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Christian Bender, Fabio Botta and Thomas Lenk

Changing Europe's Budgetary Framework

Implications for the German Independent Advisory Board

European governance is in a state of upheaval. Due to the impact of the coronavirus pandemic, the Russian war of aggression in Ukraine and the energy price crisis, European fiscal policy has come under increasing pressure. In this complex situation, the European Commission considers a return to the previous fiscal rules to be impracticable and has presented reform proposals. These include the strengthening of national independent fiscal institutions through the bundling and expansion of tasks and duties. This article examines the implications that the implementation would have with regard to the Independent Advisory Board to the Stability Council in Germany.

The European Commission's initiative on fundamental change in European governance has laid the groundwork for reform. In the wake of the coronavirus pandemic, a return to the previous rules was considered impractical from the perspective of the member states and the European institutions. Following a public participation process initiated by the Commission in 2020 and the subsequent publication of a Commission communication in 2022, legislative proposals have now been published. In addition to the much-publicised reform proposals on fiscal rules (European Commission, 2023a; 2023b), reforms to the budgetary framework have also been put forward (European Commission, 2023c).

This paper discusses the changes that would result from the proposed modification of the Council Directive 2011/85/EU (European Commission, 2023c). In particular, with regard to national independent fiscal institutions (IFIs), changes are planned that will permanently affect the budgetary framework. The amendments to fiscal rule

monitoring will have an impact on the way in which policies are designed, monitored and evaluated. The area of policy evaluation will most likely be structurally strengthened in this respect. The IFI provisions are intended in particular to promote a more stringent and comprehensive analysis of financial relations and compliance with fiscal rules. Before discussing the changes underlying the Commission's legal proposal, this paper describes the current design of IFIs by European Union law and applies it to the German Advisory Board. It thus shows the changes entailed in the Commission's proposal. Subsequently, the main innovations presented by the Commission with regard to the budgetary framework are presented, followed by a critical assessment.

Current design of IFIs: The European dimension

IFIs are public bodies responsible for monitoring compliance with fiscal rules, producing or endorsing macroeconomic forecasts for the budget and advising the government on its fiscal policy (European Commission, 2023d). They are financed by public funds and are functionally independent from fiscal authorities (European Parliament, 2013, Art. 2). This includes a statutory regime grounded in national law, no authority of budgetary authorities to issue directives, the capacity to communicate publicly as well as adequate resources and appropriate access to information to carry out their mandate (European Parliament, 2013, Art. 2).

From a political economy perspective, the deficit bias and procyclical fiscal policy in particular have been decisive factors that have significantly favoured the introduction of IFIs. The deficit bias can arise, for example, when the consequences of a deterioration in the fiscal position become

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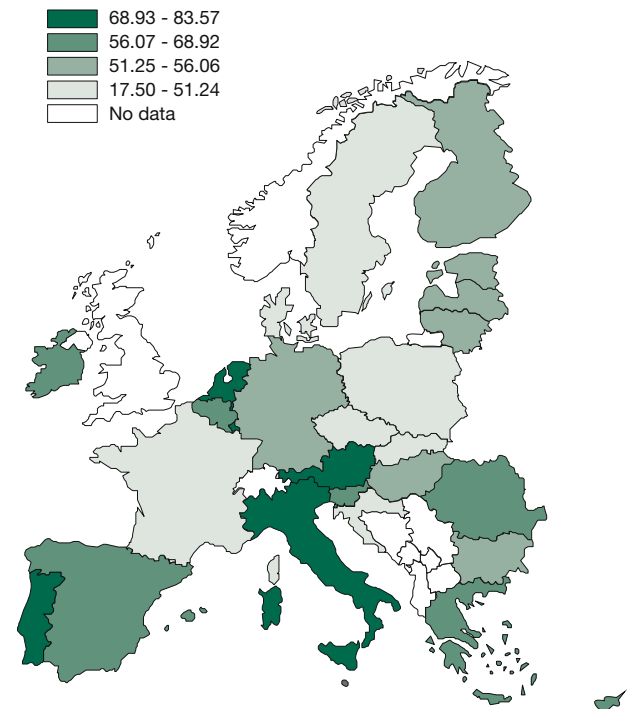
visible only with a time lag (fiscal illusion), expansionary fiscal policies are implemented not on the basis of fiscal policy considerations but on the basis of electoral decisions (election cycles), or interest-driven redistribution mechanisms of public funds exist (common-pool problem) (Eyraud et al., 2018, 8). As early as 2006, the Commission concluded: “The importance attached to national fiscal rules and institutions in the reformed SGP is not fortuitous. Recent economic history provides evidence that policymakers do not always pursue time consistent and sustainable fiscal policies” (European Commission, 2006, 140).

