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Independent Fiscal Institutions in the European Union: Is Coordination Required?

Xavier Debrun,[1]

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Abstract. Increased reliance on national frameworks to improve compliance with EU standards of fiscal soundness calls for coordination among EU member states. We focus on the rationale and forms of coordination among national independent fiscal institutions (IFIs). IFIs aim at strengthening governments' incentives to adhere to national fiscal rules mainly through monitoring activities that provide non-partisan information on the conduct of fiscal policy to all stakeholders in the budget process. Such activities increase the costs of inadequate policies in terms of reputation loss, financing conditions, and electoral sanctions. The case for coordination is two-pronged. First, national IFIs are not all born equal, with questions remaining as to how some of them can effectively play their role. Accepting too many weak IFIs would undermine the aim of recent reforms to strengthen rules-based fiscal policy and bolster the stability of the euro area. Second, as national IFIs and the European Commission (EC) both monitor fiscal policies, disagreements could lead to cacophony and weaken IFIs' impact on the public debate about fiscal policy. Thus, coordination should aim at (i) ensuring that all national IFIs converge to international best practice in their operations and (ii) mitigating the risk of cacophony in fiscal surveillance. To preserve national IFIs independence, coordination—both between the EC and IFIs and among the latter—should be limited to information exchanges and peer-pressure-through-emulation. A beefed-up European Fiscal Board would have a key role to play in facilitating such coordination.

JEL Codes: F42, F55, H61.

Keywords: Independent fiscal institutions, European Union, fiscal governance, international coordination, European Fiscal Board.

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I. Introduction

The European Union (EU) offers a rich set of processes, procedures and central institutions aimed at coordinating economic policies among its member states. Since the founding impetus of the 1950s, deepening integration in a growing number of areas (trade, finance, money) has magnified the spillovers of national policies and bolstered the economies of scale from certain common initiatives. Although greater integration made intergovernmental policy coordination increasingly desirable, the absence of a political union guided by a clear vision never made it easier to achieve. In the end, policy coordination within the EU has been shaped by gradualism and a pragmatic adherence to the subsidiarity principle. The result is frustratingly complex, with an array of interdependent policy instruments subject to different approaches ranging from pure delegation to the center (e.g. monetary policy, agricultural policy), binding rules (e.g. fiscal policy), peer pressure stirred by time-bound benchmarks (e.g. structural policies), and regular consultations held in the context of surveillance.

Since the launch of the single currency in 1999, perfecting fiscal policy coordination has mobilized considerable energy. The numerical rules embedded in EU law (the Excessive Deficit Procedure in the Treaty on the Functioning of the European Union and the Regulations forming the Stability and Growth Pact) have by and large failed to deliver the levels of fiscal discipline and stabilization required for a smooth functioning of the currency union. The two major reforms of fiscal governance (in 2005 and 2010) were well-intended but did not help enough, leaving the framework hopelessly complicated (e.g. Debrun and Jonung, 2019; and Deroose et al. 2018), and in urgent need of a third reform (e.g. Bénassy-Quéré et al. , 2018; or Christofzik et al., 2018).

That said, a critical and promising dimension of the 2010 amendments to fiscal governance was an increased reliance on *national*, rules-based fiscal frameworks to achieve the desired degrees of fiscal discipline and stabilization. The underlying argument is sound. Since fiscal policy remains inextricably linked to national politics, legitimacy sits there, and centrally enforced fiscal rules may lack the local ownership required to effectively tie the hands of policymakers or at least encourage them to behave. Homegrown fiscal frameworks might be more legitimate and stand a better chance to productively constrain fiscal discretion. For this to work, national frameworks had to be consistent with EU-wide rules, and some coordination in their design and implementation had to take place. The necessary harmonization was codified in EU law through a 2011 Directive and a 2013 Regulation (part of the so-called "Two-Pack") applying to euro area countries.[2]

The present paper focuses on an intriguing dimension of those harmonized fiscal frameworks at the national level: the reliance on independent fiscal institutions (IFIs) to foster commitment to the rules (see Larch and Braendle, 2018; or Jankovics and Sherwood, 2017).

