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Poor Quality of Fiscal Forecasts as a Trigger for Fiscal Imbalance in the European Union Countries – The Scale and Methods of Limiting It

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The economic crisis revealed the imperfections of the solutions aimed at maintaining fiscal discipline among Member States. Therefore, measures are taken at the EU level to strengthen the institutional aspects of a budgetary process that is based on reliable forecasts. What has proven to be of special importance in this context is the creation of fiscal instruments to minimise the occurrence of such phenomena in future, which has been reflected in the European regulations applied. The article seeks to evaluate the extent to which the use of instruments such as fiscal rules, medium-term budgetary frameworks and the emergence of independent fiscal institutions has had an impact on the quality of forecasts and, consequently, on the scale of fiscal imbalance.

Keywords: fiscal policy, fiscal rule index, public debt, budget deficit, fiscal imbalance.

Jakość prognoz fiskalnych impulsem generowana nierównowagi fiskalnej w państwach Unii Europejskiej – skala i metody ograniczania

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Kryzys gospodarczy wskazał na niedoskonałości rozwiązań w zakresie utrzymania dyscypliny fiskalnej wśród krajów członkowskich UE. Dlatego na poziomie Unii Europejskiej podejmowane są działania służące wzmocnieniu instytucjonalnych aspektów procesu budżetowego opartego na wiarygodnych prognozach. W tym kontekście szczególnie istotne stało się stworzenie instrumentów fiskalnych minimalizujących powstawanie tego rodzaju zjawisk w przyszłości, co znalazło odzwierciedlenie w stosowanych regulacjach europejskich. W artykule dokonano oceny na ile zastosowanie instrumentów, takich jak reguły fiskalne, średniookresowe ramy planowania budżetowego oraz powstanie niezależnych instytucji fiskalnych miało wpływ na jakość prognoz, a w konsekwencji na skalę nierównowagi fiskalnej.

Słowa kluczowe: polityka fiskalna, indeks reguł fiskalnych, dług publiczny, deficyt budżetowy, nierównowaga fiskalna.

JEL: H3, H62, H63

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1. Introduction

In the context of European integration, it is often emphasised that the effective functioning of the community requires not only labour mobility, cross-border fiscal transfers, the convergence of business cycles and concurrent economic crises, but also adequate fiscal tools (Jonung & Drea, 2009). As the European community became an ever tighter union, it was believed that only strong fiscal discipline of national governments would ensure its successful functioning and help avoid excessive public expenditure leading to uncontrollable budget deficits in Member States. Upon identifying the causes of fiscal imbalance, measures are taken to strengthen the institutional aspects of a budgetary process that is based on reliable forecasts, the most important of which are fiscal governance instruments such as: fiscal rules, medium-term budgetary frameworks and independent fiscal institutions.

The purpose of the article is to evaluate the quality of forecasts for principal macroeconomic indicators in European Union countries and their correlation with the introduction of fiscal governance instruments. The authors will attempt to demonstrate in this paper that the propensity to generate deficits in EU countries can be limited by the use of fiscal governance instruments. The research hypothesis put forward for the purposes of the research conducted is: In countries using fiscal governance instruments, the propensity for fiscal imbalance decreases and the quality of budgetary forecasts improves. To empirically verify the hypothesis derived from the research problem presented, a mixed methodology is used, combining the results of qualitative and quantitative research for two available periods: 2004–2017 and 2004–2015 (for evaluating the quality of forecasts). Qualitative research is based on descriptive analysis, and the quantitative research will include the method of statistical information systemisation, based on statistical source data analysis.

2. Causes of the Growing Fiscal Imbalance

The economic crisis that hit the EU in 2007–2008 revealed the imperfections of the *Stability and Growth Pact*. Public debt-to-GDP ratios in some European Union countries became a major source of concern on financial markets as they greatly exceeded the reference value. It became obvious that EU Member States had not taken advantage of the strong cyclical conditions between 2005 and 2007 to reduce their debt to a sustainable level. Non-enforcement of the excessive deficit procedure came hand in hand with an optimistic attitude in medium-term fiscal forecasts of EU Member States' governments contained in Stability Programmes and Convergence Programme Updates provided to the European Commission. These programmes were perceived by some governments as a fulfilment of reporting requirements which do not involve a commitment to undertake public

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finance reform. In some cases, especially in France and Germany, promises made by governments to end the excessive deficit procedure became an elusive policy objective, involving no accountability or enforcement by means of specific sanctions. Examples show that public finance management may be efficient unless political decisions prevail over the problems of mounting public finance deficits and public debt levels.

