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Medium-Term Budgetary Frameworks in the EU Member States

Monika Sherwood

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European Commission

Directorate-General for Economic and Financial Affairs

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Monika Sherwood

Abstract

Effective budgetary management requires medium-term planning, by which the horizon for fiscal policymaking is extended beyond the annual budget cycle. All EU Member States have some sort of a Medium-Term Budgetary Framework (MTBF) in place but these frameworks differ substantially across countries in terms of political commitment, planning horizon, coverage, level of detail, formulation of targets, exclusion of certain items, carryover arrangements and binding nature. The experience of the recent crisis shows that allowing for more flexibility in the design of the MTBFs might be warranted. This, however, should be accompanied by more transparency in adjusting of the budgetary targets and increased role for independent monitoring of government's fiscal policy and execution.

JEL Classification: H50, H60.

Keywords: Medium-Term Budgetary Frameworks, Budgetary Frameworks Directive, multiannual fiscal planning, fiscal rules, expenditure ceilings, budgetary targets.

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1. SUMMARY AND CONCLUSION

The essential role of medium-term budgetary frameworks (MTBFs) in the design and execution of fiscal policy has been acknowledged both by the literature and policymakers. Thus there has been growing focus on endowing budgetary planning with multiannual perspective as short-sighted approach came to be deemed as a poor instrument for fiscal policy management.

The growing realisation of the importance of looking at public finances from a medium-term perspective and the observed lack of such practice in a majority of EU Member States triggered introduction of appropriate provisions in the EU legislation, i.e. in the Stability and Growth Pact, the Six-Pack (more precisely, the Budgetary Frameworks Directive) and the Two-Pack. To a large extent in response to these legal requirements, vast majority of Member States either introduced their MTBFs for the first time or revamped them in the recent past.

The purpose of this paper is to stimulate a discussion on the most desirable features of MTBFs in the context of the peer review exercise. Therefore, it should not be regarded as a systematic assessment of national transposition of the relevant provisions of the Budgetary Frameworks Directive.

Since the EU legal provisions leave a significant margin of discretion in terms of their transposition into national legal order or practice, a plethora of models of MTBFs has been applied in the Member States. Looking at the experience of various countries, we arrive at the following conclusions regarding the discussed features of these frameworks.

Political commitment

National parliaments should play an important role in the preparation of multiannual budgetary planning documents. Their involvement in the process of adoption of these documents is crucial as it endows these targets with more weight and political commitment. It should also contribute to strengthening the connectedness between the medium-term plans and the annual budgets. Debating the medium-term targets in the national parliaments would also enhance their visibility in the budgetary process.

Planning horizon

There is not one-size-fits-all choice in terms of the length of the period covered by a medium-term budgetary planning document. The length set by the Budgetary Frameworks Directive, which calls for "a fiscal planning horizon of at least 3 years", appears a reasonable minimum. Whether it is sensible to extend the timespan for the targets beyond that period depends on the national context and in particular on the length of the electoral cycle (it is worthwhile mentioning that the Directive acknowledges the right of a new government that comes to power to revise the medium-term fiscal plans of its predecessor).

Coverage

Since national central authorities are held accountable for the budgetary outcomes of the whole general government according to the European fiscal governance framework, the widest possible coverage of the multiannual planning documents appears desirable. All expenditure under control of the central government (or other entities of the central administration) should be encompassed in the targets/ceilings. A comprehensive approach without leaving special entities outside the scope is recommended. There is also a case for comprehensively including national blocks of social security such as pensions. It is understood that including targets for finances of sub-national governments in such documents might not be possible or desirable because of constitutional arrangements or other country-specific factors. However, in such situations it is of utmost importance that the fiscal framework contains rules constraining fiscal planning of lower levels of government, such as balanced-budget rule, expenditure rule and/or debt rule.

Level of detail

There is no acknowledged best practice in term of the level of detail that a given expenditure ceiling should entail. The experience of various countries shows that both global and departmental expenditure ceilings (or a combination of the two) can constrain spending effectively. However, in order to provide for greater predictability for spending ministries some level of detail regarding the ceiling is recommended, while possibly accepting greater flexibility to rearrange priorities over time within sub-entities than would be allowed in the case of an overall ceiling.

Formulation of targets

The way in which the medium-term budgetary targets are formulated reflects the underlying fiscal rules in force in a given framework. The most commonly applied options are expenditure ceilings set either in nominal terms or as real growth rate. Inflation surprises risk distorting significantly a purely nominal framework's effectiveness by making it either too rigid when inflation overshoots or diminishing its stringency if inflation turns out substantially lower. In this context, setting targets in real terms is more conducive to fiscal control in a medium-term perspective.

Exclusion of certain items

An encompassing coverage is advisable in the light of sustainability considerations, though the controllability argument can justify restrictive exclusions (in particular unemployment benefits or interest payments). Alternatively such spending items should be kept under the ceiling, but be readjusted each year on the basis of the latest forecast of the underlying parameters. There should be clear rules, preferably laid out in legislation, according to which such readjustments would be carried out. It is also crucial to limit the list to items which are indeed difficult for the government to control. As noted above, as a rule expenditure on social security should be fully incorporated in the MTBF, so that allocation priorities can be decided over the whole spectrum of government policies, favouring growth-friendly and equitable choices.

Carryover arrangements

There are convincing arguments put forward to authorise government units to make use of unspent appropriations in the next budget year or the following years. This solution addresses the phenomenon commonly known as "December fever", when towards the end of the budget year ministries endeavour to spend all of their remaining appropriations for fear of losing them in the following year, which in turn distorts the picture of veritable needs and makes potential expenditure cuts more difficult in the future. Endowing frameworks with such flexibility yields more efficient use of budgetary resources. However, it is important to set limits to the accumulation of such reserves as otherwise such arrangements may somewhat diminish the stringency and predictive power of the framework.

Binding nature

The binding nature of MTBFs is arguably the most challenging dimension to assess. Hence, it should be rather regarded on a continuous scale taking into account ex-ante aspects (ease with which adjustments can be made, requirement to make such adjustment public etc.) as well as ex-post ones (correction mechanism, timespan for making up for past slippages). For a long time the most binding frameworks were praised for their role in enhancing fiscal discipline. The recent global crisis has made the matter more nuanced as the rigidity characterising some of the frameworks also came to light. The previously predominant unequivocal advocacy for the most binding frameworks is balanced by a call for more flexibility underpinned by economic rationale but at the same time equipped with sufficient degree of transparency. As mentioned above, ideally this flexibility would involve that:

- Items closely linked to the cycle and other special categories are kept under the ceiling but precise rules are established according to which these would be adjusted on an annual basis to the latest macroeconomic forecasts.
- The crucial aspects here are predictability of such adjustments and transparency of communicating them. Explanation for the adjustments should be publicly presented to the parliament and easily available to the general public and relevant stakeholders (e.g. online accessibility). This should include detailed comparison between the original and adjusted numbers and a justification as to how the latter ones have been arrived at.
- The role of the national fiscal councils in scrutinising such a process should be enhanced as they could leverage the reputational costs involved for the governments.

2. INTRODUCTION

It is generally acknowledged that effective budget management requires medium-term plans, as a single-year perspective gives fiscal policymakers a poor basis for strategic budgetary planning. In fact, most discretionary fiscal policy decisions have economic and budgetary implications which go well beyond the year in which they are taken. Therefore, fiscal policy decisions should be adopted in the context of medium-term budgetary frameworks (MTBFs), which offer a broader outlook on future implications of policy measures.