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[2] A 2013 intergovernmental treaty containing the so-called Fiscal Compact confirmed these provisions, expanding them to 3 non-euro members (Bulgaria, Denmark, and Romania).

The idea is to entrust "independent bodies" with monitoring compliance with national fiscal rules, advising on the activation of correction mechanisms and escape clauses associated with the rules, and producing or endorsing macroeconomic projections underlying the budget. Although EU law leaves ample room for interpretation as to the specific institutional format of these bodies, it seems clear that they echo the recent emergence of independent fiscal institutions (IFIs)—or "fiscal councils"—as part of leading international practice in the design of fiscal frameworks.[3]

While the injunction to give a role to independent bodies in national fiscal frameworks follows a global trend (see Beetsma et al. 2018), the limited efforts to harmonize their roles, functions and institutional models, and the absence of explicit coordination mechanism in their operations are more surprising. Although this may reflect the legitimate concern that IFIs must espouse the country-specific contours of fiscal decision-making (OECD, 2014), it is equally legitimate to wonder whether their effectiveness in the EU—and even more so in the euro area—context would not call for some form of coordination. In the end, national fiscal frameworks—including IFIs—are supposed to contribute to improved fiscal policy coordination, a vital dimension of euro area stability (see e.g. Bergin, 2000; and Debrun, 2000).

In 2016, the creation of the European Fiscal Board (EFB), an EU-wide IFI nested in the Commission itself, was a first step in concretely acknowledging the need for coordination, at least vertically between the center and the national IFIs, if not horizontally, among IFIs. However, the initial intention expressed in the Five Presidents Report (Juncker et al., 2015) to task the EFB with the "coordination" of national IFIs raised serious concerns. The risk that IFIs could be perceived as agents of a central agenda was in direct contradiction with the national ownership that is critical to their role in shaping national public debates about fiscal issues. In the end, the EFB's mandate includes a vague request to "cooperate" with national IFIs. However, the precise nature and form of such cooperation is yet to be fully fleshed out, although hard (or institutionalized) forms of coordination—that would imply joint decisions binding all IFIs—currently seem to be ruled out.

Three questions guide our analysis of coordination issues among IFIs in the EU. First, how do national IFIs really influence fiscal policies? Second, given the public good dimension of fiscal soundness in the EU, what does the answer to the first question imply in terms of potential coordination failures? Third, to the extent that such failures raise meaningful concerns, how should coordination be organized? After reviewing the specific functions and impact of national IFIs, we discuss the case for coordination among IFIs in the EU and between them and the center. Doing so, we take the current architecture of fiscal governance as given and

[3] A draft directive of December 2017 is unambiguous about the definition of independent bodies as good-practice fiscal councils of the type codified by the OECD (2014).

ignore possibly superior, but certainly more ambitious, reforms of the central governance that might improve the effectiveness of EU rules (see e.g. Bénassy-Quéré et al., 2018).

We conclude that the case for coordination exists at two levels. First, failing to support effective national IFIs in all countries would undermine a central underpinning of the 2010 fiscal governance reform, which is that government commitments to national rules are stronger than commitments to EU rules. Second, there could be significant costs to allowing open conflicts between national IFIs and the center regarding the monitoring of fiscal rules, the assessment of the forecasts underlying national budgets, and the existence of circumstances warranting either a correction of past budgetary slippages or the activation of escape clauses. The same concern applies to the normative assessments made by certain fiscal councils if they collide with the country-specific recommendations adopted by the European Council (under recommendation of the Commission) at the end of the European semester. Finally, the center's views on the desirable euro area fiscal stance may also create tensions with IFIs' assessments at the national level.

In the current setup, the EFB can only partly mitigate these risks. We discuss options along the trade-off between preserving national ownership and IFIs' independence on the one hand, and the avoidance of public conflicts on fiscal oversight, recommendations and the aggregate fiscal stance on the other. In all cases, the EFB could play a key role in ensuring a regular flow of relevant information between national IFIs and EU institutions.