Alesina and Perotti (1995), when looking for the causes of the high deficit and the growing public debt, pointed out to the imperfections of the institutional model of fiscal policy. They distinguished the following imperfections:

- the phenomenon of "fiscal illusion" due to the fact that the public does not understand the intertemporal budget constraints, which results in a lack of social pressure to counteract the lack of fiscal adjustment;
- insufficient concern for the costs passed on to future generations when taking political decisions in the interest of the present generations;
- present governments using debt as an instrument that limits the activity of future governments;
- a lack of political consensus resulting in the need to postpone the necessary fiscal adjustments;
- the tendency among representatives of interest groups to overstate the benefits secured by public funds compared to the burden of costs on the society as a whole;
- ineffectiveness of fiscal institutions, including budget preparation, approval and implementation procedures.

Among the causes of fiscal imbalance, major significance is ascribed to the formulation of budgetary forecasts. The poor reliability of budget forecasting is seen as one of the causes of the *deficit bias* phenomenon (propensity to generate deficit). The ECOFIN report dated 20 March 2005 *Improving the Implementation of the Stability and Growth Pact* points to the need to formulate budget forecasts based on realistic and cautious macroeconomic forecasts. There are many studies analysing the differences between budget plans and budget implementation. They touch on issues such as: how much budgetary parameters deviate from the forecasted values and in which direction; the source of deviations (taking special account of the impact of political and institutional factors); the quality of macroeconomic forecasts created by respective institutions; transparency of the forecasting process. Two principal lines of research can be distinguished here. One centres on the quality of budget forecasts included in *Stability and Growth Programmes* and on testing their impartiality and realism (Strauch et al., 2004; Annett, 2006; Jonung & Larch, 2006). Another focuses its attention on the political nature of projections contained in those programmes. In this case forecasts are equated with the government's medium-term fiscal intentions (von Hagen, 2010). This means that discrepancies between fiscal plans and their implementation may be, on the one hand, due to unexpected economic disturbances, and on the other hand, they may result from deliberate political intentions. In this situation at least a part of deviation from the declared fiscal targets should be treated as an expression of intended political action rather than a forecasting error.

The fact that fiscal authorities may be motivated to run a policy leading to deviation from fiscal forecasts is well documented. One can identify a number of factors that contribute to forecast deviations (e.g. Beetsma et al., 2009; Frankel, 2011). It has been established that they are higher in countries bound by European fiscal rules (e.g. Frankel, 2011; Pina & Venes, 2011). Their other potential source is the electoral cycle (e.g. Brück & Stephán, 2006; Brogan, 2012; Merola & Pérez, 2013). By contrast, better national fiscal institutions in the form of more rigorous national fiscal rules (e.g. Pina & Venes, 2011; Frankel & Schreger, 2013; Debrun & Kinda, 2014) or the existence of independent fiscal councils (Debrun & Kinda, 2014) are linked to lower deviations.

Some problems related to the inaccuracy of national fiscal forecasts could be solved by moving the responsibility for forecasting to the transnational level. It can be expected that transnational agencies will be less sensitive to political and economic changes in respective countries in producing their forecast. Research confirms this phenomenon (Beetsma et al., 2009). This is especially true of European Commission forecasts (Cabanillas & Terzi, 2012). At the same time, forecasts by international institutions such as the European Commission and OECD may take insufficient account of the political and economic developments in respective countries (e.g. Brück & Stephán, 2006; Christodoulakis & Mamatzakis, 2009; Jong-A-Pin et al., 2012). Similar conclusions are reached by Merola and Pérez (2013). Gilbert and de Jong (2014) further pointed out that this is mostly the case of euro area countries, while for non-EMU EU Member States such assertion cannot be unequivocally made. In addition, they indicated that the existence of national independent fiscal institutions mitigates the risk of over-optimistic forecasts that fail to predict exceeding the 3% of GDP ceiling for budget deficit.

