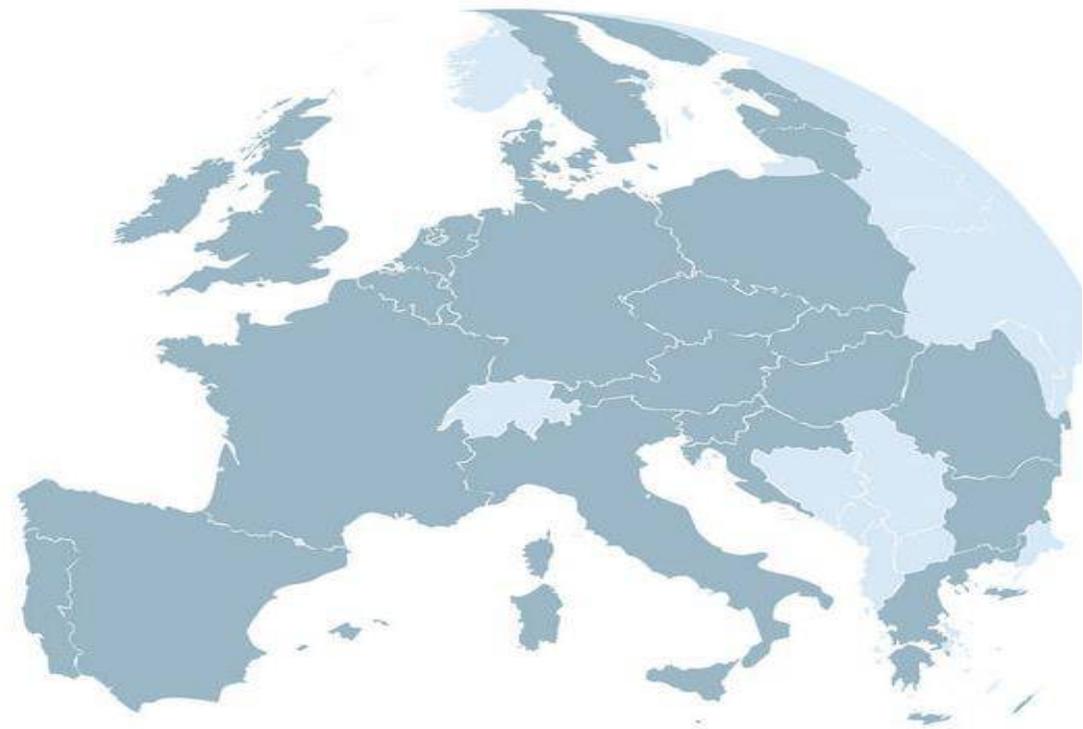




An overview of EU IFIs: main tasks and challenges



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Sound theoretical background for IFIs' role in promoting sustainable public finances

- ❑ IFIs provide analysis and data that inform the decision-making process with technical criteria that help preventing the main sources of public debt bias

	How does this bias materialize?	What responsibilities can be transferred to IFIs?
Time inconsistency	Optimistic forecasts	Production/endorsement of projections
	Discretionary fields due to lack of transparency	Objective analysis of the fiscal situation and prospects
	Bias towards the short-term	Medium-term approach and sustainability analysis
	Reluctance to adhere to the rules	Guardians to the rules. Increase in the reputational cost
Common pool theory	Lack of internalization of the total costs of the decisions taken	Assessing policy options without pressures from lobby groups (costing)

