THE EVOLUTION OF FISCAL GOVERNANCE IN THE EUROPEAN UNION

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Abstract:
The fiscal governance is a fiscal framework consisting of those rules, regulations and procedures affecting premeditated manner in which fiscal policy is planned, approved, managed and monitored at European Union level. Through this fiscal framework the tax authorities strengthen the fiscal and budgetary positions and support the adherent member states' structural reforms on the medium and long term. In this paper we present an evolution of successive revisions occurred on the fiscal framework and their impact on recorded tax results, based on the evolution of fiscal and budgetary indicators, the structural deficit and conventional accounting deficit.

Key words: governance, taxation, consolidation, evolution

JEL classification codes: H1, H6, H7

Introduction

The fiscal governance is a fiscal framework consisting of those rules, regulations and procedures affecting the manner in which fiscal policy is planned, approved, managed and monitored at European Union (EU) level. In other words, fiscal governance is an „up to down" complex process implemented from the EU tax authorities levels to the national levels of member countries, guided by rules, regulations and procedures, taken into the national legislation, which aims to strengthen fiscal and budgetary positions and to support the acceding member countries structural reforms on medium and long term.

The fiscal governance objectives are to: achieve some strong budgetary positions by removing the tendency to adopt unsustainable fiscal policies that lead to increased deficits and public debt; reduce pro-cyclicality of implemented fiscal policies; improving the efficiency of public spending and increase the transparency of fiscal policy.

The fiscal governance process is forwarded and implemented using three operational instruments, namely:

- *numerical fiscal rules* promote, in particular, compliance of reference velues of the deficit and public debt, established under the Treaty and adopt a multiannual fiscal planning horizon respecting the medium-term budgetary objectives;

- *independent fiscal institutions* represent an important tool to support fiscal governance, with independent character against the national budgetary authorities, which have as main objective the prevention and limitation of risks associated with fiscal policy actions rather different from country to country, but targeting common issues that consist in providing: independent analysis on the promoted fiscal policy; independent forecasts on the trajectory of fiscal policy and some relevant indicators; assessments and recommendations on legislative initiatives in the taxation and budgetary field; recommendations on multiannual fiscal and budgetary strategy;

- *medium term budgetary frameworks* are fiscal mechanisms that allow tax authorities to expand the horizon of fiscal policy beyond the annual budgetary calendar, respecting the following conditions:

  - annual budget remains a key stage in which important decisions are taken on budget policy, but some fiscal measures have budgetary implications that go beyond the usual annual budget cycle;
  - a budgetary objective over the medium term included in such a budgetary framework does not incorporate binding targets, but are weaker commitments, which can help ensure fiscal discipline by assessing the impact of current fiscal policies on the government

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balance in the coming years by providing reference points in relation to which budgetary developments can be measured over time;
   - one budgetary framework must be developed properly reflecting the impact of previous budgetary commitments and future costs of new fiscal policy measures.

Based on these theoretical and methodological aspects, we present further the legislative evolution and issues covered by its successive revisions and development results achieved during 2010 - 2016, based on two fiscal - budgetary indicators: conventional accounting deficit and the structural deficit.

The legislative evolution

The fiscal regulations on tax policy coordination at EU level occurred with the advent of the euro zone being introduced explicitly criteria for public finances.

The European fiscal framework that provides the normativo - regulatory support of the fiscal governance consists of:

- **The Treaty of Maastricht (1992)** - establishes rules for Economic and Monetary Union (EMU) and limits for the main fiscal indicators - deficit and public debt;
- **Stability and Growth Pact (SGP)** - adopted in 1997, in force since 1999, aims to secure sound public finances, supporting the implementation of the provisions of the Maastricht Treaty, through the implementation of preventive and coercive elements to achieve and maintain fiscal criteria. SGP originally was reformed in two stages, namely:
   - a reform of SGP in 2005 aimed at replacing the public deficit indicator with the budgetary structural deficit, which excludes certain temporary influences of the economic cycle, but also a certain flexibility of the Medium-Term Objective (MTO) to economic extraordinary financial events. These changes have made the SGP more adaptable to the specific characteristics of each country and they were a prerequisite for improving the fiscal criteria fulfillment;
   - a reform of the SGP in 2011 (generated by the financial and economic crisis on fiscal and budgetary indicators) - aimed at implementing a package (six pack) to strengthen macroeconomic governance and budgetary surveillance in the EU by:
      - launch the European Semester (ES), which synchronizes oversight processes in several stages of budgetary and economic policies of the Member States before their development and approval;
      - providing increased attention to public debt indicator, the excessive deficit procedure being possible to be triggered if this criterion is violated;
      - structural balance requirement, convergent with MTO is more flexible and supplemented by explicit quantitative criteria regarding the dynamics of government spending and reduce public debt, for situations when it exceeds 60% of the Gross Domestic Product (GDP).
- **Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG) – Fiscal compact** - adopted in March 2012, entered into force in January 2013, has in centre the Fiscal compact - a mechanism that aims to strengthen the supervision and coordination of acceding countries fiscal policies (all EU countries except the Czech Republic and the United Kingdom) in order to strengthen fiscal discipline. Constraining elements of the Fiscal compact covers:
   - a budgetary position must be balanced or in surplus. This rule shall be deemed to be met if the annual structural deficit complies with the medium term budgetary objective with a lower limit of the structural deficit of 0.5% of GDP;
   - a structural deficit may have a higher value than the one specified above, up to maximum 1% of GDP if the public debt is significantly below 60% of GDP and the risks for long-term public finances sustainability are low;
   - establishment of a correction mechanism to be triggered automatically in case of significant deviation from the medium-term objective or the adjustment strategy;
   - a fiscal rule to be introduced (within one year after the entrance into force of the Treaty) by national provisions with binding legal force and permanent character,

preferably constitutionally, or, respectively, through another level that ensures entirely compliance within the budgetary national process;

- the countries with a debt level exceeding 60% of GDP will need to reduce the difference between the recorded debt and the reference value at an average rate of 1/ 20 per year.

Overall, the successive revisions of the European fiscal legislative framework pursued several objectives, namely:

- *provide stronger economic base to fiscal framework* - tax regulations have often focused on the tax actions and less on tax results, the latter being affected by economic conditions that were not in a strict control of government authorities (crises, cyclical fluctuations). In this context, tax results assessment methodology, namely of some indicators, has been improved by introducing elements that eliminate the effects of specified economic conditions;
- *increasing the attention to public debt indicator* – compared to the original version of the SGP, which focuses more on the budgetary deficit, without capturing enough the dynamics of public debt within the deficit target - in the current version, the public debt indicator is seen as an important source of vulnerability and being assigned prerogatives to establish the structural deficit level and trigger the excessive deficit procedure;
- *strengthening the mechanisms for implementing the fiscal framework* by: transposition of some European tax framework rules into the national legislation and better integration of budgetary European surveillance with national budgetary calendars, which ensures greater incorporation of Commission' s recommendations in the national budgets and policies; early introduction of penalties for budgetary slippages, except the terms of exceptionality, and their levels to eliminate the characteristics of non-credibility and non- productivity generated by the previous system of sanctions; creation of independent fiscal institutions (such as fiscal councils), entrusted with monitoring frameworks / national tax regulations according to the European fiscal framework;
- *implementing more flexible fiscal regulations* - experience has shown that regulations with rigid character, which do not provide procedures applicable in exceptional economic circumstances, are frequently challenged and suspended. To mitigate this risk, it has been brought some flexibility to the fiscal framework by expanding the scope and allowing deviations from the objectives, in conditions in which are adopted structural reforms that entail budgetary costs on the short term and multiplication effects on long term;
- *clarification of provisions / tax regulations* - tax regulations characterized by ambiguity are difficult to implement (this was a major criticism of the initial public debt criterion, which did not provide a measure / threshold to assess the sufficiency of debt reduction.