Another factor having impact on the quality of budget forecasts is the current stage of the economic cycle. It was observed that in European Union countries fiscal balance forecasts are particularly optimistic during an economic upturn, while a downturn enforces greater caution in forecasts (Annet, 2006). Moulin and Wierts (2006) emphasise a special role of deviations from the planned budgetary spending. Their findings are confirmed by Beetsma et al. (2009) and Holm-Hadulla et al. (2012), who note that discretionary spending reaches a higher level than the one expected in the budget plans. Frankel and Schreger (2013) highlight the impact of the 3% of GDP ceiling on budget forecasts by national governments (especially for countries in the excessive deficit procedure). They point out that fiscal balance forecasts are more optimistic in countries whose deficit exceeded 3% of GDP. This stems from their governments' desire to bring the deficit down quickly.

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3. Propensity to Generate Deficits in European Union Countries Between 2004 and 2016

Fiscal policy remains the competence of respective EU Member States and the *Treaty on the Functioning of the European Union* (TFEU) provides only for coordinating the economic (including fiscal) policy within the EU. This means that EU institutions have no way of directly influencing Member States' fiscal policy.

Nevertheless, in accordance with Article 126 of TFEU, Member States are obliged to avoid excessive deficit and a given euro area Member State's failure to take measures to eliminate excessive deficit may ultimately lead to the Council requiring the Member State to lodge a non-interest bearing deposit ("of an appropriate size") until the deficit has been corrected, or imposing a fine "of an appropriate size". One of the protocols attached to the treaties includes further provisions regarding the use of the procedure. First and foremost, it sets out reference limit values for deficit (3% of GDP) and public debt (60% of GDP). Such European regulations were among the factors that have compelled Member States to apply relevant fiscal instruments. Of course the principal argument in favour of the implementation of solutions aimed to enhance respective Member States' fiscal strength is the prevalence of the deficit bias phenomenon. It is explained as due to the tendency to pass on the responsibility for fiscal discipline to future governments, or even future generations (Wyplosz, 2012). What motivates such a strategy is the desire to be re-elected, which leads to fiscal expansion in pre-election periods. Such actions are often linked to the *common pool* phenomenon, where respective interest groups push for higher spending and deficit, even though the outcomes of those decisions will be a burden to the society as a whole. The prevalence of deficit bias is attested by data on the frequency of deficit in European Union countries.

In thirteen Member States in the period between 2004 and 2016 the general government sector always generated deficit, and only in three countries (Estonia, Sweden, Luxembourg) the number of years without deficit was greater than the number of deficit years. So if we were to consider as acceptable only the deficit level that does not exceed 3% of GDP, deficit remained within this limit only in Luxembourg, Sweden and Estonia throughout the period under analysis. The frequency of deficit going over 3% of GDP puts Poland nearly behind all Member States as only Greece, Portugal and France fared worse.

This tendency was particularly marked in the years between 2009 and 2013, when more than 90% of Member States generated a deficit (in 2009, all of them did), and the percentage of countries with a deficit above 3% of GDP greatly exceeded 60%, except in 2013, when fewer than 40% of the countries had a deficit above 3% of GDP.

Figure 1 presents the frequency of the excessive deficit procedure being used in EU Member States. It should be noted that for fifteen countries the procedure was applicable in at least half of the years of the 2004–2017 period, while excessive deficit was never found in only three Member States.