The concept of MTBF has evolved in both economic literature and policy environment. As regards the latter, the recent crisis has helped put medium-term fiscal planning on stronger ground by inserting key provisions into the EU law, in particular via the Six-Pack (Directive on requirements for the budgetary frameworks of the Member States) and the Two-Pack (Regulation on enhanced budgetary monitoring in the euro area). However, a minimalistic uptake of these provisions at national level may not necessarily guarantee an effective MTBF, thereby calling sometimes for additional country-specific features in terms of preparing and implementing multi-annual planning.

The purpose of this note was to inspire a debate on the most desirable features of an effective MTBF on the basis of experience observed in the EU Member States. In particular, it has been prepared as analytical support to the dedicated thematic peer review held under the aegis of the Alternates of the Economic and Financial Committee on 17 September. This note does not aim to rank Member States in terms of compliance with their frameworks or effectiveness thereof. Nor does it give an exhaustive review of all features of all Member States' MTBFs. The note rather points at various aspects of MTBFs in theory and practice in order to prepare the ground for a fruitful discussion and exchange of experience among the Member States. The conclusions from this debate could then be used in the national reflection on improving MTBFs and increasing their effectiveness in individual countries.

This paper is organised in the following way. Section 3 presents the definition of an MTBF and its rationale in the budgetary process. Section 4 tackles briefly typology of MTBFs pointing at their various features. Section 5 gives an overview of developments regarding MTBF-related provisions in the EU legislation. The aim of Section 6 is to illustrate the variety of MTBF models applied across Member States and thus it shows different MTBF options in terms of the length of the planning horizon, coverage, political commitment, level of details, formulation of targets, exclusion of certain items and binding nature.

3. DEFINITION OF MTBFs AND THEIR RATIONALE

Medium-term budgetary frameworks are generally understood as "*institutional policy instruments that allow the extension of the horizon for fiscal policy-making beyond the annual budgetary calendar*".⁽¹⁾ However, this definition is not as unambiguous as it might sound. There are at least two approaches to MTBFs. The former concept, a "procedural" one, considers the MTBFs as the structural sets of arrangements and procedures that preside over the production of multi-annual budgetary figures. The second approach, a more "quantitative" one, interprets the MTBFs as the set of figures itself, i.e. the "multi-year budget" or budget plan. The first approach is much more comprehensive as it looks at the overall "architecture" of the budgetary processes (actors, procedures and products), whereas the set of numbers constitutes just a part of the toolbox considered under the first approach. In order to avoid confusion between the two conceptual approaches, in this paper the notion of MTBF will be used when discussing aspects regarding mostly the procedures, rules, etc. and the notion of "medium-term planning documents" will be used to denote concrete sets of multi-annual budgetary plans.

One lesson learned from the latest crisis is that short-sighted approach to budgetary planning, usually limited myopically to the next year's horizon, is a poor instrument for fiscal policy management and can result in enormous strain on public finances and considerable sustainability risks. What has ensued is a renewed focus on giving the budgetary planning a medium-term orientation. This does not prevent the annual budget preparation from still being the centrepiece of the budgetary planning. However, most discretionary policy measures have an impact that goes beyond the annual cycle. Consequently, decisions on the expenditure side in particular should always be taken with the medium-term perspective in mind.

European Commission (2007)⁽²⁾ lists the following major benefits of using medium-term budgetary frameworks in fiscal planning:

- they enhance transparency of the medium-term budgetary objectives of the country, providing economic agents with information on the ongoing trends in public finances;
- they allow better time consistency in the conduct of fiscal policy;
- they help address the common pool problem of public resources which occurs when a group that benefits from a particular type of government spending or tax exemption does not bear the full cost of such measures;
- they constitute a better planning tool improving quality and stability of the decision-making process, facilitating implementation of structural reforms.

According to International Monetary Fund (2013)⁽³⁾, an MTBF can contribute to enhancing fiscal discipline by 1) showing a multi-year impact of planned measures, 2) issuing early warning about the lack of sustainability of existing policies and 3) setting binding multiannual expenditure ceilings. OECD (2014a)⁽⁴⁾ points to the importance of medium-term budgetary planning, particularly in the cases where: 1) capital projects with changing operational costs are implemented; 2) programmes come into effect toward the end of the year and their full annual costs are not materialising in the initial year; 3) programmes' spending implications are not visible in the given year but would become so in the following years.

⁽¹⁾ Based on European Commission, Directorate-General for Economic and Financial Affairs (2007), "Public Finances in EMU – 2007"

⁽²⁾ European Commission (2007), "How to stick to medium-term budgetary plans" chapter in "Public Finances in EMU"

⁽³⁾ IMF (2013), "Public Financial Management and Its Emerging Architecture", editors M. Cangiano, T. Curristine and M. Lazare

⁽⁴⁾ OECD (2014a), "Medium-term expenditure frameworks" in "Budgeting Practices and Procedures in OECD Countries", OECD Publishing

4. DEFINING FEATURES OF MTBFs

MTBF models applied across the EU differ fairly substantially in their various aspects from one country to another. This section provides a brief description of structural features differentiating among MTBFs, whereas a more detailed overview of MTBFs in the EU Member States follows in Section 6.

To begin with, the level of *political commitment* involved in an MTBF differs across countries. Typically it is the government that adopts a medium-term fiscal plan. In some cases it then sends it to the national parliament either for information or debate. Subsequently parliaments of some countries formally adopt such plans (sometimes in the form of a law), but very often such parliamentary adoption does not take place.

MTBFs encompass *planning horizons* of different lengths. Up until recently some Member States adopted fully-fledged budget laws encompassing two consecutive years (e.g. Slovenia), considering them as their MTBFs as indeed the budgetary perspective was longer than one year. However, a vast majority of MTBFs cover a period of three or four years. Most of the medium-term planning documents are produced on a rolling basis whereby a new outlying year is added every year, similar to the approach adopted in the Stability and Convergence Programmes. However, there are countries where the planning documents cover a fixed period of time beyond the budget year, i.e. they are not being extended by one year on an annual basis. This timespan usually coincides with the term of an elected government.

Another defining feature is the *coverage* in terms of general government sub-sectors. A vast majority of MTBFs encompass almost the whole general government, but the coverage of the medium-term planning documents tends to be narrower. Including all sub-sectors in the MTBF makes it a much more effective instrument in striving to ensure respect of budgetary objectives for the general government for which in the EU the central government is held accountable. However, given the country-specific system of relations between the layers of government, the inclusion of local governments in the national medium-term planning documents is not always possible.

Member States apply different *level of detail* in the formulation of targets/ceilings under their MTBF, which typically reflects the formulation of the underlying fiscal rules in force. Some countries content with setting one global expenditure ceiling whereas other adopt separate ceiling at the level of ministries. Typically, ceilings set at departmental level are endowed with greater flexibility than the global ceilings, which allows better allocation of resources.

Formulation of targets in the medium-term planning documents takes various forms. Such ceilings are usually expressed as nominal level of expenditure, real growth of expenditure or expenditure as percentage of GDP. There are trade-offs between these options in terms of the ease of the monitoring on the one hand and predictability on the other.

There are arguments for *exclusion of certain items* from the ceilings and Member States vary to some extent in terms of the choice of such spending categories. The most common exclusions concern interest payments and cyclically-sensitive expenditure, in particular unemployment allowances.

Some Member States introduced into their frameworks *carryover arrangements* whereby government units are authorised to make use of unspent appropriations in the next budget year or the following years. These arrangements differ across countries in terms of the proportion of the original appropriation which can be accumulated as well as the time horizon for which it can be "stored".