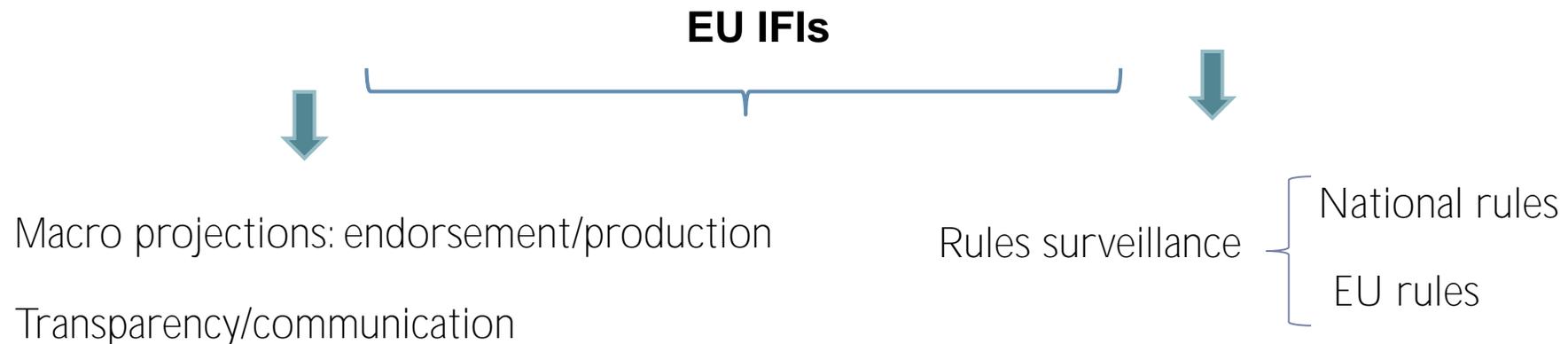
Rapid expansion of IFIs at global level

IFIs en el mundo - Pre-crisis



- ▶ Specially after the **crisis.....in** particular, within the EU

EU IFIs are singular institutions: integrating two models



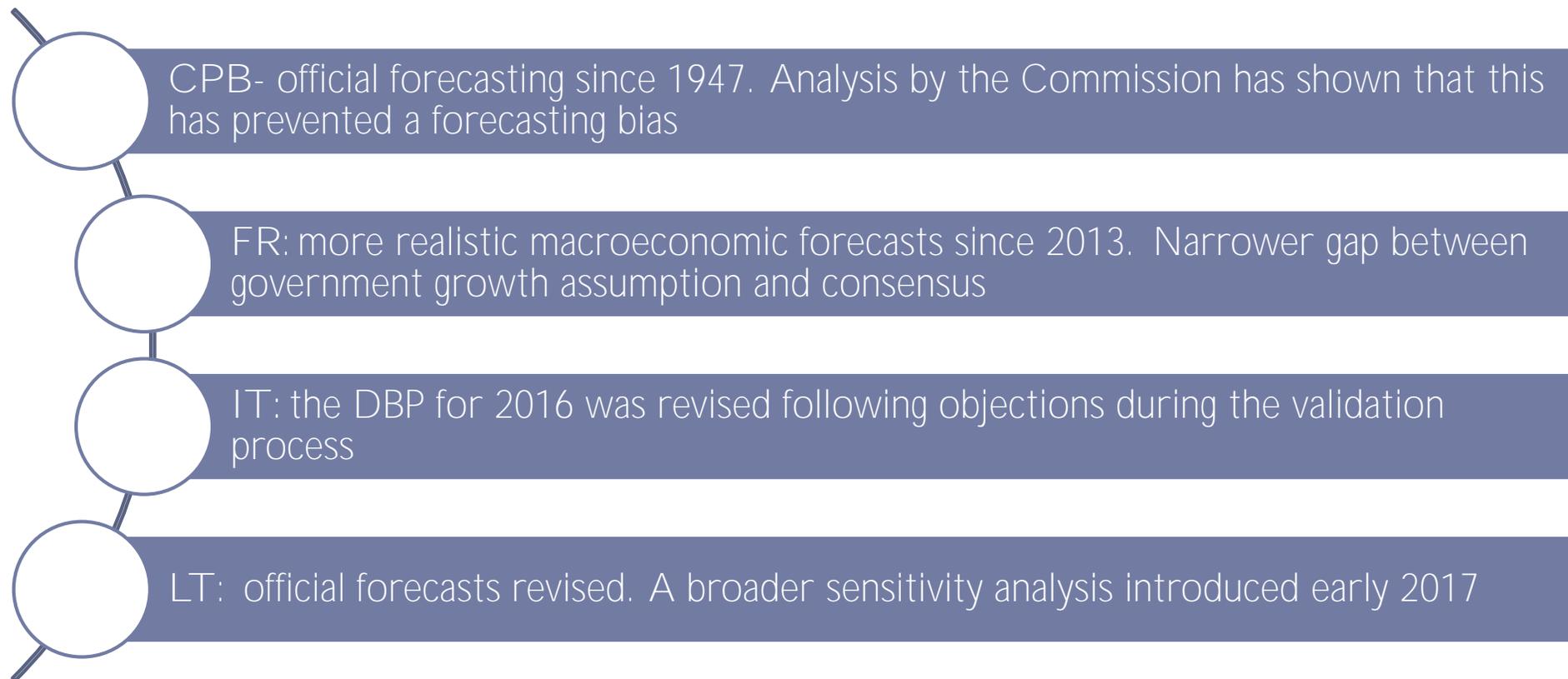
COMBINATION OF TASKS OF A VERY DIFFERENT NATURE

This double task/nature is very challenging for a single IFI

- ▶ Challenges:
 - Intense resource-demanding
 - Need for a combination of different expertise: economic and good legal background
 - Development of macro and fiscal models: out or in-house
 - Multiple actors to relate with, in particular in decentralized countries
 - For new IFIs: need to build up reputation and become technically solvent very rapidly
- ▶ In a few number of countries (in particular those with older IFIs), these double functions are performed by various institutions (AT, BE, NL, LU)
- ▶ But most new IFIs have been tasked with both type of functions.
- ▶ So far, more visible outcomes in terms of macro forecasting, transparency and budgetary practices than in fiscal rules monitoring