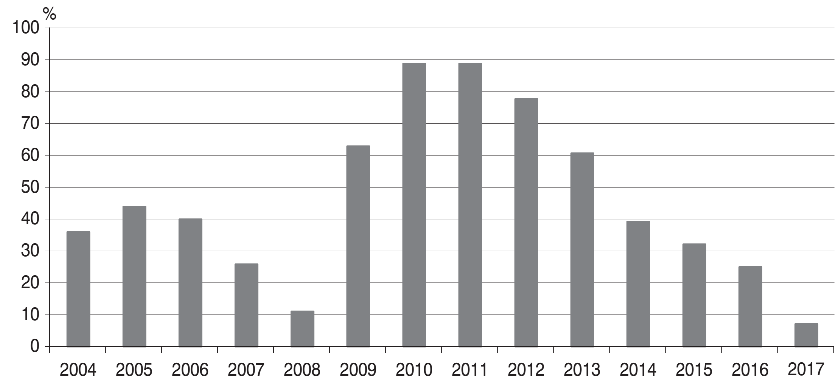

Fig. 1. Percentage of EU states in the excessive deficit procedure in the period between 2004 and 2017. Source: Own compilation based on European Commission data.

The use of excessive deficit procedure was widespread in the period between 2009 and 2013 (between 2010 and 2011 it was not applied only to Sweden, Estonia and Luxembourg), whereas the recent years show that there is a growing number of countries that have improved their fiscal position. As at the end of 2017, the procedure was applied only to France (the procedure was lifted in 2018) and Spain.

The prevalence of fiscal imbalance is also attested by the data on the frequency of medium-term budgetary objectives being met. For eight EU countries, this objective has never been successfully achieved, and in only four countries (Denmark, Sweden, Estonia, Luxembourg) more years could be observed where MTOs were achieved compared to years where MTOs were exceeded. Only in 2016, more than half of EU countries were able to meet their MTOs, while in the other years most Member States had structural balance that was not compliant with their MTOs.

4. Fiscal Imbalance in EU Countries Between 2004 and 2016, and the Quality of Fiscal Forecasts

As pointed out earlier in the article, among the causes of fiscal imbalance of great significance are the quality of budget forecasts and the method used to produce them. Figure 2 shows the development of average forecasting errors published by EU Member States in their Stability Programmes and

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Convergence Programmes presented on a yearly basis to the European Commission for four variables: GDP growth rate, general government spending-to-GDP ratio, general government balance-to-GDP and public debt-to-GDP. Different forecasting horizons were taken into account: from the year following the forecast publication (t + 1) to year t + 3. An average error for each forecast was calculated as a difference between the actual value and the forecasted value.

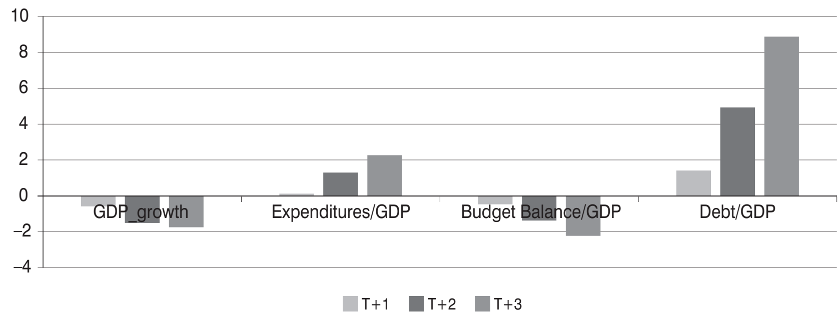

Fig. 2. Average forecasting errors for the period between 2004 and 2016 in EU countries. Source: Own compilation based on Convergence Programmes, Stability Programmes and Eurostat data.

These data reveal that in the period analysed the forecasts contained in Stability Programmes and Convergence Programmes were over-optimistic on average. This means that for GDP growth and fiscal balance the actual values stood below those set in forecasts, while the spending and public debt level as a percentage of GDP turned out higher than the forecasted values. The scale of this forecasting over-optimism was the higher the longer the forecast horizon was. Hence it should be concluded that the level of fiscal adjustment set out in Stability Programmes and Convergence Programmes is usually lower than originally forecasted. In this situation it should come as no surprise that most countries for which the excessive deficit procedure is implemented have it in place longer than foreseen by corrective plans announced under those circumstances.

Figures 3 and 4 present the accuracy of forecasts calculated as the average forecasting error for respective years from the period between 2004 and 2015 in EU countries for the GDP growth rate and general government balance-to-GDP ratio, respectively.