The rest of this paper is organized as follows. Section II briefly reviews the typical functions of IFIs and discusses how they can potentially influence policy outcomes. This paves the way for Section III which focuses on IFIs in the euro area and assesses the costs of potential coordination failures. Section IV explores broad options to better coordinate IFIs activities without impinging on national ownership.

II. Independent Fiscal Councils: Rationale and Functions

A. Constraining Discretion and the Rise of IFIs

Four decades after Kydland and Prescott's (1977) seminal insights, the rules vs. discretion debate has converged on a broad consensus that even though strict rules-based policymaking is in most cases impractical, policymakers' discretion ought to be constrained.[4] One key reason is that pure discretion allows policymakers to overexploit macroeconomic policy instruments to extract short-lived gains, destroying the credibility of commitments to optimal policies (Barro and Gordon, 1983). Excessive inflation, large public deficits and procyclical fiscal policies invariably follow.

[4] By discretion, we mean policymakers' ability to optimally adjust their instruments to changing circumstances at any point in time.

Over the years, formal macroeconomic frameworks have been developed to tame those policy biases. The underlying idea is to provide policymakers with the right incentives to deliver on socially desirable policies. Because monetary and fiscal policies are strongly interconnected, it has also been increasingly recognized that such frameworks had to be envisaged in a holistic fashion, encompassing both monetary and fiscal instruments (Castellani and Debrun, 2005; Combes et al. 2018).

Policy frameworks are typically made of two basic ingredients, rules and independent institutions, combined in varying proportions. After monetary rules proved ineffective in the face of volatile money demand, monetary policy was placed in the hands of politically independent central banks with a clear mandate to target inflation. Accountable central bankers are constrained by the need to deliver on their mandate or face consequences; and today, formal rules play virtually no role in the conduct of monetary policy.

On the fiscal side, rules—in the form of numerical caps on relevant fiscal indicators—have remained the dominant approach to constrain discretion. The delegation of fiscal instruments to unelected officials remains anathema, if only because a budget is the financial translation of a political platform that elected policymakers are legitimately expected to implement. From a normative point of view, the primarily distributive nature of fiscal policy and the lack of consensus on the objectives it should pursue also preclude the delegation of fiscal instruments to unelected officials (see Alesina and Tabellini, 2007; and Calmfors and Wren-Lewis, 2011). In recent years, however, independent institutions playing mainly an oversight role have emerged to foster policymakers' commitment to fiscal policy rules.

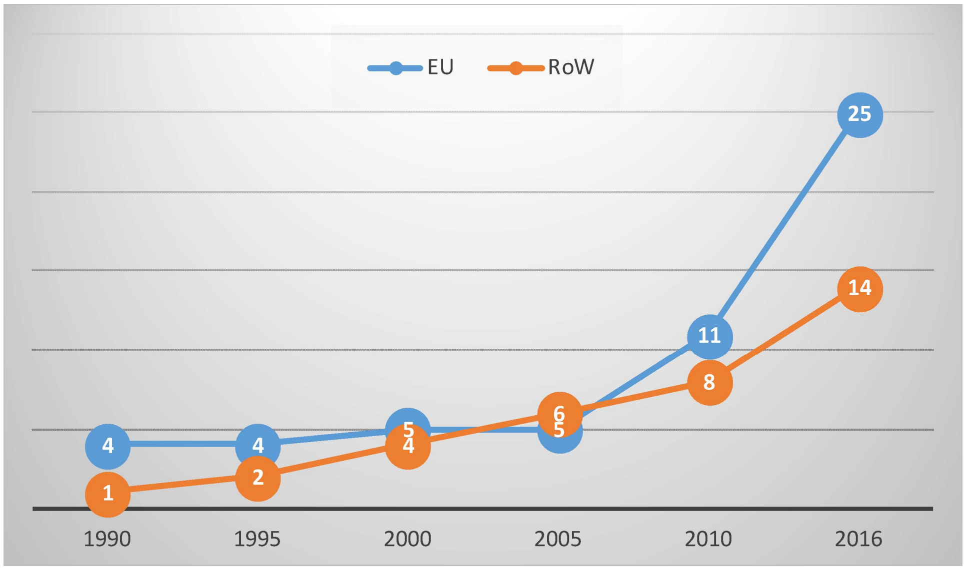
The OECD (2014) defines independent fiscal institutions as "*publicly funded, independent bodies under the statutory authority of the executive or the legislature which provide non-partisan oversight and analysis of, and in some cases advice on, fiscal policy and performance.*" Thus, unlike early academic proposals (surveyed in Debrun et al., 2009), real-world IFIs do not exert any formal authority over fiscal policy. Their role is only to inform, analyze, and possibly also advise.[5]