The Commission is thus aware of the existence of divergent behaviour and has been pricing it into its considerations of fiscal rules and budget monitoring for some time. Fiscal rules, as well as IFIs, are understood as mechanisms to address these circumstances. In their role as fiscal watchdogs, IFIs have several responsibilities. For their main role, namely the monitoring of compliance with fiscal rules, IFIs should also assess the medium-term budgetary objective (MTO),¹ the activation and monitoring of its correction mechanism (if necessary) as well as the surveillance of deviations in the wake of an unusual event outside the control of the member state (European Parliament, 2013). Concerning macroeconomic forecasts, regulation 473/2011 (which is part of the so-called two-pack) stipulates that these have to be produced or endorsed by IFIs (European Parliament, 2013, Art. 2, Art. 4). Therefore, the regulation leaves room for some national implementation options. These forecasts serve as the basis for the medium-term fiscal plans and the draft budgetary plans. Accordingly, IFIs do not only monitor fiscal rules, but they also analyse the underlying macroeconomic projections of the budgetary plans. Therefore, they are, at least in an indirect way, partly embedded in the national budget cycle. Their role is twofold: first, IFIs should foster budgetary discipline; and second, as fiscal watchdogs, they should promote national ownership of the fiscal rules. This is where the link between IFIs and fiscal rules comes from: they serve as complements and are intended to support each other in their effect.

In 2015, the Directorate General for Economic and Financial Affairs (DG ECFIN) launched the Scope Index of Fiscal Institutions, which is based on surveys and is in-

¹ The MTO is a country-specific budget requirement. It ranges between a structural -1% and a balanced or surplus budget and applies over a period of three years. All EU countries are expected to reach their medium-term budgetary objectives or to be heading towards them by adjusting their structural budgetary positions at a rate of 0.5% of GDP per year as a benchmark. Regulation 1466/97 describes the concept of the medium-term budgetary objective in more detail (European Parliament, 2011).

Figure 1
Scope Index of Fiscal Institutions in 2021 by country



Note: The index aims to measure the breadth of tasks covered by independent fiscal institutions and consists of the following tasks: monitoring compliance with fiscal rules, macroeconomic and budgetary forecasting, sustainability assessment, fiscal transparency and normative recommendations.

Source: DG ECFIN (2023), own Illustration.

tended to cover the range of tasks performed by IFIs. The index score for 2021 is shown in Figure 1 and divided into quantiles. As shown in the figure, the scope of tasks and mandates of IFIs are heterogeneous across Europe. In particular, the southern European countries, which were hit hard by the sovereign debt crisis, seem to grant IFIs a more comprehensive mandate than, for example, some northern European countries. Germany’s board is in the lower midfield. Even if this is only a momentary impression, there are still factors that limit the work of the board in a European perspective. The following section therefore initially describes how the German IFI, the Independent Advisory Board, is structured and what competencies it has.

The German Independent Advisory Board of the Stability Council: State of play

Under Paragraph 8 of the Stability Council Act, the Stability Council’s attached Independent Advisory Board is re-

Table 1
Schedule of the Independent Advisory Board

	April	May	October	November	December
External Projections	Joint Economic Forecast		Joint Economic Forecast	SVR Annual Report	Conclusions of WG Tax Estimates
Internal Projections - Federal Govt	Spring Forecast		Autumn Forecast		
EC	Stability Programm to EC	Spring Forecast from EC	Draft budgetary plan to EC	Autumn Forecast from EC	
Advisory Board	3-5 meetings and first draft → Final statement		3-5 meetings and first draft → Final statement		
Stability Council	Financial projections	Press conference	Financial projections	Press conference	

EC: European Commission; SVR: the German Council of Economic Experts; WG: working group.

Source: Own illustration.

sponsible for monitoring compliance with the upper limit of the structural general government deficit (StabiRatG, § 8). This is set at 0.5% for the general government in Section 51(2) of the Budget Principles Act and is derived from the requirements of the Fiscal Compact (HGrG, §51). The results of the monitoring are published biannually and are sent to the Stability Council (Independent Advisory Board, 2022). The Advisory Board is composed of one representative each from the Deutsche Bundesbank, the Council of Economic Experts, the Joint Economic Forecast, the leading municipal associations and the leading social insurance organisations. Two experts each are appointed by the federal and state governments for a period of five years. All members of the Advisory Board work on a voluntary basis.