Box 4.1: Selected studies on medium-term budgetary frameworks

A number of studies looking into the design and effectiveness of national medium-term budgetary frameworks were published over the recent past. Some of them focus on one country, whereas other present comparisons between various models. These studies identify a broad range of aspects necessary for MTBFs to be successful in enhancing fiscal discipline.

Ljungman (2007)¹, looking at the Swedish framework, states that for an MTBF to be effective, it needs to be integrated into all aspects of the budget process. The paper puts the emphasis on the importance of building a capacity to produce accurate macroeconomic and budgetary forecasts, facilitated by the introduction of an integrated computerised budget management system.

IMF (2008)² ventures out to identify features of most effective frameworks looking at the examples of seven industrialised countries³, out of which four EU Member States. In this context the study stresses the role of transparency and public clarity of the medium-term fiscal frameworks. It shows the importance of introducing the MTBF as a part of a broad-based budgetary reform and of building a strong track record early on to gain credibility. The paper also advocates basing MTBFs on analysis of long-term sustainability. It demonstrates as well that during the years 1998-2007 most countries with MTBFs had stronger fiscal balances that could have been expected given their GDP growth. However, the study acknowledges that it is difficult to isolate the effects of institutional arrangements from other factors.

Boije (2012)⁴, discussing the Swedish experience with medium-term budgetary planning, stresses the essential role of political commitment to the MTBF. It points to the fact that some countries, which theoretically had had a strong fiscal framework, fared badly during the recent crisis as there was not enough resolve on the part of the fiscal authorities to respect the budgetary rules in force.

IMF (2013)⁵ presents another batch of lessons from the experience of advanced economies with MTBFs. According to the study, in order to succeed, multiyear budgetary planning requires existence of sound fiscal institutions and needs to be connected with annual budgets in a credible way, based on prudent macroeconomic forecasts, guided by stable, transparent fiscal objectives and integrated into a comprehensive top-down budgetary process. The paper states that binding MTBFs are more effective in enhancing fiscal discipline than indicative ones and that in the wake of the crisis, it was easier for countries with binding MTBFs to convince markets of the credibility of their fiscal consolidation plans.

Based on the analysis of MTBFs of its member countries, OECD (2014a)⁶ comes with the following list of elements which are required for an MTBF to be effective: i) prudent forecasting of expenditure and revenue; ii) incentives for ministers to underspend; iii) possibly widest coverage of the MTBF; iv) keeping it simple; v) compliance must be a binding consideration in the design of sectoral policies; vi) deviations from the set ceilings should be reconciled in a transparent way every year.

¹ Ljungman G. (2007), "The Medium-Term Fiscal Framework in Sweden" in OECD Journal on Budgeting

² IMF (2008), "Medium-term budgetary frameworks – Lessons for Austria from international experience"

³ Australia, Canada, Denmark, New Zealand, the Netherlands, Sweden and the United Kingdom

⁴ Boije R., and Kainelainen A. (2012), "The importance of fiscal policy frameworks – Swedish experience of the crisis" in "Rules and Institutions for Sound Fiscal Policy after the Crisis", Banca d'Italia

⁵ IMF (2013), "Medium-term budgetary frameworks in advanced economies: objectives, design and performance" chapter in "Public financial management and its emerging architecture"

⁶ OECD (2014a), "Medium-term expenditure frameworks" chapter in "Budgeting Practices and Procedures in OECD Countries", OECD Publishing

The MTBFs differ across countries in terms of their *binding nature*, i.e. the extent to which the plans prepared on the basis of them constrain the budgetary process. Arrangements applied in Member States imply various degrees of connectedness between the multiannual budgetary targets and the preparation of the annual budgets. Here the options range from the obligation of preparing an annual budget strictly respecting the medium-term projections to the situation where the annual budget can deviate from the MTBF and where the latter is treated only indicatively. A very small number of countries effectively base

their frameworks on the presumption that the agreed set of targets/ceilings will not be changed during the applicable period. Another group of countries allow changes to the set numbers but only under certain conditions which are defined in a more or less stricter way. In the most non-committal option, the planned targets are perceived as purely indicative and their change does not even require a public justification.

5. EVOLUTION OF PROVISIONS CONCERNING MTBFs IN THE EU LEGISLATION

The growing realisation of the importance of endowing budgetary planning processes with a medium-term perspective gradually found its reflection in the legislation at the European level. The introduction of appropriate provisions into the EU law was triggered by the observation that only a very limited number of Member States practiced genuine multiannual budgeting and execution. The new provisions were meant to encourage Member States to apply these concepts to their national planning processes.

5.1. STABILITY AND CONVERGENCE PROGRAMMES

Since 1998, in accordance with Regulation (EC) No 1466/97 also known as the preventive arm of the Stability and Growth Pact, EU Member States are obliged to present to the Commission on an annual basis (initially in the autumn and subsequently from 2010 by end of April) their medium-term budgetary plans contained in their Stability Programmes (for euro area Member States) or Convergence Programmes (for non-euro area Member States). More specifically, Member States are obliged to present, among other things, information on their medium-term budgetary objective and the adjustment path towards it, the expected path of the general government debt ratio, the planned growth path of government expenditure, including the corresponding allocation for gross fixed capital formation, the planned growth path of government revenue at unchanged policy and a quantification of the planned discretionary revenue measures. Subsequently, the Commission produces an assessment of the programmes, which is currently made public within the framework of the European Semester.

There is copious evidence that the plans presented in the Stability and Convergence Programmes (SCPs) were in many instances not executed as envisaged⁽⁵⁾. This suggests that the link between the annual budgets and these programmes has been weak. Arguably the programmes were perceived more as an imposition from the EU level than as a genuine instrument of national fiscal policy making. In other words, the national ownership of the fiscal projections presented in these programmes has been missing to some extent.

5.2. BUDGETARY FRAMEWORKS DIRECTIVE

The lack of ownership of SCPs pointed to the need to anchor the production of medium-term budgetary plans in the national context. This need was addressed by the Six-Pack adopted in November 2011 and in particular by the Council Directive 2011/85/EU on requirements for budgetary frameworks of the Member States (henceforth "Budgetary Frameworks Directive"), which acknowledges the instrumental role of MTBFs in ensuring that Member States' budgetary frameworks are consistent with the EU legislation and calls for the Member States to have in place, among other things, such frameworks at national level by 31 December 2013.

The directive follows mainly the "procedural" approach referred to before and expressly defines an MTBF as **a specific set of national budgetary procedures that extend the horizon for fiscal policy-making beyond the annual budgetary calendar, including the setting of policy priorities and of medium-term budgetary objectives.**

According to Article 9(1), "*Member States shall establish a credible, effective medium-term budgetary framework providing for the adoption of a fiscal planning horizon of at least three years, to ensure that national fiscal planning follows a multiannual fiscal planning perspective*". Furthermore, the directive

⁽⁵⁾ European Commission (2014), "Planning versus implementation: why are medium-term budgetary targets not always respected?" chapter in "Public Finances in EMU"

introduces a list of items for the production of which there should be dedicated procedures in place. This list includes:

- comprehensive and transparent multiannual budgetary objectives in terms of the general government deficit, debt and any other summary fiscal indicator such as expenditure, ensuring that these are consistent with any numerical fiscal rules;
- projections of each major expenditure and revenue item of the general government with more specifications on the central government and social security level, for the budget year and beyond, based on unchanged policies;
- a description of medium-term policies envisaged with an impact on general government finances, broken down by major revenue and expenditure item, showing how the adjustment towards the medium-term budgetary objectives is achieved compared to projections under unchanged policies;
- an assessment as to how in the light of their direct long-term impact on general government finances, the policies envisaged are likely to affect the long-term sustainability of the public finances.