This way a phenomenon manifests itself which cannot be avoided amid economic turbulence which hit EU countries' public finance between 2008 and 2009. One can hardly expect forecasts from years immediately before the turmoil to reflect the changing economic conditions. However, three subsequent years of the public finance crisis in the EU did not change the optimism in forecasting the business cycle and budget balance. This illustrates a state of affairs where forecasts are treated like an instrument of staving off potential sanctions related to the lack of effective corrective actions for a country in the excessive deficit procedure.

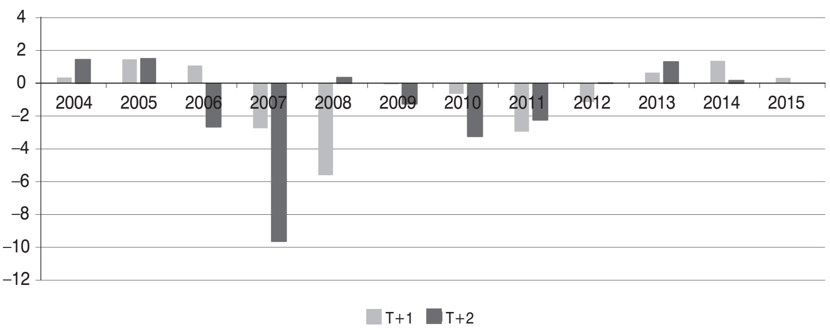

Fig. 3. Comparison of forecasting accuracy for GDP growth between 2004 and 2015 in EU countries for years t + 1 and t + 2. Source: Own compilation based on data from Convergence Programmes, Stability Programmes, and Eurostat data.

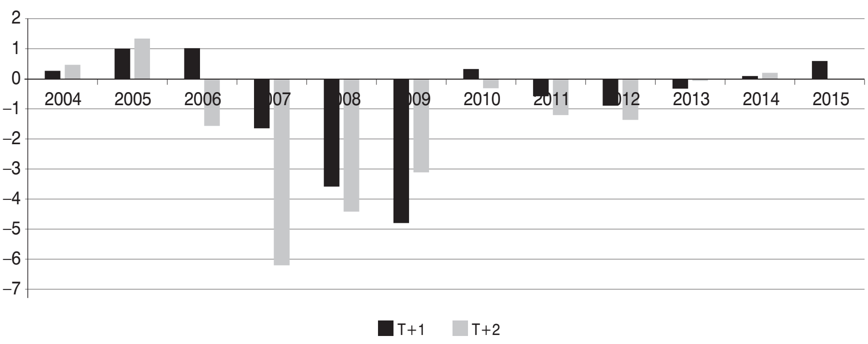

Fig. 4. Comparison of forecasting accuracy for budget balance-to-GDP ratio between 2004 and 2015 in EU countries for years t + 1 and t + 2. Source: Own compilation based on data from Convergence Programmes, Stability Programmes, and Eurostat data.

Moreover, the analysis of forecasting accuracy for economic growth measured with GDP and budget balance indicates that only in a small number of countries can a lack of over-optimism be observed in the forecasts produced. Table 1 presents a breakdown of European Union countries with their relevant average errors in forecasts contained in Convergence and Stability Programmes between 2004 and 2016 for economic growth and budget balance for the years from t + 1 to t + 3.