1. Improving forecasting- some examples

- ▶ There are positive examples of improving macro forecasting in old and new IFIs. Some examples provided by IFIs:



Potential reasons behind this performance

Strong legal backing

- 2011 Directive on requirements for budgetary frameworks
- More importantly- 2013 Regulation 473 of the 2 pack: fiscal documents should be based on independent macroeconomic forecasts, and shall indicate whether the budgetary forecasts have been produced or endorsed by an independent body.

Relatively low resource intensity (in case of endorsement)

- Wide range of macro forecasts against to which assess official forecasts
- Quite standard statistical and econometric tools

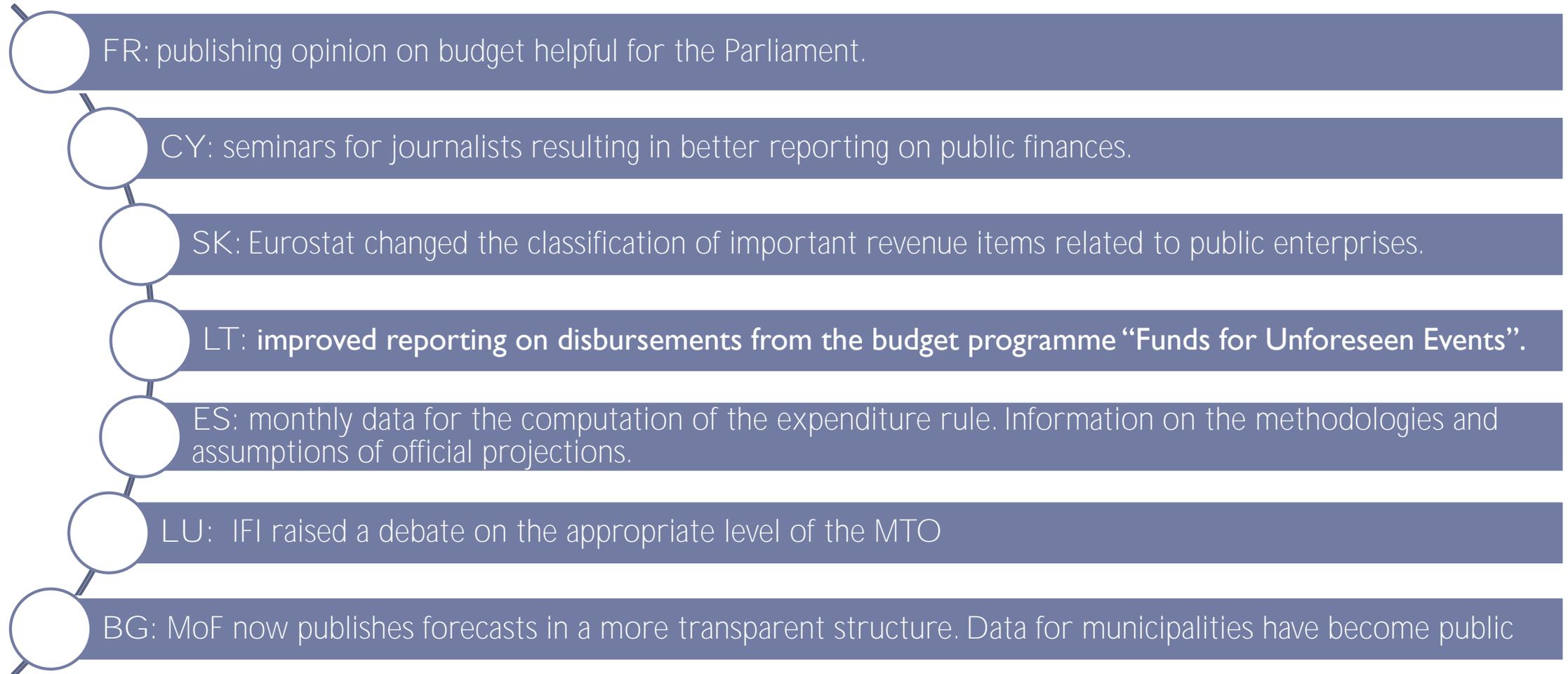
- ❖ There is no such a demanding procedure for fiscal projections so that the consistency between macro and fiscal projections is not guaranteed. More prudent macroeconomic projections are not always leading to more prudent fiscal projects.
- ❖ Only a few IFIs (MT among them) mandated to endorse budgetary forecasts