Importantly, Article 9(3) requires Member States to base their budgetary projections on realistic macroeconomic and budgetary forecasts. Article 10 asserts the critical link between the medium-term perspective and the annual budgeting in that Member States should make sure that their annual budgets are consistent with multiannual fiscal planning stemming from the national medium-term budgetary frameworks and any deviations should be duly explained. Finally, Article 11 refers to the possibility for a new government taking office to "*update its medium-term budgetary framework to reflect its new policy priorities*", from which one can infer that in this particular case the MTBF also concerns the set of medium-term fiscal parameters and not only the underlying procedures to arrive at those numbers.

5.3. TWO-PACK

In order to enhance the coordination of the formulation of fiscal policy strategies by the euro area Member States, Article 4 of the Two-Pack Regulation 473/2013 adopted in May 2013⁽⁶⁾ introduced the notion of a common budgetary timeline, covering the preparation of both the national medium-term fiscal plans and the annual budgets. Euro area Member States are thus required to make public every year their national medium-term fiscal plans (NMTFPs) at the same time as their Stability Programmes and National Reform Programmes, preferably by 15 April and no later than 30 April. Although the Regulation does not explicitly state it, the publication of the NMTFPs at the same time as the Stability Programmes should promote a wider domestic debate on the medium-term direction of fiscal policy and possibly a higher involvement of national parliaments, aiming to reinforce the emphasis on national ownership of fiscal policymaking heralded by the Budgetary Frameworks Directive.

The NMTFPs are documents laying down the national fiscal strategy "*in accordance with the medium-term budgetary framework*" defined by the Directive. The Regulation requires that NMTFPs contain at least the information required for the Stability Programmes (and in fact they can be the same document⁽⁷⁾) and include information on how the reforms and measures set out are expected to contribute to the targets and national commitments established within the framework of the Union's strategy for growth and jobs. Their content should be consistent with the framework for economic policy coordination in the context of the annual cycle of surveillance. Additionally, indications on the expected economic returns on non-

⁽⁶⁾ Regulation (EU) No 473/2013 of the European Parliament and of the Council of 21 May 2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area.

⁽⁷⁾ In 2015 almost all of the euro area Member States submitting SPs used them as well as their NMTFPs.

defence public investment projects that have a significant budgetary impact should be included either in these NMTFPs or in the National Reform Programmes.

On top of the provisions regarding the timing of submission of the key documents in the national budgetary processes, Article 4(4) requires the euro area Member States to base their NMTFPs and annual budgets on independent macroeconomic forecasts. The Member States should also indicate whether the budgetary forecasts have been produced or endorsed by an independent body. All such forecasts should be made public.

6. MTBFs IN THE EU MEMBER STATES

MTBFs are not a completely new invention inspired by the recent crisis. As a matter of fact, in some countries they have already been operational for decades. The German Financial Plan of the Central Government has been prepared on the basis of the 1967 Act to Promote Economic Stability and Growth⁽⁸⁾. The medium-term planning perspective has been applied in various forms in budgetary processes in the UK since the 1960s⁽⁹⁾. Italy passed legislation on introducing medium-term budgetary planning aspects in 1988⁽¹⁰⁾. Finland, the Netherlands and Sweden introduced the medium-term perspective into the process of budgetary planning in mid-1990s. In Finland and Sweden this happened in response to a severe economic and financial crisis, which in turn made the introduction of the MTBFs easier as benefits of enhanced fiscal discipline appeared even more evident given the circumstances and there was a high political willingness to adopt them. In the Netherlands, the main motivation for extending the budgetary planning horizon beyond one year was the realisation that expenditure was growing at unsustainable pace and that tax cuts could only be possible if the expenditure growth was reined in.

The growing consensus on the desirability of adding the multiannual dimension to budgetary planning inspired other five EU Member States (Austria, Estonia, France, Poland and Slovakia) to introduce brand new MTBFs into their practice/legal order or substantially upgrade the existing arrangements in the 2000s. The process was then accelerated by the adoption of the Budgetary Frameworks Directive, which obliged the Member States to have such frameworks in place by the end of 2013, and subsequently by the entry into force of the Two-Pack. Intense activity ensued across the EU Member States and developments linked to strengthening the medium-term planning dimension of fiscal policy are illustrated in the Commission-managed database of Fiscal Governance in EU, more specifically in the MTBF index presented in Graph 6.1. The index captures the connectedness of the MTBFs with annual budgets, involvement of national parliaments in the preparation of MTBFs, coordination mechanisms between the levels of government prior to setting an MTBF as well as monitoring and enforcement of multiannual budgetary targets (see Annex 1 for more details). At the time of writing, the process of introducing/reforming the MTBFs according to the standards established by the new EU fiscal governance framework has not been completed yet as a small number of Member States are still in the process of preparing/adopting legislation transposing the budgetary frameworks directive into their legal order.

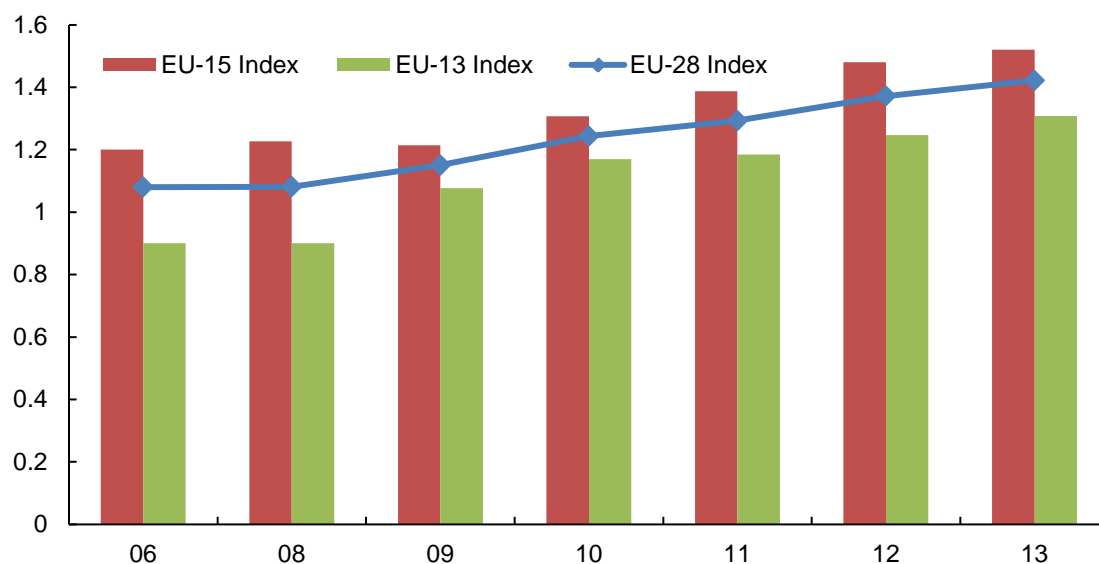
At first glance, without pre-empting the formal assessment of the Directive transposition which is currently being carried out by the Commission, one can conclude that medium-term budgetary planning is now in place to at least some extent in all EU Member States. However, since the Directive only sets the general requirements for such frameworks and is not prescriptive on details of their arrangements, a variety of solutions reflecting national administrative settings and political preferences has been applied. First, from the formal point of view, MTBFs differ in that some Member States (Belgium, Hungary, Ireland and Spain) have medium-term budgetary procedures in place that result in the production of solely Stability or Convergence Programmes that all EU Member States are obliged to submit annually, whereas in other Member States a country-specific multiannual document is produced alongside the Stability or Convergence Programme. Second and more important, in terms of substance, MTBFs differ quite significantly from one country to another in terms of their various features as it will be showed here below: 1) political commitment, 2) planning horizon, 3) coverage, 4) level of detail, 5) formulation of targets, 6) exclusion of certain items, 7) carryover arrangements, and 8) binding nature.