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Country	GDP growth rate			Budget balance-to-GDP		
	t + 1	t + 2	t + 3	t + 1	t + 2	t + 3
AT	–0.17	–1.46	–0.78	–0.09	–1.00	–1.19
BE	–0.41	–0.40	–1.07	–1.05	–1.36	–2.56
BG	–1.70	–3.37	–2.70	–1.30	–2.50	–2.90
CY	–1.28	–3.14	–3.49	–0.48	–2.06	–2.25
CZ	–0.75	–2.12	–0.71	**0.89**	**0.32**	**0.53**
DE	–0.36	–0.48	–0.99	0.81	0.43	–0.22
DK	–0.83	–0.70	–1.17	1.36	0.64	–0.22
EE	–1.35	–3.34	–4.43	**0.68**	**0.06**	–0.56
EL	–4.63	–5.33	–5.03	–4.96	–7.51	–8.33
ES	–0.73	–1.69	–1.73	–2.04	–3.59	–5.37
FI	–1.59	–2.05	–1.62	–0.21	–1.07	–1.63
FR	–0.98	–1.69	–1.83	–0.70	–1.94	–3.47
HR	**0.27**	**0.35**	–0.30	**0.51**	**0.82**	**1.70**
HU	–1.27	–1.88	–3.51	–0.36	–0.86	–1.51
IE	**1.90**	**1.15**	**0.58**	–2.19	–4.21	–6.42
IT	–1.03	–2.03	–1.83	–0.66	–0.92	–1.68
LT	**0.39**	–1.54	–3.74	–0.56	–1.89	–2.63
LU	–0.43	–0.66	–1.17	**2.41**	**2.33**	**2.09**
LV	–1.39	–3.63	–3.77	–0.50	–1.57	–2.00
MT	**1.85**	**1.64**	**1.64**	–0.15	–1.16	–1.52
NL	–0.55	–0.74	–0.56	–0.05	–0.44	–1.44
PL	–0.30	–0.74	–0.68	–1.02	–1.74	–2.12
PT	–0.66	–1.75	–1.89	–1.52	–2.31	–3.77
RO	–0.02	–1.86	–2.08	–0.95	–1.46	–1.23
SE	–1.21	–1.27	–0.84	–0.05	–0.88	–1.95
SI	–0.05	–2.01	–2.64	–1.79	–2.74	–4.31
SK	**0.38**	–1.18	–1.03	–0.18	–0.76	–1.76
UK	–0.70	–1.15	–1.80	–0.52	–2.09	–4.21

* values of forecasting errors for Ireland are distorted by a 25.6% GDP growth achieved as a result of the tax inversion the country benefited from.

Tab. 1. Average forecasting errors for years between 2004 and 2016 for GDP growth and budget balance in EU countries. Source: Own compilation based on European Commission data.

In forecasts for one year ahead, only in a small number of countries (Slovakia, Malta, Lithuania, Croatia) was the value of GDP growth achieved better than the forecasted value. Budget balance forecasts for the same horizon are cautious in a greater number of countries (Germany, Denmark, Czech Republic, Croatia, Luxembourg, Estonia). However, as the forecasting horizon becomes longer, the over-optimism intensifies. In economic growth forecasts with a time horizon of $t + 3$ only Malta achieved, on average, in the period analysed, better values than those forecasted. Budget balance forecasts for the same time horizon turned out lower than the actual values only for the Czech Republic, Croatia and Luxembourg.

5. The Role of Fiscal Governance Instruments in Ensuring EU Countries' Fiscal Stability and in Improving the Quality of Fiscal Forecasts

Upon identifying the causes of fiscal imbalance, measures are taken to strengthen the institutional aspects of a budgetary process, the most important of which are fiscal governance instruments such as:

- fiscal rules,
- medium-term budgetary frameworks,
- independent fiscal institutions.

In this context, creating fiscal instruments to minimise the occurrence of such phenomena in the future has become all the more crucial. The first time fiscal instruments were given any attention in EU regulations was in Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States (which was one of the "six-pack" components). It was pointed out there that the EU's strengthened budgetary surveillance framework should be founded on numerical fiscal rules that are subject to effective and timely monitoring.

Moreover, it was emphasised that these rules should be based on a reliable and independent analysis carried out by independent bodies or bodies endowed with functional autonomy vis-à-vis the fiscal authorities of the Member States. This way a recommendation was made to appoint independent fiscal institutions in Member States.

In addition, a principle was formulated whereby the annual budget legislation should comply with the provisions of medium-term budgetary frameworks, and all departures in this respect should be duly justified. At the same time, the possibility was given to update the medium-term framework upon forming a new government to reflect its new policy priorities.

These provisions were supplemented by the solutions contained in 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 (a "two-pack" component). They

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mostly referred to the preparation of realistic budgetary forecasts. They convey the belief that biased and unrealistic macroeconomic and budgetary forecasts can considerably hamper the effectiveness of budgetary planning and, consequently, impair commitment to budgetary discipline. Hence, it is concluded there that unbiased and realistic macroeconomic forecasts can be provided by independent bodies or bodies endowed with functional autonomy vis-à-vis the budgetary authorities of a Member State and which are underpinned by national legal provisions ensuring a high degree of functional autonomy and accountability.

