played a key role in preventing strong tax receipts in good times from translating into pro-cyclical spending increases. This has provided the necessary margin for automatic stabilisers to play their role in recessions, even making room for discretionary fiscal stimulus.

During the 2011 EPC Peer Review process, Sweden received one item of policy advice, on how the surplus target in the Swedish fiscal framework is evaluated.

Policy advice: Further clarify how the surplus target should be assessed by specifying the weight attached to each indicator

Assessment of progress made: Not implemented.

The surplus target encompasses the finances of the general government, i.e. including both central and local governments (counties and municipalities) and the pension system. After a phasing-in period of three years, the target came into full effect in 2000 stipulating that an overall surplus of 2% of GDP should be achieved over the business cycle. In 2007, it was changed to 1% of GDP due to a reclassification of one of the pillars of the pension system from the public to the private household sector. The fulfilment of the surplus target is assessed by five indicators:

(i) the 10-year average of the general government balance,
(ii) a corresponding cyclically adjusted average,
(iii) a seven-year moving average (including the three preceding years, the current year and the three following years),
(iv) a corresponding cyclically adjusted average, and
(v) the structural budget balance (net lending adjusted for the cyclical situation, for major one-off effects and extraordinary levels of household capital gains).

Although the fiscal framework has worked very well, further clarification should be given to how the surplus target should be evaluated. Currently, it is unclear what relative weight the government puts on the five indicators used to assess its fulfilment. This uncertainty raises the risk of an "opportunistic" interpretation of these indicators. Therefore, national authorities should more clearly state the relative weight it attaches to each indicator.

II. ADDITIONAL INFORMATION ON PROGRESS UNRELATED TO THE POLICY ADVICE

The Swedish fiscal framework, characterised by a cautious approach, has been relatively stable since 2011. Some changes and debates can however be reported.

a) Introduction of some flexibility in the balanced-budget rule for local governments to avoid pro-cyclical budgeting

Since 2000, the balanced-budget rule for local governments forbids municipalities and counties to approve *ex-ante* deficit budgets and requires them to compensate for any *ex-post* deficits within three years.

The 2013 Budget Bill included new rules allowing municipalities and counties to balance revenues over time through so-called results-balancing reserves, by means of reserving a proportion of the surplus in good times, which can then be used to cover deficits in a recession. The new rules entered into force on 1 January 2013, with the possibility to include surpluses as from 2010, and are expected to give local governments more opportunities to avoid pro-cyclical budgeting.

b) An on-going review of the budget process

At the end of 2012, a parliamentary committee was set up to review the budget process. Initial results have recently been published (SOU 2013:32) and a full report is to be published in October 2013. The present public inquiry evaluates whether the Swedish budgetary framework is in line with Council Directive 2011/85/EU on requirements for budgetary frameworks of the Member States, which is to be transposed by 31 December 2013. The inquiry concludes that the overall compliance is good but that Sweden lacks a regular evaluation of the government's macroeconomic forecasts and budget forecasts, as required by the Directive. The inquiry therefore proposes to keep the process generally intact, with the addition that the government should be required to regularly publish evaluations of the forecasts presented in the Budget Bills and the spring budget. The government should also address significant discrepancies against the Commission's forecasts.

Fiscal governance in Slovenia – 2013 update

Further to the 2011/12 cycle of the Peer Review, the Economic Policy Committee was to revisit the issued policy advice and take stock of the progress achieved by the Member States.

EPC policy advice

In spite of several recent innovations, the medium-term budgetary framework (MTBF) and the new expenditure rule are insufficiently binding and insufficiently focused on achieving the medium-term objective (MTO) and securing long-term sustainability, while the new Fiscal Council does not yet weigh on fiscal strategy development and the use of ESA 95 accounting in the national MTBF is not widespread. In this context, national authorities should introduce the following measures:

• Strengthen the MTBF and its legislative base to make it more binding and transparent. Gear it at making adequate progress towards the MTO and support it by a better targeted and well-specified expenditure rule. Express the MTBF and expenditure rule in ESA 95 terms and provide relevant information in ESA 95 terms on the annual budget.

• Reinforce the role and the resources of the Fiscal Council, possibly also through closer cooperation with other institutions analysing fiscal policy, so that it can provide a meaningful contribution to the ex ante development and ex post assessment of the medium-term fiscal strategy.

The following factsheet from the Commission services assesses the progress to date in implementing the policy advice adopted by the EPC in 2011/12 and provides some updated information on the latest developments in relation to Slovenia's fiscal framework.