⁽⁸⁾ OECD (2014), "Budget Review: Germany", OECD Journal on Budgeting, Issue 2

⁽⁹⁾ IMF (2011), "United Kingdom: Four Chancellors Facing Challenges" chapter in "Chipping away at public debt" edited by P. Mauro

⁽¹⁰⁾ IMF (2011), "Italy: Medium-Term Fiscal Planning under Frequent Government Changes" chapter in "Chipping away at public debt" edited by P. Mauro

Graph 6.1: The MTBF index



Source: DG ECFIN Fiscal Governance Database

With the wave of MTBF reforms that have recently been introduced as part of the broader overhaul of national fiscal frameworks in the EU, generally speaking the MTBF landscape is still evolving. The new or upgraded MTBFs should be allowed to operate for several years before a meaningful conclusion as to their actual impact on fiscal outcomes can be drawn. Therefore, at this stage the analysis is still dominated by design issues while punctually providing some considerations on the extent to which Member States respect their own MTBFs.

6.1. POLITICAL COMMITMENT

The level of political commitment associated with an MTBF fluctuates across countries. There is a presumption that active involvement of parliaments gives more weight to the plans set within the MTBFs. In particular, adopting these plans in the form of laws should exercise additional pressure on the policymakers to respect these targets/limits. However, in majority of the EU Member States it is the government that adopts a medium-term fiscal plan and sends it to the parliament either for information or debate, which is typically not followed by a parliamentary vote on these projections. Nevertheless, there is a group of countries (Austria, the Czech Republic, France, Greece, Latvia, Lithuania, Luxembourg, Romania, Slovenia, Sweden and the United Kingdom) where such parliamentary adoption does take place. In Italy, the parliament issues an opinion on the medium-term budgetary plans.

6.2. PLANNING HORIZON

There is a certain variety in terms of the time period covered by MTBFs in different countries. An obvious trade-off exists between the length of the period covered and the stability of the plans set. On the one hand, a longer time horizon presents the benefit of giving a broader picture of public finances in the medium term, but on the other hand, the reliability of the underlying forecasts increasingly diminishes in the outer years of the period covered.

The EU fiscal governance framework has set a minimum as regards the time span of an MTBF. Specifically, the Budgetary Frameworks Directive obliges the Member States to have in place MTBFs "*providing for the adoption of a fiscal planning horizon of at least three years*". Having reviewed this particular aspect across the EU, it appears that a vast majority of the country-specific MTBFs cover a period of three years, i.e. from t+1 to t+3. Furthermore, in quite a number of Member States the budgetary authorities are obliged to present plans for the coming four years (Austria, Denmark, Estonia, Finland, Germany, Greece, Italy, Luxembourg, the Netherlands and Portugal). In Belgium and France, even though the minimum requirement is a three-year period, in practice plans encompass longer timespans.

Most of the medium-term planning documents are produced on a rolling basis whereby a new outlying year is added every year, similar to the approach adopted in the SCPs. However, in some cases (Finland, the Netherlands and the United Kingdom) the planning documents cover a fixed period of time beyond the budget year and they are not being extended on a rolling basis. This timespan usually coincides with the term of an elected government, which typically entails stronger ownership and greater willingness on the part of the policymakers to respect the fiscal plans for which they took political responsibility. The French model can be considered as partly fixed as the period of the plans is being extended only every other year and not on an annual basis. Latvia uses a rolling model on an annual basis, but the legislation envisages the possibility of skipping a year, i.e. not producing a new version of the plans extended by one year in order to address the situation of an outgoing government.

6.3. COVERAGE

Coverage in terms of general government and its subsectors is an essential defining feature of MTBFs. National central authorities are held accountable for the budgetary outcomes of the whole general government under the European fiscal governance. Hence, including finances of sub-national authorities in the MTBFs should make it easier for central governments to keep control over the global budgetary execution.

An inclusive budgetary planning approach finds explicit backing in the Budgetary Frameworks Directive, which calls upon the Member States to include in their MTBFs "*procedures for establishing [...] comprehensive and transparent multiannual budgetary objectives in terms of the general government deficit, debt and any other summary fiscal indicator such as expenditure*". All Member States provide information on such objectives on a regular basis in their SCPs. However, the coverage of the general government sub-sectors in the national planning documents prepared within the country-specific MTBFs varies across countries. About three quarters of the Member States produce, on the basis of their MTBFs, national planning documents that encompass the entire or nearly the entire general government. In other countries, for various reasons it is either not possible or not desirable to extend the scope of the multiannual fiscal planning documents to sub-national governments. However, in such cases these documents should be looked at in conjunction with other elements that can be regarded as part of the given country's MTBF. For example, in Austria the periodical Federal Budgetary Framework Law sets ceilings for the central government expenditure and number of personnel. However, by law it is accompanied by a strategy report that presents budgetary objectives for the entire general government, which in turn are prepared in accordance with the Austrian Stability Pact, which sets out fiscal rules binding all sectors of government. In Germany, while the Stability Programme includes the financial plans of all levels of government and therefore presents the national medium-term fiscal plan according to the Two-Pack, the Financial Plan presents solely the fiscal outlook of the central government, but is then followed by a presentation in a monthly bulletin of the Ministry of Finance of the budgetary objectives for all sectors of the general government set in line with the debt brake providing for fiscal targets for all levels of government. In Sweden, the medium-term expenditure ceilings regard only the central government and the pension system but the sub-national governments are bound by a balanced-budget rule for local governments. Furthermore, a surplus target is set for general government net lending.

6.4. LEVEL OF DETAIL

The level of detail presented in the national medium-term planning documents differs substantially across countries, depending in particular on the formulation of the underlying fiscal rules contained in the MTBFs. Most common are various combinations of the structural balanced budget rule, expenditure rule and debt rule, applied either to the general government or a subset thereof. Since governments have much more control over the expenditure side of the budget than over the revenue one, MTBFs and the national budgetary planning documents produced in accordance with them typically hinge on some form of expenditure restraint as a means to respecting the other rules in force. Revenue forecasts are typically also presented in the planning document itself or in an accompanying one, but usually the reining in of expenditure is the guiding principle of the framework as expenditure rules are perceived as the most "operational" tools in the hands of the policymakers.

Here are some examples which seek to illustrate the level of detail observed in the planning documents. Sweden and Finland put emphasis on setting global expenditure ceilings for the central government. In the Netherlands, next to an expenditure ceiling for the central government, there is a separate one for the social security system and another one for the healthcare system. The Danish framework sets two sub-ceilings for the central government (operating expenditure and income transfers), one ceiling for municipalities (net operating expenditure) and two sub-ceilings for regions (healthcare and regional development). Some national budgetary planning documents present both the revenue and the expenditure side in a quite detailed way, either mimicking or constituting the Stability/Convergence Programme (e.g. Hungary, Italy, Malta, Poland, Spain). In Cyprus, Greece, France, Ireland and the UK, medium-term expenditure ceilings are set also at ministerial level. In some Member States more detailed ceilings are set for the first years of the framework and less detailed ones are decided on for the outer years. For example, Austria sets ceilings for the central government expenditure grouped in five budgetary headings that are binding for the whole duration of the four year period while the accompanying sub-heading ceilings are only binding for the following year. France sets global expenditure ceilings for all general government sectors for a five-year period and ceilings for central government expenditure broken into 30 sub-components for a three year period.