The schedule to which the work of the Advisory Board is subject is dense, as shown in Table 1. According to the schedule, April and May are months of more intensive work phases for the first statement in spring, and Octo-

ber and November are more intensive due to the second statement in winter. The work of the Advisory Board is therefore relatively concentrated. This is particularly due to the European semester, which works towards a better linking of national and European reporting. However, the work of the Advisory Board has to fit in this scheme. This must also be seen in the context of the fact that the publication of external projections has been largely retained, while national and European reporting has shifted in line with the provisions of the six-pack.

The work of the Advisory Board is limited by some constraining factors, such as the absence of a legal basis for access to all information necessary to create its report (DG ECFIN, 2023). Although there is privileged access to non-public information, some important data, such as detailed budget data for the German *Länder*, are not fully available. That ultimately undermines the monitoring of the general government deficit. In addition, the comply-or-explain principle (CoEP), formerly prescribed at the EU level, has only recently been implemented by the government. Until 2022, this principle has not been followed. The principle is not enshrined in Section 51 of the Budgetary Principles Act, nor in the Stability Council Act. Rather, the legal derivation of the principle can be drawn from the European level, where it is mentioned in a Commission's communication from 2012.

Although financing is shared equally between the federal and state governments, neither the amount nor the periodicity is regulated by law. There is currently less than one staff member (0.75 full-time equivalent) available to support the work of the Advisory Board, which is funded from the Advisory Board's total annual budget of €150,000 (Jankovics and Sherwood, 2017, 17; DG ECFIN, 2023). Accordingly, the Board does not prepare its own forecasts, but instead refers to the forecasts of the Deutsche Bundesbank, the Council of Economic Experts, the Joint Economic Forecast, the IMF and the OECD. Additionally, the principle of endorsement or planning is not applied directly. Rather, the governments' macroeconomic forecasts are assessed against the forecasts of other institutions. Neither the government nor the parliament consults the Board with regard to budget planning.

In conclusion, the efficacy of the German Independent Advisory Board is limited. The Board prepares reports that are submitted to the Stability Council, which gives rise to two possible control mechanisms. First, the Stability Council has the task, in accordance with the CoEP, of either following the Advisory Board's statements or publicly explaining why the Stability Council does not do so (Independent Advisory Board, 2023, 2). It has done this only recently. Second, the Advisory Board has the oppor-

tunity to make its voice heard publicly through its statements. The Chairman of the Advisory Board can express the Board's position at the press conference of the Stability Council. In reality, however, this usually results in a short statement. The principle itself follows the logic of the theory of fiscal rules, in which publicity is a way of exerting pressure on policymakers via public opinion. However, since the resources of the Advisory Board are limited, the public perception of the Advisory Board is also diminished. This is reinforced by the fact that there is usually not much time available to prepare the Advisory Board's opinions. Since this cannot be compensated by the staff of the Advisory Board, the pressure on its members increases.

More is worth more? An analysis of the Commission's proposals and their implications

After first describing the European ideas on the part of IFIs and setting out the national design of the German Independent Advisory Board, this section discusses the Commission's proposals, which are intended to reform the national IFIs.

At the heart of the European governance reform is the re-drafted Article 8 of the Commission's proposed Directive, which sets out the additional powers and responsibilities to be given to IFIs (European Commission, 2023c). Due to the diversity of the requirements, these are clustered and evaluated below. A distinction is made between the areas of evaluation and assessment, the endorsement-or-production principle, the comply-or-explain principle, IFI monitoring and independence.

Evaluation and assessment

Referring to the IFI's core task, monitoring compliance with the country-specific fiscal rules and the EU's fiscal framework, the provision states that it should maintain the role of assessing compliance with the fiscal rules (European Commission, 2023c, Art. 8). However, the information it receives is notably expanded by Article 14: a problem inherent in the current mandate is that extensive lists of special funds and reserves from the federal and state governments are missing (Independent Advisory Board, 2023, 23). Since the *Länder* as well as the *Bund* continued to outsource credit authorisations into special funds outside of the core budget, the inclusion of those funds would be a step towards a comprehensive assessment of public finances. This would also be in line with the budget principles of annuality and maturity. According to the Commission's proposal, this should include past and expected future operations (European Commission, 2023c, Art. 14). If applied, this would lead to a more transparent view of public budgets. Under the impression

of the current outsourcing of spending activities from the core budget to extra budgets, this is also advisable. This would include, for example, the Climate and Transformation Fund, the Bundeswehr Special Fund or the Economic Stabilisation Fund at the federal level as well as the various Corona Special Funds and pension reserves at the state level. The Commission explicitly includes important fiscal policy instruments in the consideration of public finances.