2. Reducing info asymmetries and improving transparency-also positive practice

- ▶ Transparency is a distinguishing feature of most if not all IFIs:
 - Wide dissemination policy of reports and their underlying technical documents, including the methodologies and data bases. In many cases, analysis can be replicated
 - Efforts to make documents accessible to the general public
 - Institutional information is also published: annual reports, letters with **MoF's**, annual accounts.
 - English versions: executive summaries (at least)
- ▶ Complemented with active communication strategy: press releases, briefings, interviews are frequent
- ▶ Network of EU IFIs committed to contribute as well: recent initiative- European Fiscal Monitor <http://www.euifis.eu/eng/fiscal/198/eu-independent-fiscal-institutions-launch-regular-joint-publication>

Some particular examples of reducing info asymmetry

- ▶ IFIs encouraging the government/other institutions to improve the provision of data or background documents



3. But IFIs find it more difficult as fiscal watchdogs

In some cases, MoFs question the rules, promote methodological changes or change the targets

- FR: 2014 partial reaction to the identification of SD but new trajectory integrating past deviations. In 2015 and 2016 government did not answer to HCFP pointing out that structural adjustments were less than required by EU rules.
- CY: MoF disagreed with IFI and Commission figures. Pushing with other countries for a change of the methodology.

In other cases, more mixed results.
Spanish case:

- Warning on the disequilibria of the Social Security understood. A reform to restore its long-term sustainability is under discussion and budgetary targets (social security contributions, included) have become more realistic.
- On the contrary, deviations or risk of deviation by regions identified by AIReF and the corresponding request for activation of the different preventive and/or correction mechanisms have been recurrently ignored.

Main factors behind this duality

1. An overly complex fiscal framework
2. Very demanding task in terms of resources
3. Weaknesses of the CoE principle

An overly complex fiscal framework

- ▶ Despite 2016 December ECOFIN (“**Improving** predictability and transparency of the **SGP**”), the rules-based system is still too complex
- ▶ Main consequences:
 - High potential discretion in the implementation of the SGP.
 - Pact implementation is becoming rather unpredictable.
 - Transparency and communication hindered.
 - Weak enforcement and ultimately credibility at risk.