With the notable exceptions of Austria (1970), the Netherlands (1945), and the United States (1974), the rise of IFIs is a recent phenomenon. Most of them were created after the 2008 global financial crisis (Figure 1). Interest in IFIs largely stems from the mixed experience with fiscal rules as an effective mean of achieving sound policies and the post-crisis efforts by governments to strengthen commitments to sustainable public finances. It is, however, notable that most existing IFIs identified by the IMF at end-2016 were in the EU, pointing to the role of external incentives such as fiscal reforms agreed in the context of bailout packages

[5] The jury is still out on the desirability of any advisory function because it can bring the council dangerously close to the political fray.

(e.g. Hungary, Portugal and Ireland) or the need to comply with the new common requirements for national fiscal frameworks.

Figure 1. Number of Independent Fiscal Councils in the World (end-2016)



Source: IMF Fiscal Councils Dataset (2017).

The mandate of IFIs, their institutional format, and the tasks they perform vary greatly across countries, reflecting the idiosyncrasies of national budget processes, history and political customs. However, all IFIs ultimately strive to provide objective information and adequate incentives to elected policymakers, to those they account to (voters), and to all other stakeholders in a country's public finances, including international or supranational institutions with a surveillance mandate, and of course, investors.

A natural question is how an institution that does not control any fiscal lever could constrain policy discretion and encourage better fiscal outcomes. The emerging consensus is that the effectiveness of IFIs rests on their ability to enhance fiscal transparency. By publicly providing objective information on the state of public finances, the effects of current and announced policies, or potential deviations from prior commitments, an IFI can raise the reputational costs of unsound policies, untenable promises, and attempts to creatively embellish public accounts or hide policy mistakes. Better-informed voters can more effectively reward sound policies and sanction bad ones, whereas market participants can form a more accurate view of a sovereign's creditworthiness and price it accordingly. That said, the specific channels through which IFIs can potentially influence policy outcomes remain relatively diffuse, and therefore hard to theorize or to identify statistically (see Beetsma et al. 2017, 2018).

Beyond bolstering market discipline and democratic accountability, IFIs can also play a useful role in the budget process by enabling checks and balances *within* the political system. For instance, an IFI providing objective and credible information on the state of the economy and expected tax revenues can facilitate the centralization of budget requests from line ministries, mitigating pressures to produce optimistic revenue forecasts that could accommodate politically tempting spending requests. In a context where fiscal rules serve as a reference for budget preparation, independent views on key parameters of a rule, such as the structural budget balance, the need to correct past slippages or the existence of conditions requiring the activation of an escape clause can only help a proper implementation of the rule.

That said, the transparency-reputation-market-discipline nexus at the root of IFIs' effectiveness should not be viewed as a panacea against unsound fiscal policies. First, the political context matters a great deal when it comes to the impact of fiscal transparency on policy choices. For instance, if the likelihood of winning an election is primarily shaped by other factors than policymakers' competence in managing public finances, transparency could actually encourage financially irresponsible initiatives targeted at winning votes to offset the adverse effect of revealed competence issues (Beetsma et al. 2017). Second, the mapping between the many possible sources of deficit bias and the typical tasks and roles of IFIs is far from clear-cut and remains open to discussion (Calmfors and Wren-Lewis, 2011). Third, as the explosion of social media suggests, information overload can be as damaging the lack of information. Government budgets are already subject to many different formal and informal "independent" assessments and the voice of an IFI might just be viewed as adding to the noise rather than distilling an audible signal.