Furthermore, even if a sunset clause is already implemented within the German debt brake, it has to be emphasised that the country-specific numerical rules should, under this proposal, be amended with a sunset clause if necessary (European Commission, 2023c, Art. 5). This would lead to first, a homogenisation of the existing rules across Europe, and second, a more cautious approach with regard to escape clauses.²

It is worth noting not only that the preparation and execution of its evaluation and assessment tasks are stated in Article 8, but also, that the Board should have the capacity to communicate their assessments in a timely manner. This refers to the reputational cost argument: if the Board concludes that the government does not comply with the rules, its only option is to execute its CoEP and to make its point of view public. However, if the Board does not have the resources to do so in a timely manner, then the only sanction mechanism that the Board has is considerably undermined. This also raises the question of whether the evaluation and assessment would be effective in the first place.

The most groundbreaking new role by far is established in section (f) of Article 8: The Commission wants the IFI to "conduct, on a regular basis, reviews of the national budgetary framework in order to assess the consistency, coherence and effectiveness of the framework, including mechanisms and rules that regulate fiscal relationships between public authorities across subsectors of general government" (European Commission, 2023c, 15). This is remarkable in the sense that this would cover not only the 17 national and sub-national fiscal rules, but also the fiscal relationship between the governmental sub-sectors as it is covered by the term "mechanism". This would, in principle, encompass the fiscal equalisation mechanism between the *Bund* and the *Länder*, its municipal equalisation mechanisms as well as funding outside of the equali-

² The German debt brake stipulates that the exemption must be established annually via the Budget Act. The implicit sunset clause is therefore annual in nature. The situation is different in the area of European fiscal rules. They do not contain a specific sunset clause. A repeal of the sunset clause must therefore be actively initiated (BMF, 2022; Tesche, 2023).

sation schemes, especially the direct financial aid, cash benefit laws as well as the joint agreements.

Although this would be restricted to a review function, its implications would be extensive. First, this would involve a massive expansion of the mandate. The possibility of also examining fiscal federal mechanisms gives the Board the option of examining German fiscal federalism in its entirety. Second, this includes, not least, the distribution of tasks, expenditures and revenues, since “consistency” and “effectiveness”, which are open to interpretation, are quite widely used. This opens the door to discussions of task and financial responsibilities (connexity principle) or, stated differently, the passive fiscal equalisation mechanism. In addition to distributive elements, the Board can therefore also address allocative and stability-oriented issues. Third, by opening up its mandate in this way, the Board can increasingly respond to public controversies, investigate them and express opinions. This gives the Board the opportunity to position itself strategically and to provide impetus to the debate. Its only lever, the exertion of public pressure, is thus greatly enhanced. Moreover, since the proposal speaks “a regular basis”, the Advisory Board can choose the periodicity of this new lever independently, giving it additional leeway.

Endorsement-or-production principle

The endorsement-or-production principle (EoPP) has a new and prominent role in the Commission proposal. It is used with regard to the annual and multiannual budgetary forecasts underlying the government medium-term planning, debt sustainability analysis as well as assessments concerning impacts of policies on fiscal sustainability (European Commission, 2023c, Art. 8). In the case of the German Advisory Board, the EoPP is not applied in its entirety yet, neither in the context of fiscal forecasts nor for budgetary planning (DG ECFIN, 2023). Moreover, the principle is not established in German law (StabiRatG, § 8; HGrG, § 51).

Concerning the proposed modifications of the governance architecture, changes in national legislation would be necessary to equip the Advisory Board with these new responsibilities. Since the Board or its tasks are not rooted in constitutional law, a simple majority is needed to change both national provisions. If it is the goal to establish an effective EoPP, changes in national legislation would be inevitable. Since the EoPP refers to three different fiscal areas, a serious evaluation would need to go hand in hand with a reform process covering a build-up of personnel, financial resources and know-how. In particular, if, for example, the EoPP were to be taken more seriously in the future, with respect to macroeconomic

financial projections, additional capacity and expertise will be needed for the preparation of the projections, their assumptions and technical details. Given that the build-up of resources takes time, the implementation of the EoPP would lead to a massive increase in requirements concerning the Stability Council and the Federal Ministry of Finance. The Advisory Board would have to opt for an endorsement policy without the necessary personnel to accurately perform the given set of new tasks. Given the time frame in which the Commission wants to put its proposal into practice, this would lead to a massive overload of the capacities of the Advisory Board.