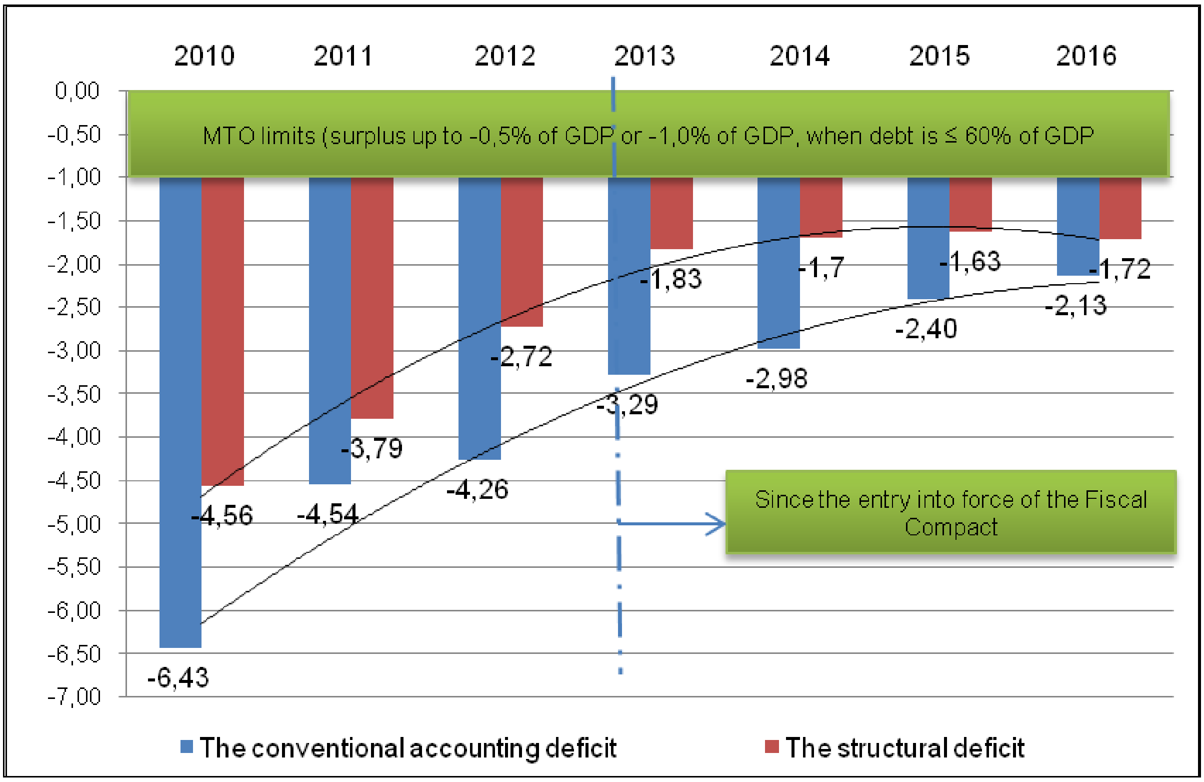
The successive reforms have improved measurability and specificity of such tax laws, including defining MTO, quantifying annual fiscal effort and the pace of debt reduction. It was also recognized and have implemented certain tax regulations specific to each country, to reflect the importance and national concerns on the sustainability of public debt, MTO has become country-specific, methodology taking into account the level of debt and the prospective costs on population ageing for each country.

Results of the implementation of new regulations on the fiscal governance

We appreciate the concrete results of the implementation of the Fiscal compact by the dynamics of indicators: conventional accounting deficit and structural deficit, relative to the MTO, the EU average, the EMU and Romania during 2010-2016.

The graphical representation of Fig. no. 1 indicates that implementation of the Fiscal compact at the EU average level caused a structural deficit moving from its original position (4.56% of GDP in 2010) to a higher position (1.64% of GDP in 2015). This development is the result of subordinating minimum limits of the structural deficit to the objective on the medium term, taking into national laws of those limits, which increased responsability, but also of strengthening preventive and compulsory measures of the SGP and monitoring of budgetary policies, in correlation with economic policies by ES.