6.5. FORMULATION OF TARGETS

There is also a variety of ways in which Member States set the expenditure ceilings underpinning their frameworks. These ceilings are usually expressed in one of the following forms: 1) nominal level of expenditure; 2) real growth of expenditure or 3) expenditure as percentage of GDP. All of these options have their pros and cons. Setting expenditure ceilings in nominal terms (e.g. in Austria, Cyprus, the Czech Republic, Denmark, Sweden and the United Kingdom) or as ratio to GDP (e.g. Croatia) endows the framework with a high degree of transparency allowing, in most cases, straightforward monitoring. However, the in-built rigidity of the nominal targets might contribute to pro-cyclicality of the policy conducted by the government striving to respect the set limits in spite of macroeconomic surprises. Expressing the expenditure limit as percentage of GDP confers the policymakers with a difficult task of controlling in real time a ratio over which they do not have enough control and involves an additional pro-cyclical adjustment due to the denominator effect. Alternatively, defining the ceilings in terms of real expenditure growth (e.g. Finland, the Netherlands and Poland) gives the framework more flexibility albeit admittedly diminishing its simplicity and transparency as the ceilings need to be converted each year into nominal terms using various, sometimes complex, parameters⁽¹⁾. However, since such a solution gives the government more control of the targets in comparison to the other options, setting ceilings in terms of

⁽¹⁾ In Finland each year the ceiling for t+1 is converted into nominal terms taking into account several indexes considered relevant in each case (e.g. Building Cost Index for transport infrastructure expenditure). This bottom-up approach differs from the Dutch system in which the overall ceiling is converted into a nominal figure by using only one deflator.

real growth of expenditure seems to be the most effective operational tool in restraining expenditure in the medium-term perspective.

The thinking above inspired the introduction of the expenditure benchmark at the European level (for more details please see Box 6.1), which aims at keeping growth of real general government expenditure at the level of or below (depending on the initial distance to the MTO) the medium-term reference rate, defined as potential GDP growth averaged over 10 years (from t-4 to t+5).

Box 6.1: The expenditure benchmark

The first pillar of the preventive arm, the structural balance, has been at the core of the budgetary surveillance since the 2005 reform of the Stability and Growth Pact. It envisaged that the position of the structural balance of EU Member States is assessed against a country-specific Medium Term Objective (MTO), i.e. the balanced budget which ensures a buffer against bad economic times and covers ageing cost over the medium-run, while avoiding pro-cyclical economic policy in good times. However, monitoring the structural balance only gives a partial view of public finance imbalances as it does not provide a comprehensive overview of expenditure dynamics. Indeed, in this first pillar, public expenditures are expressed as a share of potential GDP. Their share remains constant if expenditures grow in line with potential GDP, diminishes if expenditures grow below potential GDP and increases if expenditures grow faster than potential GDP.

The "Six-Pack reform" of the Stability and Growth Pact introduced in 2011 added a second pillar to the preventive arm, which aims at putting the dynamic of public expenditures at the center of the budgetary surveillance. The first reason for this reform is that, over the long run, only expenditure trends can be controlled by the government. Therefore, it is of core importance in a context where sustainability of public finances can be at risk. The second reason is to create an alternative indicator to the structural balance. Indeed, this one can be affected by tax windfalls/shortfall and depends on the output gap which cannot be directly observed.

The rationale of the expenditure benchmark derives from the necessity to contain the growth rate of government spending at (or below) the medium-term potential growth of the economy, unless the excess is matched by discretionary revenue measures. This is why reference is made in the regulation, to a '*net* growth rate of government expenditure', i.e. a growth rate that is net of discretionary measures. The computation of the expenditure aggregate in a given year also reflects the need to capture what is under the strict control of government. Therefore, public expenditures aggregate is recalculated. Public expenditures are netted from the cyclical part of unemployment expenditures and interest expenditures which are not considered to be discretionary expenditures. Moreover, expenditures matched by EU funds are also removed as they are not funded by the general government. Finally, public investment is smoothed over four years in order to avoid peaks related to the public investment cycle.

According to Art. 5(1) and 9(1) of Regulation 1466/97, annual expenditure growth of Member States that have attained their MTOs should not exceed a reference medium-term rate of potential GDP growth, unless the excess is matched by discretionary revenue measures. For Member States that have not yet attained their MTO, annual expenditure growth should not exceed a rate set below the reference medium-term rate of potential GDP growth, unless the excess is matched by discretionary revenue measures. As described in the Code of Conduct, overachievement of the MTO allows deviations from the expenditure benchmark not to be considered significant as long as the MTO is not jeopardised over the programme period, taking into account the possibility of significant revenue windfalls.

The computation of the reference rate for potential growth requires a decision on the relevant time horizon, which corresponds to the concept of the medium-term. To be appropriate, this time horizon should be long enough not to be biased by short term fluctuations in growth while being short enough to remain policy relevant. The reference rate is calculated as the 10 year average of real potential GDP growth, including both a backward looking (t-4 to t) and a forward looking component (t to t+5). Intuitively, this ensures that the Member State remains at the MTO. It is revised on a yearly basis.

The difference between the reference rate of Member States at their MTO and Member States not yet at their MTO is known as 'convergence margin'. The size of the convergence margin is country-specific and depends on the share of government primary expenditures expressed in terms of GDP as well as on the size of the structural effort, in order to ensure consistency with the first pillar – i.e. the structural balance.

6.6. EXCLUSION OF CERTAIN ITEMS

The medium-term budgetary planning documents prepared within the MTBFs often exclude a number of budgetary items for a variety of reasons, which has its pros and cons. Broader coverage is favourable in the light of sustainability considerations, but the controllability argument calls for exclusion of certain elements from such frameworks⁽¹²⁾. For example, while some views strongly favour excluding capital expenditure as it is presumed to be the most supportive to growth in the long term, the counter argument goes that poor judgement applied to capital expenditure can also eventually lead to unsustainability of public finances. Arguments are also put forward for excluding interest payments and cyclically-sensitive items (such as unemployment benefits) as their magnitude is not under the direct control of governments⁽¹³⁾. However, there is a counter argument that the economic cycle takes its toll mainly on the revenue side.

Member States apply a plethora of solutions in terms of exclusion of certain items from the medium-term fiscal planning documents. Some indeed exclude cyclically-sensitive items such as interest payments on public debt (e.g. the Netherlands, Sweden and the United Kingdom) or unemployment benefits (e.g. the United Kingdom), or interventions in the financial system (e.g. the Netherlands). Sometimes a more nuanced approach is pursued. For example, in Finland, cyclically-sensitive expenditure (such as interest payments and unemployment benefits) is excluded from the ceiling, but increases in cyclical spending due to changes in the eligibility criteria or regulation of some social benefits are included. In the Netherlands, normally unemployment expenditure falls under the ceiling, but for pragmatic reasons this item was excluded from the limit during the recent economic and financial crisis.