The regulation imposes on Member States a duty to have in place independent bodies responsible for monitoring and assessment of compliance of the country's fiscal policy with the applicable fiscal rules. It is concluded there that national medium-term fiscal plans and draft budgets should be based on independent macroeconomic forecasts and indicate whether the budgetary forecasts have been produced or endorsed by an independent body. The need to make those forecasts public was emphasised.

The role of independent fiscal institutions was detailed in Common principles on national fiscal correction mechanisms (COM/2012/0342) issued pursuant to Article 3(2) of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union of 2 March 2012 (Journal of Laws (Dz.U.) of 2013, item 1258). They point out that independent bodies or bodies with functional autonomy acting as monitoring institutions support the credibility and transparency of the correction mechanism of the fiscal rule. Their task should be to provide public assessments over: the occurrence of circumstances warranting the activation of the correction mechanism; of whether the correction is proceeding in accordance with national rules and plans; and over the occurrence of circumstances for triggering, extending and exiting escape clauses. Moreover, Member States are obliged to comply with, or alternatively explain publicly why they are not following the assessments of these bodies.

The above indicated regulations provided a formal basis for implementing in Member States measures aimed to strengthen institutional solutions involved in the budgeting process. Based thereon and drawing on experience of the Member States that had made efforts to use fiscal instruments, the role of those instruments has been greatly strengthened in recent years in basically all Member States. This is suggested by the values of fiscal governance instruments indices published by the European Commission: FRI (Fiscal Rules Index), MTBF (Medium-Term Budgetary Framework Index), SIFI (Scope Index of Fiscal Institutions).

In his analysis of the new solutions, Kopits (2016) finds that though it should be concluded that the changes in EU regulations go in the right direction, the numerical rules defined may give rise to difficulty in measuring these metrics in real time, which may render them ineffectual. His comments reflect the long-term concerns regarding economic governance in the EU, which rarely meets the expectations. Kopits is of the opinion that the condition of Member States' public finance during the crisis made it clear that the level of compliance with both fiscal rules and other mechanisms to control macroeconomic imbalances shows their poor effectiveness.

Begg (2017) believes that the coordination of the economic policy at the EU level, which is based on 2011 regulations, has its limitations due to a number of shortcomings in the approach, which means there is a need for change or for finding new instruments. As Larch (2018) has argued, the condition of EU Member States' public finance and economy might have been worse had 2011 rules not been adopted, but, looking back, adherence to and enforcement of EU fiscal rules remains imperfect. In their discussion, they demonstrate that despite the many fiscal governance reforms undertaken in the EU, the compliance of relevant measures undertaken remains disappointing.

Considering the limited progress in the achievement of medium-term budgetary objectives, the European Commission initiated a proposal for a Council directive (COM(2017) 824) laying down provisions for strengthening fiscal responsibility and the medium-term budgetary orientation in the Member States.

The proposed directive strengthens fiscal responsibility and the medium-term budgetary orientation in the Member States, and thus pursues – along with the applicable provisions in force of the Stability and Growth Pact – the fundamental objective of the Fiscal Compact, i.e. prudent levels of public debt.

This requires annual budgetary decisions to follow a steady orientation towards achieving and maintaining the medium-term budgetary objective. The proposal also lays down an obligation for Member States to have in place a framework of binding and permanent numerical fiscal rules which, while being consistent with the fiscal rules laid down in the Union framework, can embody specificities relevant to the Member State concerned. Fiscal planning must include a medium-term path for expenditure net of discretionary revenue measures and consistent with the medium-term objective or the adjustment path towards it. To ensure an enhanced sense of national ownership of fiscal policy and reflect Member States' sovereign specificities, that path should be set for the whole term of the legislature as established by the domestic constitutional legal order, as soon as a new government takes office. Crucially, that path should be respected by the annual budgets throughout the period that it covers. Evidence shows that fiscal rules equipped with independent monitoring arrangements are associated with increased transparency, better fiscal outcomes and lower sovereign debt financing costs. For that reason, the proposed Directive foresees involving independent fiscal institutions in monitoring compliance with the framework of numerical fiscal rules, including by assessing the adequacy of the medium-term budgetary orientation, as well as in monitoring how the