I. ASSESSMENT OF PROGRESS TOWARDS THE 2011 POLICY ADVICE

The only major novelty in Slovenia's fiscal framework since the autumn 2011 Peer Review is the introduction in May 2013 of the principle of a general government budget balance/surplus rule in structural terms in the Constitution, as stipulated in the Treaty on Stability, Coordination and Governance (TSCG).

a) Strengthen the MTBF and its legislative base to make it more binding and transparent. Gear it at making adequate progress towards the MTO and support it by a better targeted and well-specified expenditure rule. Express the MTBF and expenditure rule in ESA 95 terms and provide relevant information in ESA 95 terms on the annual budget.

Assessment of progress made: Not implemented.

Slovenia's MTBF and the legislation on the expenditure rule have not been amended in response to the EPC policy advice. The expenditure rule has seen little concrete application in the conduct of fiscal policy, which has instead continued to rely on ad hoc discretionary measures and the established procedures (based on the Public Finance Act) of moratoria on new expenditure commitments, supplementary budget and administrative brakes on expenditure commitments beyond a certain date, which were already described in the autumn 2011 fiche. The annual budget is still published only in cash terms.

b) Reinforce the role and the resources of the Fiscal Council, possibly also through closer cooperation with other institutions analysing fiscal policy, so that it can provide a meaningful contribution to the ex-ante *development and* ex-post *assessment of the medium-term fiscal strategy.*

Assessment of progress made: Not implemented.

The existing Fiscal Council has not developed into a visible independent body providing a meaningful contribution to the *ex-ante* development and *ex-post* assessment of the medium-term fiscal strategy. The Fiscal Council published annual reports in 2010, 2011 and 2012 with an *ex-post* assessment of budgetary execution for those years and *ex-ante* assessment of budgetary targets, documents and potential consolidation measures for the coming years. It also published two more general studies on fiscal policy in Slovenia in 2011 and 2012, but these documents do not appear to have been used in the formulation of the fiscal policy. The chairman of the Fiscal Council stepped down in 2012 and the 2013 Fiscal Council report has not been published. The authorities envisage the creation of a new Fiscal Council in the forthcoming fiscal governance package.

II. ADDITIONAL INFORMATION ON PROGRESS UNRELATED TO THE POLICY ADVICE

The authorities are preparing an ambitious overhaul of the legislation underpinning Slovenia's fiscal framework so as to comply with the TSCG and the EU legal requirements on fiscal governance. Following the constitutional amendment setting the basis for the general government budget balance/surplus rule, two legislative acts are under preparation to specify its implementation: (i) new Fiscal Rule Act; (ii) amended Public Finance Act. The former, to be adopted by Parliament with a 2/3 majority by the end of November 2013, is the main vehicle to specify the relevant concepts (e.g. revenue and expenditure, general government, medium-term objective, structural balance, etc.). More detailed fiscal governance provisions will be enshrined in the revised Public Finance Act, the parliamentary adoption of which is expected in early 2014. The government also envisages amending the decree on development planning documents and procedures for the preparation of the central government budget.

Fiscal governance in Slovakia – 2013 update

Further to the 2011/12 cycle of the Peer Review, the Economic Policy Committee was to revisit the issued policy advice and take stock of progress achieved by the Member States.

EPC policy advice

With the reform of 2005, which introduced multi-annual planning, programme budgeting and several fiscal rules, Slovakia significantly improved its fiscal framework. However, the current set-up is fragmented and has not prevented the government from running deficits even in years of high economic growth. In this context, national authorities should introduce the following measures:

- *Implement enforceable, binding and well-designed multi-annual expenditure ceilings, covering the central government and social security system, consistent with the multi-annual objectives of the medium-term budgetary framework for the general government.*
- *Introduce an independent fiscal council to support the preparation, monitoring and evaluation of fiscal policies.*
- *Improve the transparency of public finances through the timely publication (on a quarterly basis at least) of budgetary data at all levels of government.*

The following factsheet from Commission services assesses the progress to date in implementing the policy advice adopted by the EPC in 2011/12 and provides some updated information on the latest developments in relation to Slovakia's fiscal framework.

I. ASSESSMENT OF PROGRESS TOWARDS THE 2011 POLICY ADVICE

Slovakia has taken substantive steps to strengthen its fiscal framework. In March 2012 an important constitutional act on fiscal responsibility came into force. It introduced two important novelties: a fiscal council and a national debt brake. The same act also formalised a role of committees advising the Ministry of Finance on the macroeconomic and tax revenue forecasts, introduced several requirements for publication of fiscal data, and set sanctions for local governments in case of an excessive debt. The expenditure ceilings recommended both in the context of the EPC review and of the European Semester in 2011 and 2012, have so far not been implemented.

Implement enforceable, binding and well-designed multi-annual expenditure ceilings, covering the central government and social security system, consistent with the multi-annual objectives of the medium-term budgetary framework for the general government.

Assessment of progress made: Not implemented.