Implementation is even complicated for IFIs

Some examples

Lack of stability and changes of criteria without immediate information to IFIs have put some of them at difficult a position: IE 2016 unaware of agreement on the structural effort requirement for IE

Some technical decisions inadequate triggering changes (3 years freeze for 10 average potential output growth). IFIs can help spotting this type of weaknesses

Different approaches to capture the same concept: cyclical unemployment benefits differently computed in the structural balance and the expenditure benchmark

Input data to compute the rules not easy to get: EU investment fully matched by EU funds; discretionary revenue measures; one offs; reference rate or convergence margin

IFIs are input Commission-dependent. Spring data for t and $t+2$ for potential, DMR, GPU

Conclusions on the EU Fiscal Framework

- ▶ Streamlining makes full sense in a new framework where 2 type of actors have been established: national IFIs + EFB.

*This creates an opportunity to move towards less rules and less sophisticated. To some extent this would mean coming back to the origins of the SGP. These new fiscal watchdogs should play the role that at that time did not play the market. Obviously this requires solid IFIs. **Instead of strengthening the rules its is time to simplify rules and strengthening national IFIs***

- ▶ Network keeps ready to cooperate with the Commission/EFB on the initiatives to streamline the SGP.

Main factors behind this duality

1. An overly complex fiscal framework
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Resources and functional autonomy still an issue in many IFIs

- ▶ At least a third of IFIs have extremely limited financial and human resources to perform their task
- ▶ More acute in decentralized countries
- ▶ Access to information is key
 - ▶ Entities of general government (social insurance, health insurance, public enterprises)
 - ▶ Sub-national units
 - ▶ EU surveillance techniques and procedures (improving)
 - ▶ Specific government policy measures and their costing

Main factors behind this duality

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The comply or explain (CoE) principle

- ▶ Key for the effectiveness of IFIs as fiscal watchdogs:
 - Tool for a constructive dialogue between IFIs and the public administration concerned
 - Dialogue should be public and transparent
- ▶ It requires a strong legal backing. Contrary to the endorsement of macro forecasts, there is no such a provisions in EU regulation.
 - It is just a principle and only applicable to the correction mechanism of the FC
 - Not included in the 2 pack. Art 2 of 473 regulation does not include CoE when defining an IFI and its principles



Effectiveness left to national regulation and practices

What's the situation?

Survey conducted across 16 IFIs

- ▶ Poor national legal basis:
 - Not sufficiently detailed
 - **Limited scope: narrower than IFIs' mandate (in terms of tasks and administrations monitored).**
 - Recommendations compliance: lower for fiscal than for transparency recom. (MT, ES)
 - **Gov't uses** loopholes to avoid **compliance with IFI's** recommendations (SK)
 - Explanations: too general, vague, not convincing
 - No consequences from deviations: just reputational costs
 - Not automatic activation (IT)
- ▶ Confirmed by the Commission report on the transposition of the FC: problems identified in 8 countries (AT, FR, BE, IT, DK, LUX, SK, PT)

Some practical examples:

- FR:** in 2015 and 2016 government did not answer to HCFP pointing out that structural adjustments were less than required by EU rules
- SK:** government did not engage with the arguments based on which CBR identified significant deviation from adjustment path in 2016
- RO:** since 2015, fiscal council has issued warnings and identified significant deviations from adjustment path -> no response
- ES:** no reaction to deviations or **risks** of deviations from targets and requests for preventive or corrective action at the regional level/On the positive side: WG with sub nationals on the expenditure rules; study measures to rebalance Social Security (Toldeo Pact)
- IT:** 2016 **forecast** endorsement - “comply or explain” was successfully applied
- HR:** fiscal council identified significant deviation from rules, government responded within 30 days with a set of measures with specific deadlines

Main conclusions

- ▶ Most IFIs combine tasks of very different nature
- ▶ Visible outcomes in macro forecasting, transparency and budgetary practices
- ▶ Follow-up from governments on compliance with fiscal rules weak where applicable. Need to reinforce consistency between macro and fiscal scenarios. A new role for IFIs?
- ▶ Simplification of rules would support effective communication and compliance.
- ▶ Comply-or-explain mechanisms: reinforcement needed.

Thank you for your attention

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