B. What Do IFIs Do?

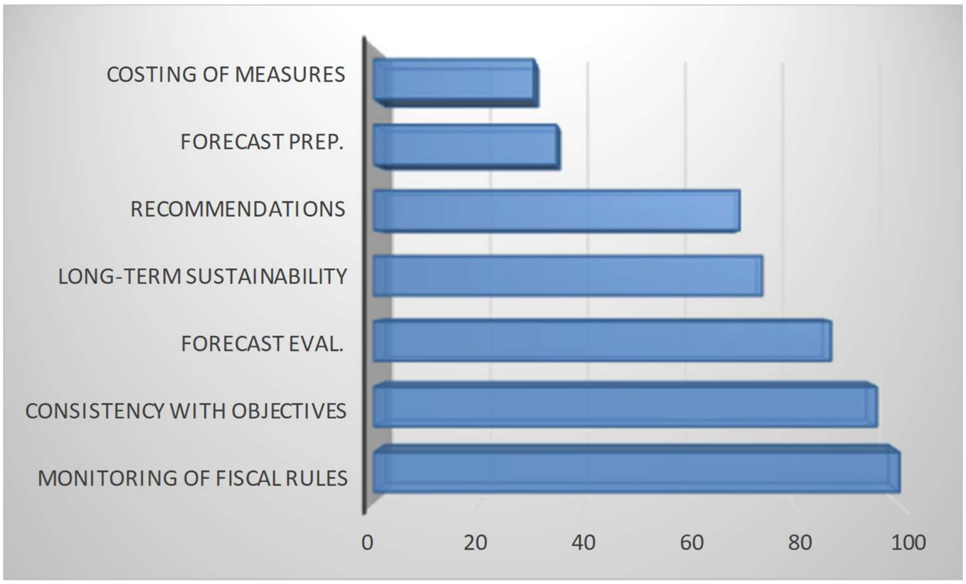
The remit of IFIs often reflects the specific circumstances in which they were born. For instance, the establishment of the US Congressional Budget Office (CBO) was part of an effort by the legislative branch to reclaim its constitutional control over the public purse, a control that had been gradually eroded by a better-informed executive. This explains why two core functions of the CBO are to provide a non-partisan costing of draft laws and to assess the sustainability of public finances through long-term projections. In the United Kingdom, the delegation of forecasts to the Office of Budget Responsibility (OBR) followed years of optimistic forecasts in a context of weak commitment to a fiscal rule.

In the EU, even though not all officially recognized independent bodies are fiscal councils in the sense defined above,[6] IFIs' mandates are well aligned on EU law requirements. Specifically, all 23 EU countries with at least one fiscal council as of end-2016 have mandated such an institution to monitor the implementation of fiscal rules. Most member states (20) have also tasked a fiscal council to assess the quality of official forecasts used in budget preparation, whereas an IFI directly contributes to the forecasting rounds in 8 countries.

[6] In the list provided by Jankovicz and Sherwood (2017), only 6 independent bodies in 5 different countries are not reported as IFIs in the 2017 vintage of the IMF Fiscal Council Dataset; and only one of those countries has no recognized IFI.

However, according to the IMF, only 3 countries have either an obligation or a consistent practice to use IFI's own forecasts in elaborating their budget. Interestingly, two thirds of the member states allow or request the IFI to make normative analyses, including specific recommendations, a greater proportion than among non-EU IFIs. Last but not least, IFIs prepare long-term fiscal sustainability assessments in about three quarters of EU members with such an institution.