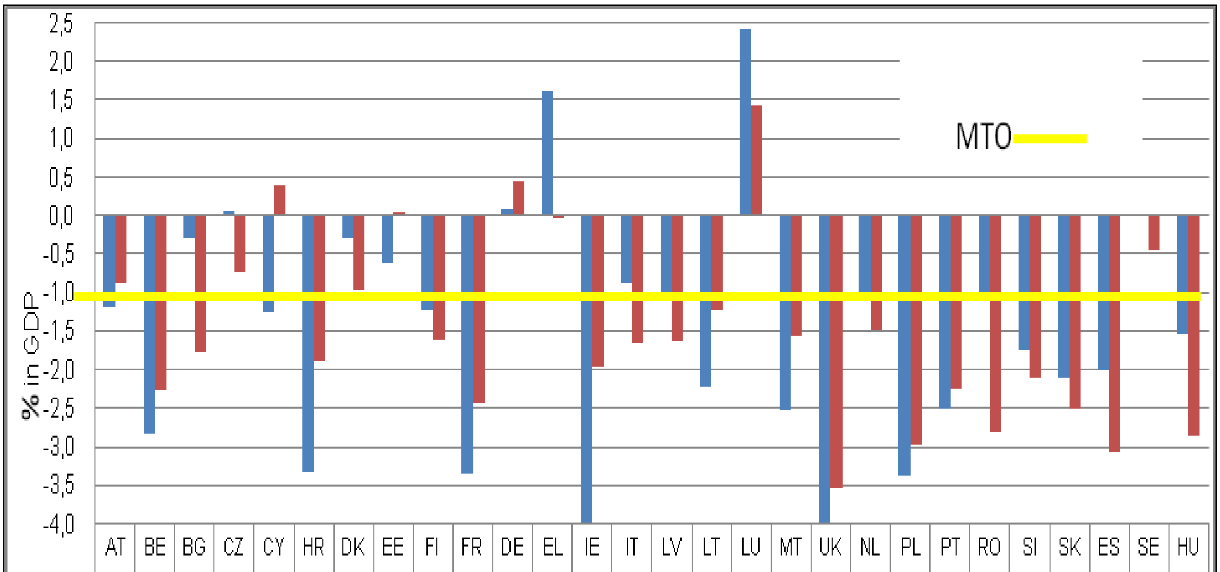
Figure 1 - Evolution of conventional accounting deficit and the structural deficit in relation to the MTO at EU level during 2010-2016



Source: made by the author based on Ameco database, available at http://ec.europa.eu/economy_finance/ameco/user/serie/SelectSerie.cfm
Note: Data for 2016 are forecast

However, we note that the average level of structural deficit at EU level in the period 2010 - 2016, has not reached the lower exceptional limit of 1% of GDP. In the structure of the EU countries in 2013, as shown in Fig. no. 2, 16 of them recorded exceedings of their exceptional lower limit of 1% of GDP, a situation which was perpetuated in 2016, reaching a total of 19 countries.

Figure 2 - Evolution of the structural deficit in EU Member States in 2013 and 2016