A public version of a law introducing expenditure ceilings was presented by the Ministry of Finance in spring 2012 and it went through the first phase of the legislative procedure, i.e. the inter-ministerial consultation. It was also described in the 2012 stability programme. Nevertheless, to date the law has not even been placed on the government agenda for discussion. The latest proposals amending the legislation on fiscal frameworks in reaction to the Fiscal Compact do not include any reference to the expenditure ceilings. These are however explicitly mentioned in the constitutional act on budgetary responsibility, which states that such ceilings are to be adopted in a separate law (although no timeline is provided).

Introduce an independent fiscal council to support the preparation, monitoring and evaluation of fiscal policies.

Assessment of progress made: Implemented.

In December 2011, the Slovak Parliament adopted a constitutional law on budgetary responsibility, which entered into force on 1 March 2012. With this law, the Council for Budgetary Responsibility (CBR) was established as an independent body for monitoring and assessing public finance developments and adherence to fiscal rules. Its main responsibilities include (i) issuing an annual report on the long-term sustainability of public finances, (ii) assessing adherence to fiscal rules, (iii) giving opinions on legislative proposals as necessary, and (iv) drafting documents related to the monitoring and assessment of budgetary developments.

The three board members (the chairman and two members) were appointed in July 2012. They are elected as public officials by the Parliament based on a proposal by the Government, the President and the Central Bank. The CBR Bureau was set up in the second half of 2012. The Council is financed through the budget of the Central Bank, which can request reimbursement from the Ministry of Finance. Any entity within the General Government sector has to provide information if requested by the Council.

The CBR has already published several reports, policy assessments and methodologies. During the meetings with the COM, the CBR indicated that so far there have been no obstacles preventing it to establish itself as an independent institution free of political influences.

Improve the transparency of public finances through the timely publication (on a quarterly basis at least) of budgetary data at all levels of government.

Assessment of progress made: Not implemented.

The policy advice aimed at ensuring timely publication of the fiscal data beyond cash data on the implementation of the state budget. This would have improved in-year monitoring of public finances. The constitutional law on fiscal responsibility includes provisions on the publication of fiscal data as described below in part II, but it does not address the in-year publication of (cash) data for individual general government subsectors.

Data on local governments is often not published even if available to the MoF. As of 1 January 2014, the information on budgets adopted by the local governments should be collected via an electronic system RIS.SAM (this project is not directly linked to the above-mentioned constitutional law). Municipalities and regions could use this system also for managing the budget in the course of the year. The system could increase accessibility of the data of the local governments and improve information flows. Nevertheless, timely publication of the data is not defined among the goals of the project. The data on social security funds has also not been made publically available.

II. ADDITIONAL INFORMATION ON PROGRESS UNRELATED TO THE POLICY ADVICE

While the policy advice has been only partially implemented, there have been other measures that have potential to improve the overall fiscal framework in Slovakia. All of them were introduced within the constitutional law on budgetary responsibility.

1) Debt brake

The law introduced a system of early corrective measures and a range of sanctions triggered by the level of the public debt-to-GDP ratio — thus establishing a debt rule for the whole general government. The interval within which the sanctions are applied spans from 50% to 60% of GDP. As from 2018, the brackets for the application of the sanction mechanism, as well as the general government debt ceiling, will be reduced annually by 1 p.p. until the upper ceiling drops to 50% of GDP (in 2027).

2) Improved transparency

The act formalises the role of two advisory bodies to the MoF – the Macroeconomic Forecast Committee and Tax Revenue Forecast Committee. These bodies were established informally several years ago. The committees group economic analysts from private banks, the Central Bank, and other think-tanks and/or institutions producing macroeconomic forecasts to assess macroeconomic and tax revenue forecasts by the MoF. With the adoption of the act they have been officially given a role in advising the MoF on its forecasts.

Moreover, the act emphasises the concept of net worth of the country, which can shed more light on some government transactions which may have positive impact on the deficit and/or debt in the short-term but can have no or even a negative impact in the long-term (i.e. reduction of the private fully funded pillar improves the general government figures in the short-term, but increases its liabilities in the long-term). Moreover, it postulates that additional information is included in the multi-annual budget, to provide a more complete picture of public finances (e.g. tax expenditures, contingent liabilities, one-off effects, etc.).

3) Stronger enforcement of local governments fiscal rules

One of the new elements is that municipalities and self-governing regions will be sanctioned if their debt exceeds 60% of their actual current revenues in the previous fiscal year.

4) Definition of analytical terms

The act directly defines several important analytical terms, such as long-term sustainability, baseline scenario and long-term sustainability indicator, and paves the way for introducing expenditure ceilings specified in detail in the amendment to the General Government Budgetary Rules Act. The exact methodology of calculation is to be defined by the CBR.