Figure 2. Remit of IFIs in the European Union



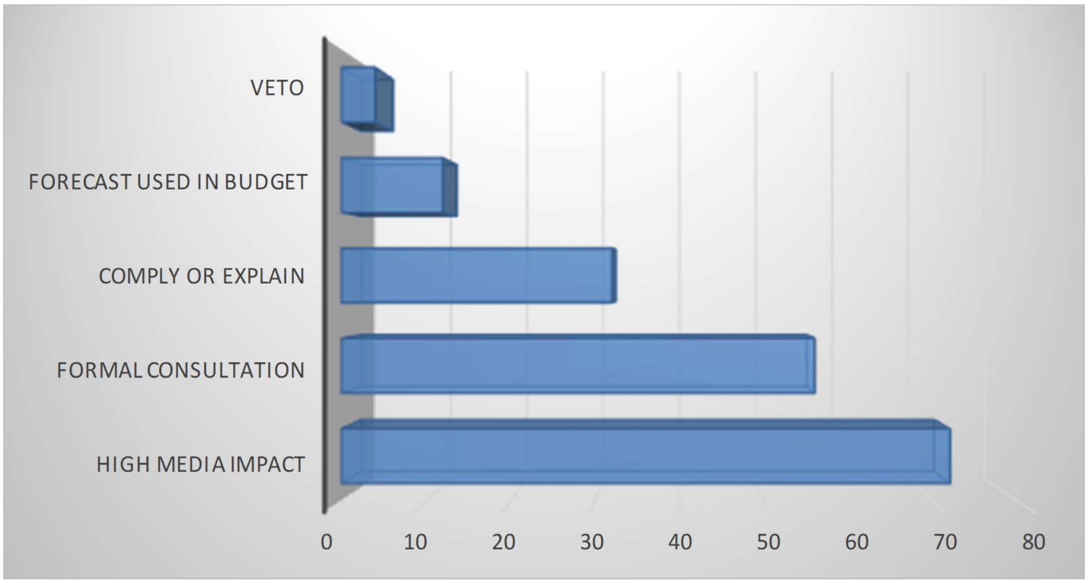
Note: Numbers expressed in percent of countries with at least one IFI.
Source: IMF Fiscal Councils Dataset (2017).

C. IFIs Effectiveness: The Central Role of the Public Debate

As mentioned earlier, there is still preciously little evidence on the effectiveness of IFIs. In addition to having too few observations to establish robust statistical linkages, the transmission channels from the activities of an IFI to policy outcomes are multiple and diffuse. The existing evidence is nevertheless encouraging in the sense that conditional correlations have the "right sign." For instance, Beetsma et al. (2018) use panel regressions to suggest that the presence of an IFI has a beneficial impact on the accuracy of fiscal forecasts—although not on macroeconomic forecasts, confirming early insights from Debrun and Kinda (2017)—as well as on compliance with fiscal rules.

Another empirical approach explored by Debrun et al. (2017) is to assess the media impact of fiscal councils' activities and then to check whether a greater impact can be systematically connected to fiscal performance. Focusing on a small number of long-standing and well-established IFIs, they conclude that while IFIs tend to be present in the media at times when they should indeed be communicating—e.g. in case of significant budgetary slippages—an adequate media presence does not appear to materially affect subsequent fiscal outcomes. In the EU, a large majority of IFIs consider that their potential influence on the budget process operates through a strong media presence (Figure 3). This capacity to shape the public debate on fiscal policy is important given that EU fiscal councils often lack other formal avenues to influence policymakers, such as effective "comply or explain" mechanisms.

Figure 3. Channels of Influence of EU Fiscal Councils on the Budget



Note: Numbers expressed in percent of the number of IFIs.
Source: IMF Fiscal Councils Dataset (2017).

Economists and practitioners agree that a strong presence in the public debate is instrumental for IFIs' effectiveness. On the theoretical side, Beetsma et al. (2017) show how IFIs' ability to send clear and objective signals on the state of public finances and the adequacy of fiscal policy can mitigate conventional sources of deficit bias by enabling voters to distinguish between good and bad policies. This encourages any incumbent concerned with re-election to behave, and voters to select more competent policymakers on average.