Comply-or-explain principle

In addition to the EoPP, the CoEP might play a more stringent role. For instance, the period of time in which member states have to account accordingly will be limited to one month (European Commission, 2023c, Art. 8). If legally binding, this gives the Advisory Board further leverage to get the Stability Council to take a position. As this extends to all tasks to be assigned to the Board, it also covers issues regarding the fiscal-federal structure. In view of the fact that the Stability Council's objective is not only to monitor compliance with fiscal rules, but also to decide on restructuring procedures (StabiRatG, § 5), this extension of the Board's powers appears appropriate, for example, to prevent it from acting beyond its original mandate in the event of restructuring proceedings.

IFI monitoring

Interestingly, the Commission's proposal contains a new mechanism that would imply that the Board itself should be evaluated on a regular basis (European Commission, 2023c, Art. 8). Since its evaluators should be (financially) independent themselves, the list of institutions that could perform this task is considerably small. Nevertheless, the broad idea of an evaluation mechanism can be beneficial especially in the sense that a constant monitoring reduces the public impression of an unsupervised institution as an arbitrary agenda-setter. Furthermore, constant evaluation offers the possibility of a reinsurance channel regarding the question of whether the Board is fulfilling its tasks within its mandate.

Independence

The first section of Article 8 refers to the structural independence of IFIs. This is underlined by functional autonomy, which emphasises that IFIs are institutions independent of the budgetary authorities (European Commission, 2023c, Art. 8).

However, it is difficult to meet this requirement against the background of the budget. Since the Board has practically no downstream personnel resources for research and evaluation, it can only fulfil the tasks entrusted to it to a limited extent. Moreover, this is particularly relevant because the division of funds between the federal government and the *Länder* as a whole significantly limits the fiscal burden (DG ECFIN, 2023). Increased funding for the Board is therefore not dependent on the fiscal burden, but rather on the political will to provide the Board with the resources it needs to fulfil its tasks. In order to ensure constant management of the audit tasks, it would be appropriate to allocate the scarce resources to the institution and not the chair. However, this organisational task could be accomplished by a change in the Board's statute. This would also stand in line with the new Article 8 section 3(c) which states that the Advisory Board should have adequate and stable own resources to carry out their mandate (European Commission, 2023c, Art. 8). Apart from this organisational point of view, the question remains about whether the Board is able to fulfil its task without having the resources to do so. This stands in contrast to the idea of the proposed amendment.

As noted in Article 8, the selection of Advisory Board members must be presented in a transparent manner. This is done by detailing how many Advisory Board members each institutional unit may appoint. Paragraph 2 shows that competence and experience in the field of public finance, especially in its application, is of particular relevance for the appointment of the Advisory Board. This is considered necessary, particularly given the audit mandate.

Critical assessment and conclusion

The present paper discusses the Commission's proposal for a Council Directive amending Directive 2011/85/EU (European Commission, 2023c), which represents a milestone for the reform of the European governance framework in general and for the German IFI in particular. As has been shown, the German Independent Advisory Board is subject to various restrictions that effectively limit its work. If the proposed Directive were adopted, this could be partially remedied. Aside from the proposed innovations, however, it must be mentioned that there are two main cross-sectional problems that effectively limit the implementation of the envisaged reforms.

First, some provisions of the proposed amendment are subject to general interpretation and, consequently, also to national interpretation. For example, the phrases of "adequacy" or "timely" access to information are so vague that a potential functional loss of the proposed

amendment is to be expected. Accordingly, it could be argued on the part of the legislator that the new interpretative requirements are already considered, thus substantially limiting the intention of the Commission's proposal. The fact that this consideration could be taken into account is shown, for example, by the deadline in the CoEP being set at one month, which would provide additional room for manoeuvre vis-à-vis the Stability Council. While this circumstance is commendable, the structural underpinning with concrete formulations is not inherent in the Commission's proposal.

Second, although the regulation speaks of "adequate and stable resources", this is in the eye of the beholder. Whether the financial position of the Advisory Board will change, especially against the background of the extended mandate, is not to be expected so far. Therefore, this underlying problem, the resource allocation, must be addressed by federal and state governments independently from the EU. Momentarily, the capacities and competencies of the German Advisory Board – also in relation to its European neighbours – are expandable. Closely related to the question of financial resources is the question of additional personnel for the Advisory Board. Since here, too, there is only a vague reference to adequate and stable resources, there is no direct pressure on the legislature to make structural changes.

Thus, while the European Commission's innovations are well intentioned, their implementation remains dependent on factors that will be negotiated at the national level. Consequently, even if the Commission's proposal is adopted, this will not automatically lead to the improved resources that would be necessary for this new audit mandate. Bringing the resource endowment in line with the new reality requires that governments take note of the importance of a functional advisory board and provide it with appropriate resources. A detailed and comprehensive analysis of the general government budget is also in everyone's best interest.

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