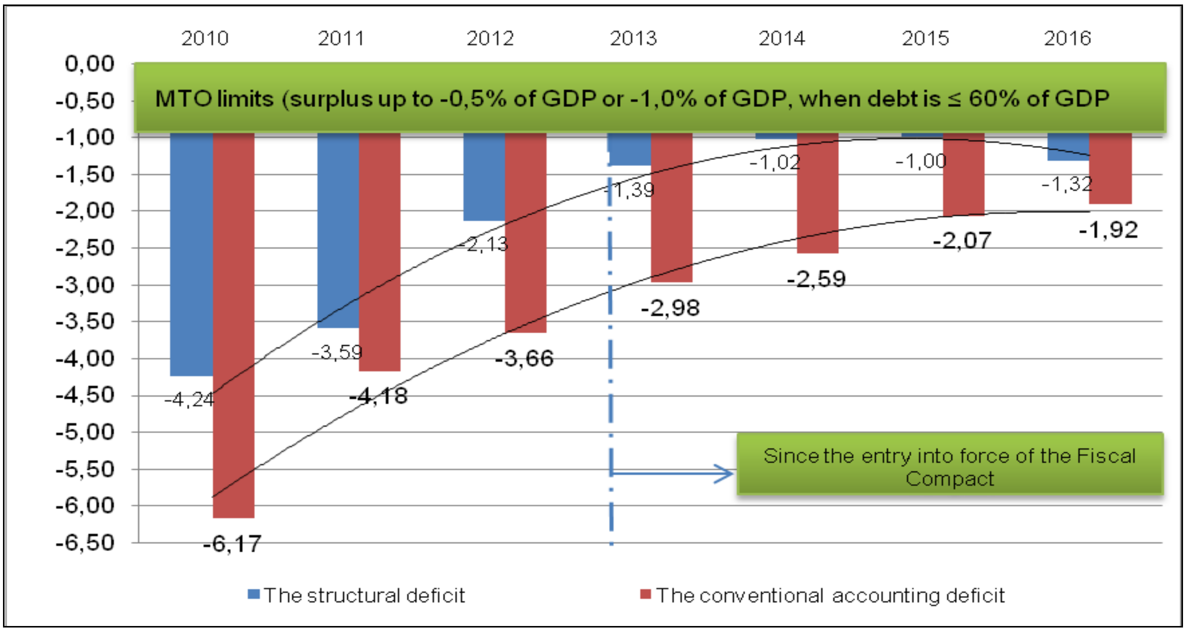


	AT	BE	BG	CZ	CY	HR	DK	EE	FI	FR	DE	EL	IE	IT	LV	LT	LU	MT	UK	NL	PL	PT	RO	SI	SK	ES	SE	HU
2013	-1,	-2,	-0,	0,0	-1,	-3,	-0,	-0,	-1,	-3,	0,0	1,6	-4,	-0,	-1,	-2,	2,4	-2,	-4,	-0,	-3,	-2,	-1,	-1,	-2,	-2,	0,0	-1,
2016	-0,	-2,	-1,	-0,	0,4	-1,	-0,	0,0	-1,	-2,	0,4	-0,	-1,	-1,	-1,	-1,	1,4	-1,	-3,	-1,	-2,	-2,	-2,	-2,	-2,	-3,	-0,	-2,

Source: made by the author based on data Ameco database, available at http://ec.europa.eu/economy_finance/ameco/user/serie/SelectSerie.cfm
Note: Data for 2016 are forecast

The fiscal constraints led to a wider movement of the structural deficit in the Eurozone, compared to the EU from its original position (4.24% of GDP in 2010) to a higher position (1.00% of GDP in 2015), as shown in Fig. no. 3.

Figure 3 - The evolution of conventional accounting deficit and the structural deficit in relation to the MTO in the Eurozone during 2010-2016



Source: made by the author based on data Ameco database, available at http://ec.europa.eu/economy_finance/ameco/user/serie/SelectSerie.cfm
Note: Data for 2016 are forecast

Even based on the positive evolution of structural deficit in the Eurozone, twelve countries were monitored in 2015, the preventive component of the SGP, being in different stages of progress, namely:

- five countries (Germany, Estonia, Luxembourg, the Netherlands and Slovakia) were found to comply with the requirements for 2016, within SGP;
- four countries (Belgium, Latvia, Malta and Finland) have proven to be largely in line with requirements for 2016 the SGP, with the possibility of deviations from fiscal adjustment routes towards achieving the medium-term budgetary objective of each country;
- three countries (Italy, Lithuania and Austria) presented a risk of non-compliance for 2016 in the SGP, which may result in a significant departure from the ways of adjustment towards the medium term objective.

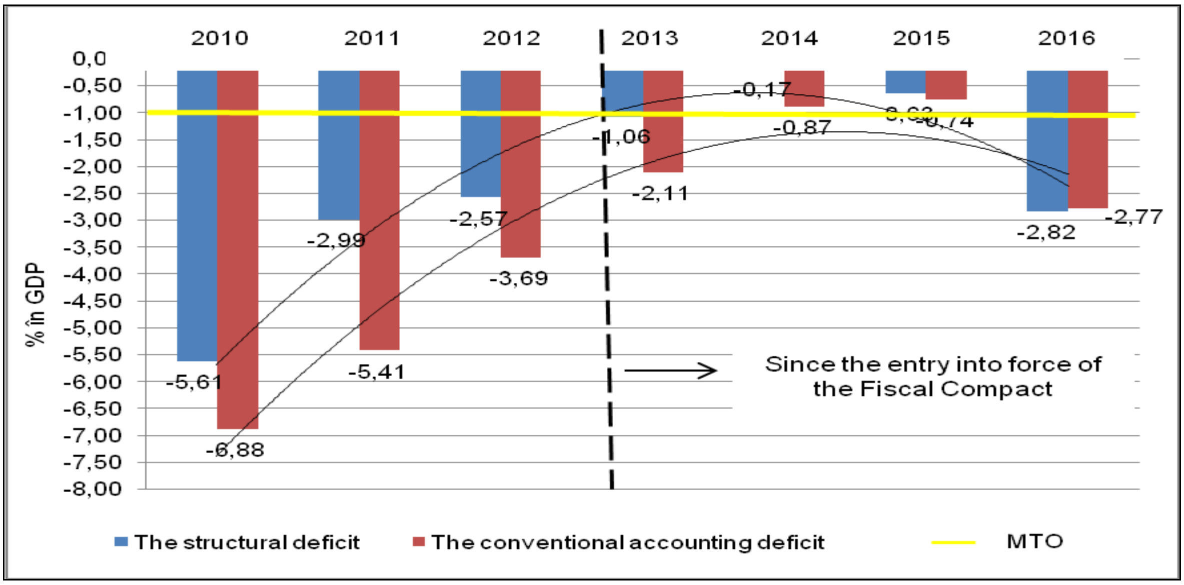
Five others were monitored in the same period in the corrective part of the SGP (excessive deficit procedure), being in different stages of progress, namely:

- three countries (France, Ireland and Slovenia) have shown that largely comply with the requirements for 2016 in the SGP, for Ireland and Slovenia being real possibilities of crossing to the preventive component in 2016;
- Spain and Portugal have been presenting risks of failure of budgetary requirements for the year 2016, within the SGP, estimating that necessary fiscal measures to bring the deficit within the SGP will not be implemented.

Analysis of the evolution of the two types of fiscal and budgetary deficits in Romania indicates that there has been significant progress in the first three years after joining the TSCG – Fiscal compact, the conventional accounting deficit entering the SGP target of 3% of GDP in 2013 and structural deficit reached the MTO target faster than planning, target within it maintained in the years 2014 and 2015.

This development, shown graphically in Fig. no. 4, has been sustained by the economic growth recorded during this period (approx. 3% in 2014 and 4% in 2015), the increasing tax collection and reduction of public investment expenditure, especially in years 2013 and 2014.

Figure 4 - The evolution of conventional accounting deficit and the structural deficit in relation to the MTO in Romania during 2010-2016



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Meanwhile, on the economic growth mentioned above, some expectations regarding the expansion of tax base and potential tax multiplication effects, government authorities have implemented measures of fiscal relaxation (the reduction of the SSC, VAT rate) and growth of budgetary expenditures (wage growth in the public domain), measures that will lead them out of the MTO target in 2016.

Some conclusions

EU can be seen as an institution that seeks to address issues of mutual interdependence between national and EU levels, allowing in the same time, a high degree of decentralized public policies. The Fiscal compact can be viewed as an additional tool which seeks modeling these two objectives (interdependence and decentralization) with nuances apparently opposable.

The Fiscal compact is in this context, an addition to an existing tax legislation and treaties, strengthening the two arms, prevention and correction, and having structural balance as the operational objectives through which it should be limited the probability of being broken the provisions of fiscal framework agreed.

Results of the analysis suggest that the implementation of tax provisions of the EU and their successive revisions generated, to some extent, progress on fiscal discipline and obvious positive trajectory of both types of deficits, symmetry between the three entities analyzed, reflecting an uniform implementation of regulations resulting from the monitoring of both the Commission and of the independent national fiscal institutions.

There are also delays in the implementation of regulations and/or significant results/progress generated by:

- delayed adoption of reforms aimed at transposing the new settings and fiscal governance requirements into national legislation;
- inconsistency of effective functioning newly created or upgraded fiscal frameworks so that they can ensure full role in pursuing the objectives;
- noncompliance with the internal fiscal policy objectives with the budgetary commitments resulting from the Fiscal compact;
- complex methodology, the difficulties and the frequent changes and a lack of transparency in the calculation of fiscal indicators in the Member States, leading to uncertainties, revisions and estimates that may affect the consistency of fiscal measures adopted.

Based on statistics recorded at the end of 2015 (which may be subject to revision) based on forecasted data for 2016, shaping a firm conclusions about the effect of the Fiscal compact implementation in 2013 on the fiscal stance can be tenuous. A preliminary apreciation leads to a modest assessment of progress, not existing sufficient evidence indicating improved and sustainable fiscal policies (forecasts for 2016 and 2017 are unfavorable).

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