On the practical side, developing an effective communication strategy has been an early concern in the growing community of independent fiscal institutions.[7] In a world already flooded with information and commentaries of all kinds, the golden rule for good IFI communication is to boost the "signal-to-noise ratio". This means that they should talk only when they must, and on topics for which they can claim to be a reliable, independent source. Thus, maximizing the signal-to-noise ratio implies that timely, focused, and impactful engagement with the public should be preferred to frequent interventions about everything possibly related to the government budget (Debrun et al. 2013).

[7] See for instance Sunshine (2018).

A legitimate question is whether all fiscal councils have been equally successful in influencing the public debate. As mentioned earlier, IFIs form a highly heterogenous group with varying degrees of operational independence and capacities, and one would expect that patterns of engagement with the public on fiscal issues could vary substantially from one institution to the other.

As a simple, comparable metric for an IFI's influence on the national public debate, we analyze data on the number of Google searches for 3 well-established IFIs generally recognized as being close to international leading practice: the Office for Budget Responsibility (or OBR, United Kingdom), the Netherlands Bureau for Economic Policy Analysis (better known under its Dutch acronym of CPB), and the Independent Authority for Fiscal Responsibility (or AIReF in Spain). These three councils are also sufficiently different in their mandates, activities and history to exhibit a priori distinct patterns in their cyber presence. The data capture Google searches originating in each individual country either spelling out the IFI's name in the country's language, in English, or using its conventional acronym (whichever yielded the most meaningful time series). All the series show the number of hits as a percentage of the maximum reached over the period under consideration.

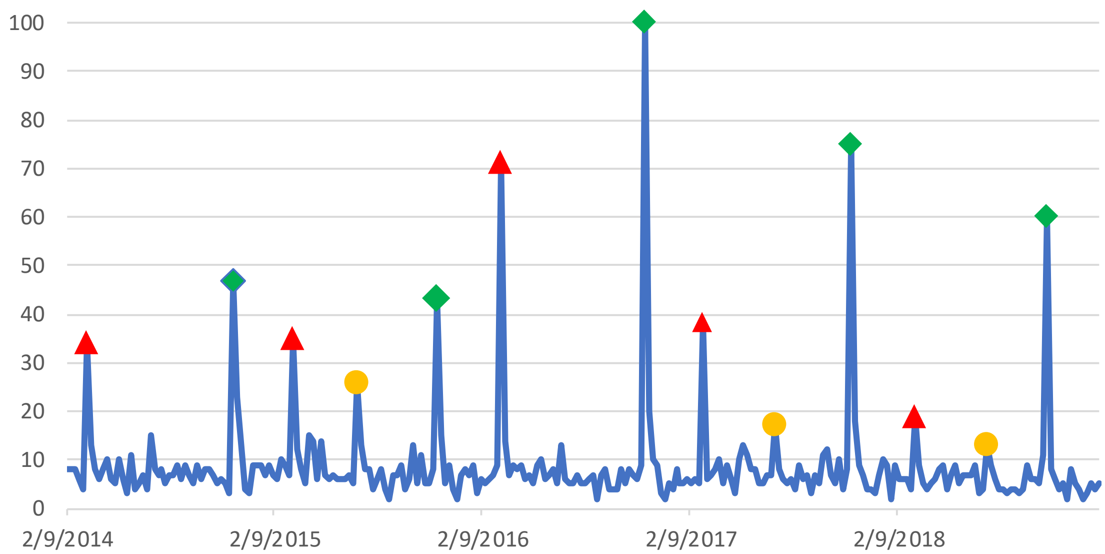
The data for the OBR, which covers the last 5 years of weekly Google hits, suggests a highly focused communication stirring public interest right around the critical times of the budget process (Figure 4). The top panel exhibits marked spikes around the autumn (November, identified by a diamond) and spring (March, identified by a triangle) budget statements. Since 2017, all the measures and draft legislations for the yearly cycle are announced in a single package during the autumn statement only, which helps explain why the diamonds have since then peaked much higher than the triangles. Finally, the dots identify much more modest spikes corresponding to the publication of OBR's sustainability analysis and fiscal risk statements (both in July).[8]

The bottom panel of Figure 4 corroborates the impression that the public interest in the OBR occurs at times when the issue of government deficits (search item: "government budget balance") also seems to get a lot of attention from internet users. However, the OBR's carefully planned communication also means that it does not seem to opportunistically intervene (or at least generate public interest) each time the issue of government budget balances somehow "makes the buzz."