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correction mechanism is activated and applied. When they detect significant deviations from the medium-term objective or the adjustment path towards it, the independent fiscal institutions should call upon the national budgetary authorities to activate swiftly the correction mechanism and should assess the planned corrective measures and their implementation. Public assessments prepared by the independent fiscal institutions in the performance of their tasks, accompanied by a duty for the budgetary authorities of Member States to 'comply-or-justify' in relation to the recommendations of the independent fiscal institutions, would boost the reputational costs of non-compliance and therefore increase the credibility and enforceability of the medium-term orientation. Since the adoption of the 'Six-pack', 'Two-pack' and the Fiscal Compact has already led to establishing independent fiscal institutions in almost all Member States, the proposed Directive is unlikely to require new structures although amendments to the current remits of existing independent fiscal institutions coupled with improved access to information and some reinforcement of resources may be warranted.

As regards fiscal rules, only the United Kingdom, Sweden, Denmark and Croatia have not recorded a significant increase in their strength in the recent years. However, the first three countries mentioned have years of experience in applying them, dating back to 1920s, and are characterised by a strong position of other institutional fiscal solutions. The Czech Republic was the last EU Member State to introduce this instrument to its budgetary framework (Ministry of Finance…, 2017)[1]. According to 2017 data, countries with considerable strength of fiscal rules were Bulgaria, the Netherlands and Italy (which was mostly due to them using a number of different rules), while the Czech Republic and Croatia were countries where fiscal rules play a minor role in the fiscal policy.

For most countries, a significant progress was also recorded as regards the implementation of medium-term budgetary frameworks, as suggested by the high increase in MTBF Index values in countries such as: Greece, Latvia, Bulgaria, Lithuania, Luxembourg, Cyprus, Ireland and Portugal. According to 2017 data, countries with high quality of medium-term fiscal planning were: Greece and Spain, while Hungary, the Czech Republic and Poland got the lowest rating in this area.

The research conducted reveals that in countries characterised by high values of indices measuring the fiscal instruments implementation the level of forecasting deviations is significantly statistically lower.

6. Conclusions

The economic crisis exposed the imperfections of the Stability and Growth Pact, and the inaccuracy of macroeconomic forecasts produced by EU Member States, which shows that the propensity to generate fiscal imbalance is quite underestimated. Public debt-to-GDP ratios in some EU countries, especially euro area Member States, became the main source of concern on financial markets as they significantly exceeded the reference values and those forecasted in planning documents submitted by Member States. It became obvious that EU and euro area Member States failed to take advantage of the favourable economic times of 2005–2007 to reduce debt to a sustainable level. Non-enforcement of the excessive deficit procedure came hand in hand with an optimistic attitude in medium-term fiscal forecasts of EU Member States' governments contained in Stability Programmes provided to the European Commission. These programmes were perceived by some governments as a fulfilment of reporting requirements which do not involve a commitment to undertake public finance reform. In some cases, especially in France and Germany, promises made by governments to end the excessive deficit procedure became an elusive policy objective, involving no accountability or enforcement by means of specific sanctions. Since over-optimism in budgetary forecasting could be observed in most EU countries, it became necessary to introduce solutions to strengthen the fiscal framework. In this context, the use of fiscal governance instruments gained special importance. The research conducted showed a considerable variability in terms of how these instruments are used by respective European Union Member States. This means that it is legitimate to study their aggregate impact on fiscal stability as then they contribute to improving the quality of budgetary forecasts.

Endnotes

[1] In the Czech Republic, Act No. 23/2017 Coll., on fiscal responsibility rules, and the amending Act No. 24/2017 Coll., amending certain laws in connection with the adoption of fiscal responsibility regulations, entered into effect on 21 February 2017 and introduced: the structural balance rule and the debt rule for general government and the debt rule for local governments (European Commission, 2019).

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