Some Member States have opted for having binding ceilings even on the cyclically-sensitive expenditure items and other special categories of expenditure but these ceilings are more flexible than those regarding other types of spending. For example in Ireland, cyclically-sensitive areas (in particular unemployment-related) and "certain other expenditure categories" are not excluded from the scope of expenditure ceilings, but they must be revisited each year in the light of updated economic forecasts. They are ring-fenced in the sense that if the final outturn is smaller than the allocated appropriation, the difference accrues to the Exchequer and cannot be shifted to fund other non-cyclically sensitive items. If in turn the final outturn is higher than the original allocation, the parliament votes on a "supplementary estimate". The payments for funding projects co-financed by the European funds are subject to the same rules⁽¹⁴⁾. Austria applies flexible ceilings for cyclically-sensitive items and some other special categories. Expenditure ceilings are divided into fixed (encompassing about 80% of total expenditure) and flexible (for the remaining 20%). A special regulation adopted by the Minister of Finance defines areas for which flexible ceilings are to be set. They concern, *inter alia*, areas which depend on cyclically-sensitive expenditure such as unemployment benefits, giving the government scope for manoeuvre during economic downturns. The flexible ceilings are determined on the basis of certain pre-defined indicators contained in regulations adopted by the Minister of Finance.

Finland and Sweden apply another solution to deal with unforeseen cyclical developments as they provide for an additional safety valve in the form of a budgeting margin. The expenditure ceiling set for the central government includes a buffer to be used for expenditure arising from unforeseen cyclical factors and inflation. As uncertainty increases with the length of the time horizon, smaller margins are set for the year(s) closer to the current budget years and bigger margins are allowed in the outer years. For example, in Sweden the budgetary margin amounts to 1% of the forecast expenditure for the year t , 1.5% for $t+1$, 2% for $t+2$ and 3% for $t+3$ respectively. Such a budgetary margin endows the framework with a certain

⁽¹²⁾ IMF (2015), "Expenditure Rules: Effective Tools for Sound Fiscal Policy", Working Paper

⁽¹³⁾ Ayuso-i-Casals (2012), "National Expenditure Rules – Why, How and When", European Commission European Economy, Economic Papers, 473

⁽¹⁴⁾ Irish Department of Finance (2013), "Medium-term budgetary framework"

degree of flexibility. However, it seems important to stress that the size of the margin should remain relatively modest as otherwise the stringency of the framework could be compromised.

6.7. CARRYOVER ARRANGEMENTS

There are convincing arguments put forward to authorise government units to make use of unspent appropriations in the next budget year or the following years. This solution addresses the phenomenon commonly known as "December fever", when towards the end of the budget year ministries endeavour to spend all of their remaining appropriations for fear of losing them in the following year, which in turn distorts the picture of veritable needs and makes potential expenditure cuts more difficult in the future.

Indeed, some Member States allow the carry-over of unspent appropriations in the following budget year(s) but as in other aspects of the MTBFs, there is quite a multitude of arrangements across countries. For example, in Estonia the State Budget Act allows government units transferring part of unused resources from one annual budget to the next year's budget but it sets the limit for such carryovers at 3% of the total expenditure with the exception of investment projects and co-financing of projects partly funded by the EU, for which all unused amounts can be transferred to the following year. In Ireland, subject to approval by Minister for Public Expenditure, departments are allowed to carry over savings against original estimates from one year and thus increase the current expenditure ceilings for the next year. They can carry over: a) 100% of savings up to 2% of the gross current allocation, b) 2/3 of their savings from 2% to 6% of the gross current allocation (with the remainder accruing to the Exchequer), and c) savings above the 6%, after examination on a case by case basis⁽¹⁵⁾. However, there is also a provision that should the proposed carryover across all departments pose risk to respecting the overall government ceiling, then there is a possibility to cap it. The carried-over funds can be spent on one-off projects and structural measures, but cannot create a new lasting liability.

In contrast, Austria applies a less restraining arrangement whereby line ministries have the freedom to build unlimited reserves from any unspent appropriations at the end of the year, thereby encouraging a more efficient use of resources. According to the Austrian MTBF, the ceilings set for the chapters of the central government expenditure are then notionally increased by the size of the reserves accumulated previously under the respective chapter. In other words, the ceiling is deemed to have been respected even if it has been surpassed, on the condition that the amount of the "slippage" is not bigger than the accumulated reserves associated with the given chapter. Since the accumulation of these reserves is theoretically unlimited over time, they also constitute a risk due to their significant size in relation to the ceilings.

6.8. BINDING NATURE OF MTBFs

The overarching rationale for having in place an MTBF resides in laying out a multiannual path for the fiscal policy, with a guiding role for the yearly budgeting process. In other words, it is a tool for the fiscal authorities to ensure that annual targets for the key fiscal parameters are respected and serve the strategic fiscal policy objectives.

Many studies on the subject of medium-term budgetary plans make the distinction between binding and indicative ones. As useful as it is, this categorisation conceals the fact that there is a plethora of arrangements across countries which does not lend itself easily to such a binary verdict. Therefore, a more nuanced approach might be more appropriate. In fact, there is often no straightforward answer to the question whether the numerical targets contained in a national medium-term planning document produced

⁽¹⁵⁾ Irish Department of Finance (2013), "Medium-term budgetary framework"

Table 6.1: Level of strictness in terms of respecting the plans set out in the medium-term planning documents

	Level of strictness	Member State
1	Ceilings/targets are not expected to be changed whatever the circumstances (unless a new government comes to power or division of tasks between government levels is changed)	SE, FI
2	Expenditure ceilings can only be increased provided that sources of funding of the additional expenditure are identified ex-ante	DK, NL
3	Ceilings/targets can be adjusted in response to changes in a number of specific parameters defined by legislation or other public procedural document (e.g. change in expenditure on pensions, unemployment benefits etc.) and such changes need to be explained publicly	AT, IE, LV
4	Ceilings/targets can be changed in a number of situations foreseen by legislation or other public procedural document (e.g. in view of a substantial change in the macroeconomic forecast, new government coming to power, extraordinary circumstances, etc.) and such changes need to be explained publicly	BE, BG, CY, EL, HU, IT, MT, PL, RO
5	Ceilings/targets can be changed at the discretion of government but changes need to be explained and reputational cost is involved	CZ, EE, ES, FR, LT, LU, PT, UK
6	Ceilings/targets can be changed at the discretion of government without any public explanation	DE, HR, SI, SK

Source: DG ECFIN Fiscal Governance Database

within a given framework are effectively binding or not. It seems to be more suitable to consider instead the degree to which such plans are binding, as countries place themselves on a rather continuous scale of strictness (or lack of it) with which the set plans can be changed.

It is not unreasonable to presume that in an extreme situation even the strictest rules and budgetary plans based thereon can and might be amended in the presence of sufficient political will. However, in "normal" conditions, the following features could mark points on the scale of strictness of a framework starting with the most binding ones and finishing with purely indicative ones:

These elements seek to describe the ex-ante aspect of the medium-term planning documents, but there are also differences in terms of dealing with unforeseen slippages ex-post. For example, the Dutch MTBF provides for a correction mechanism whereby the slippage incurred in a year has to be made up for in the following budget year. In other models the catching up can be spread over a period of years (e.g. Ireland) and more discretion is given as to the decision on the timing of the correction. However, in majority of frameworks the concept of making up for past slippages is absent and the focus is only on ensuring that plans for the future are in line with the existing fiscal rules.

The Swedish framework seems to be overall the strictest among EU Member States. As regards the expenditure ceilings for the central government, they are set for the three following years in nominal terms and they are to remain unchanged from when the ceiling for a given year is fixed until that year has ended. The ceilings are not being adjusted for inflation. Even though there are no formal obstacles for the Parliament to reassess established ceilings, there is a strong expectation that the ceilings will be applied as set unless a new government comes to power. Should an approved ceiling be deemed to be at risk to be exceeded, the government is required to take measures during the current year to avoid it. There is no formal enforcement procedure based on mandating corrective action. Only reputational cost is involved.