Fiscal governance in the United Kingdom – 2013 update

Further to the 2011/12 cycle of the Peer Review, the Economic Policy Committee was to revisit the issued policy advice and take stock of the progress achieved by the Member States.

EPC policy advice
With the establishment of a fiscal council (the Office for Budget Responsibility), a fiscal mandate and a net debt target, the UK's new fiscal framework represents a significant improvement and a good basis for good fiscal policymaking. It could be strengthened further by the following measures:
- *The Office for Budget Responsibility (OBR) should conduct and publish its planned detailed analysis of the impact of the economic cycle and asset prices on the fiscal balance. This would reduce the risk of allocating spending on the basis of unsustainable revenue streams and contribute to the credibility of the OBR's point estimates of the cyclically-adjusted fiscal balance. Additional checks and balances, to avoid the use of revenue windfall increases to fund recurring spending, could be provided through the forthcoming revisions to the spending framework or by setting revenue rules.*
- *The addition of an explicit medium-term objective as defined in the Stability and Growth Pact. The government could build on the new fiscal mandate by introducing an explicit medium-term objective consistent with the Stability and Growth Pact.*
- *Strengthen spending control: as part of the further detail on its spending framework it plans to announce in summer 2011, the government could go further to ensure that the spending review framework will work in an environment of falling budgets by, for example, closer central in-year monitoring of spending performance and explicit contingency plans to manage and remedy any overspends.*

The following factsheet from the Commission services assesses the progress to date in implementing the policy advice adopted by the EPC in 2011/12 and provides some updated information on the latest developments in relation to the UK's fiscal framework.

I. ASSESSMENT OF PROGRESS TOWARDS THE 2011 POLICY ADVICE

The UK set up its independent Office for Budget Responsibility (OBR) in 2010. It produces the official forecast underlying the annual budgets and Autumn Statements, and assesses the likelihood of the government achieving its fiscal mandate[50] and debt sustainability target[51]. The latter fixed-date target was missed in the Autumn Statement 2012.

a) The Office for Budget Responsibility (OBR) should conduct and publish its planned detailed analysis of the impact of the economic cycle and asset prices on the fiscal balance. This would reduce the risk of allocating spending on the basis of unsustainable revenue streams and contribute to the credibility of the OBR's point estimates of the cyclically-adjusted fiscal balance.

Assessment of progress made: Implemented.

The OBR published detailed analysis of the impact of the economic cycle and asset prices on the fiscal balances as planned.[52] The results were relatively stable over different output gap estimates however asset prices and transactions may have affected the UK's past fiscal position by as much as 1.3% of GDP. Nevertheless, owing to the estimation difficulties of the latter analysis, the OBR decided not to include asset price adjustments directly into their cyclical-adjustment methodology, unless judged necessary in the future.

b) Additional checks and balances, to avoid the use of revenue windfall increases to fund recurring spending, could be provided through the forthcoming revisions to the spending framework or by setting revenue rules.

Assessment of progress made: Not implemented.

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[50] The fiscal mandate requires that the cyclically-adjusted current budget (i.e. excluding investment expenditure) should be on track to be in balance by the end of a rolling five-year forecast period, currently ending in 2017–18.
[51] This requires that public sector net debt as a percentage of GDP be falling by the fixed date of 2015–16.
[52] http://budgetresponsibility.independent.gov.uk/wordpress/docs/Working-paper-No3.pdf

No additional checks were implemented to ensure revenue windfalls do not fund recurrent spending nor were revenue rules set hence overall, the advice was only partially implemented. The latter advice therefore remains relevant.

c) The addition of an explicit medium-term objective as defined in the Stability and Growth Pact. The government could build on the new fiscal mandate by introducing an explicit medium-term objective consistent with the Stability and Growth Pact.

Assessment of progress made: Not implemented.

The UK has not set a medium-term objective (MTO). The UK continues to be inconsistent with the Stability and Growth Pact and therefore this advice stands valid.

d) Strengthen spending control: as part of the further detail on its spending framework it plans to announce in summer 2011, the government could go further to ensure that the spending review framework will work in an environment of falling budgets by, for example, closer central in-year monitoring of spending performance and explicit contingency plans to manage and remedy any overspends.

Assessment of progress made: Partially implemented.

The UK published a new Spending Round in June 2013 which details spending plans in 2015-16, i.e. for one year only as a general election is foreseen in 2015. Whilst there are still no explicit contingency plans to manage and remedy overspends, the OBR publishes a commentary on the Public Sector Finances release every month; thus, there is at least close monitoring of the public finances.

II. ADDITIONAL INFORMATION ON PROGRESS UNRELATED TO THE POLICY ADVICE

There have been no changes to the UK's fiscal framework since the OBR was established in 2010.

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