The MTBF applied in Finland is set for a fixed period of four years, the expenditure ceilings for the central government are defined in real terms and then adjusted for inflation and generally no other revisions to them are foreseen. Similarly in the Dutch framework, which relies on central government expenditure ceilings adopted for a set period of time in a coalition agreement, no adjustments are generally foreseen. In contrast to Sweden, though, the ceilings are adjusted annually for inflation. There is always a possibility of renegotiating the coalition agreement and raising the ceilings but a funding source would have to be identified in advance. The ceilings can be tightened in case the general government deficit exceeds the signalling margin, i.e. when the deficit is more than 1 percentage point higher relative to the path for the general government deficit adopted at the beginning of the term of office.⁽¹⁶⁾ Detailed intra-year monitoring of expenditure is conducted and no minister can report a planned overrun in the given year. Windfall revenue can be used to cover the overruns but cannot be used for financing new policy initiatives. The success of the framework resides in incentivising line ministries to look for expenditure reallocations to finance new policies. The deviations detected ex-post have to be corrected in order to restore the initial targets.

In Denmark, the overall general government expenditure ceilings for all years included in the planning horizon are binding, but the division of expenditures between government sectors can be changed in connection with the adoption of the annual budget to reflect a redistribution of tasks between central and local governments. The guiding principle of the Danish MTBF is that expenditure ceilings can only be raised provided that sufficient financing has been identified and adopted first. Detailed intra-year monitoring of expenditure is carried out. If it becomes likely that a ministry will not respect the attributed sub-ceiling, the respective Minister is obliged to implement corrective measures without delay. If this fails, the Ministry of Finance shall impose a limit on appropriations of a total amount equal to the expected overrun. In case an overrun is detected ex-post, the Ministry of Finance shall reduce the ceiling of the following year by the appropriate amount.

The Irish framework legislation foresees that the government expenditure ceiling can only be increased in case of exceptional circumstances such as severe macroeconomic shocks or if a source of funding is identified ex-ante. However, as mentioned above there are also special provisions regulating the yearly adjustment of cyclically-sensitive expenditure items and certain other expenditure categories. The ministerial expenditure ceilings are monitored on a monthly basis and in case a risk of overspending is detected the concerned department is obliged to report to the government every month. If the overspend is not rectified within two months, a formal review is launched. If the annual ministerial limit is finally breached, the department in question might be required to "repay" the slippage in the years to come, but the rules give the government a lot of discretion in that respect.

The examples of the Austrian and Latvian frameworks are similar to the Irish one in that the expenditure ceilings adopted within them are binding but the legislation includes lists of expenditure categories which should be adjusted in line with new underlying forecasts on an annual basis. These are among others: social security benefits, expenditure financed from fee-based services and other own revenue, expenditure related to court rulings, expenditure related to co-financing projects supported by EU funds etc. This type of arrangement seems to endow the framework with a certain degree of flexibility and transparency without necessarily endangering its credibility. However, it is crucial to keep such lists to the absolute minimum and ensure that only items that clearly do not lend themselves to multiannual planning are excluded from the ceiling. Otherwise, there might be a risk of creative accounting involved as well as distortion in the composition of spending possibly to the detriment of expenditure more conducive to economic growth. Reflection is needed as to whether the list of expenditure categories treated in this special way under the Austrian and Latvian frameworks is optimal.

⁽¹⁶⁾ Ayuso-i-Casals (2012), "National Expenditure Rules – Why, How and When", European Commission European Economy, Economic Papers, 473

The majority of other Member States place themselves on the proposed MTBF scale of strictness somewhere around category 4 and 5 defined above in Table 1 whereby ceilings/targets can be adjusted but there is a requirement to publicly explain and motivate such revisions. In some cases the law lists the situations in which the medium-term targets can be revised (e.g. PL, MT) (such as extraordinary circumstances, new government coming to power, change in the division of tasks between levels of government or substantial changes in the macroeconomic forecast), whereas in other countries there are no such legal specifications. The spectrum is completed by Member States where the national medium-term budgetary documents can be amended freely and there is no legal requirement for the government to explain such revisions publicly (e.g. Germany, Slovakia and Slovenia).

ANNEX 1

MTBF index

Box A1.1: **MTBF index in the DG ECFIN database on Fiscal governance in EU Member States**

Dimension 1: Existence of a national MTBF

2 MTBF covers the whole of general government or a large part of it (e.g. central government and social security)

1 MTBF covers central government

0 there is no national MTBF

Dimension 2: Connectedness between the multi-annual budgetary targets and the preparation of the annual budget (domestic MTBF or Stability/Convergence Programme)

2 fixed framework (articulated around a pre-defined path for government expenditure, generally not revised over time)

1 the medium-term budgetary targets form the basis upon which the budget is prepared, but there can be deviations

0 flexible framework in which medium-term targets are only indicative (no clear link with the annual budget)

Dimension 3: Involvement of the national parliament in the preparation of the medium term budgetary plans (domestic MTBF or SCP)

2 vote of the parliament on the main medium-term objectives (in the context of a national MTBF or of the SCP)

1 no vote but formal presentation of the objectives to the national parliament

0 no formal presentation of the objectives to the national parliament

Dimension 4: Existence of coordination mechanisms prior to setting the medium-term budgetary targets (domestic MTBF or SCP)

2 there is a proper ex ante coordination mechanism between all levels of general government

1 coordination mechanisms only for some general government sub-sectors

0 no coordination mechanism

Dimension 5: Monitoring and enforcement of multiannual budgetary targets

2 there are well-defined actions in case of deviations from plans and a regular monitoring of targets (reports, etc.)

1 some monitoring and enforcement procedures

0 no clearly defined monitoring and enforcement procedures

Since 2006 the European Commission's Directorate-General for Economic and Financial Affairs has been running a database on the Fiscal Governance in the EU. This is a result of deliberations at the Ecofin Council, which on numerous occasions stressed the importance of robust national budgetary frameworks for sound public finances. In January 2006 the Ecofin Council urged the Commission to conduct a comprehensive analysis of the existing national fiscal rules and institutions in the EU Member States and their impact on budgetary developments. Three years later the Ecofin Council invited Member States to update on an annual basis the Commission's questionnaire on recent changes to their fiscal frameworks, while the Commission was asked to report back regularly on the results and to publish the data.

The survey information on medium-term budgetary frameworks is summarised into a composite index illustrating the quality of MTBFs in force. The index captures the quality of MTBFs based on five dimensions: (1) the existence of a domestic MTBF, (2) the connectedness between the multi-annual budgetary targets and the preparation of the annual budget, (3) the involvement of national parliaments in the preparation of the medium-term budgetary plans, (4) the existence of coordination mechanisms between subsectors of general government prior to setting the medium-term budgetary targets, and (5) the monitoring and enforcement mechanisms of multi-annual budgetary targets. The evaluation of the survey information also takes into account the relationship between MTBFs (if any) and the Stability and Convergence Programmes (SCP) of the Member States in terms of multi-annual budgeting. While SCPs can be considered a specific type of MTBF, they are not on an equal footing with the latter. This has been taken into consideration in the construction of the MTBF index as well. In absence of strong theoretical base or preference regarding the weights for each dimension, 10,000 sets of randomly-generated weights are drawn from a uniform distribution.

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