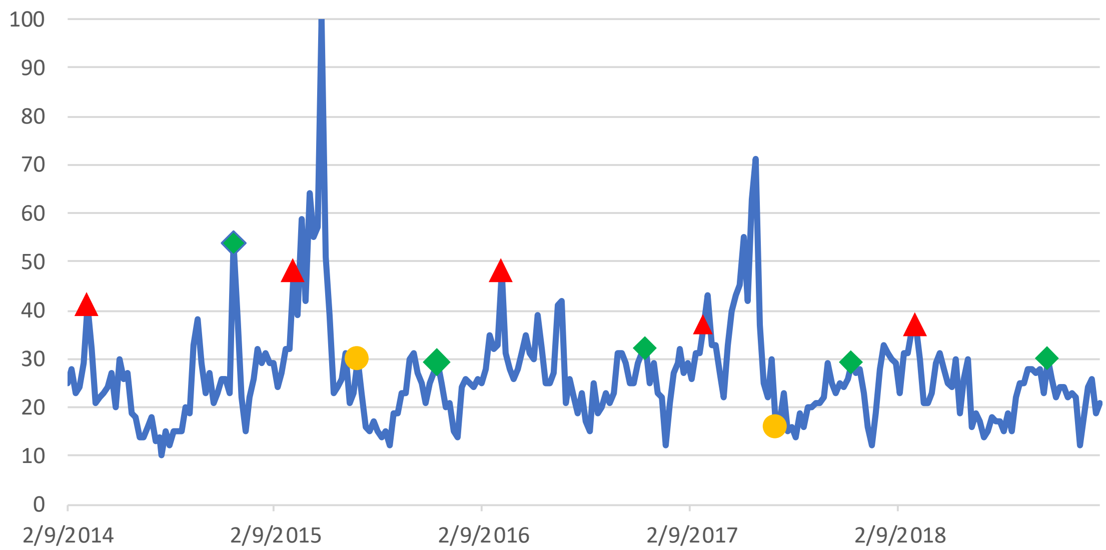
[8] The July 2015 yellow spike is more pronounced, probably reflecting the supplementary budget introduced at that time.

Figure 4. Internet Presence of the OBR in Google Searches (weekly, 2014-2018)

A. Search for "Office for Budget Responsibility" in the United Kingdom



B. Search for "Government budget balance"



Note: Numbers expressed in percent of the maximum number of Google hits over the period.

Source: Google Trend (February, 2019).

The case of the Dutch CPB would seem a priori less clear cut (Figure 5, top panel). However, the time series exhibits a very high volatility inherent to the CPB much-publicized costing of electoral platforms ahead of general elections. As the CBP has operated since the mid-1940s, we retrieved the longest time series of Google searches available (monthly data going back to 2004). Very sharp peaks in internet users' interest for the CPB systematically occur the month preceding general elections—when the report "Charted Choices" is published and identified on the Figure by a diamond—and the month of the elections—identified by a triangle. Given the dimension in which Google presents the data (in percent of the maximum observed over the entire sample), these peaks dramatically compress the rest of the series. However, aggregating monthly outcomes over the 15 years available points to a stable seasonal pattern in which the higher number of hits observed in March and September of each year coincides with the CPB's main forecast releases (Figure 5, bottom left panel).

One last observation about the Google metric of CPB's cyber presence is a pronounced downward trend, particularly after 2013. Even the spike generated by the 2017 elections did not bring Google searches above the level recorded in any year between 2004 and 2013. While such erosion could be due to multiple factors, including the fact that the CPB may have built a growing cohort of regular users who do not need to search for its website, it suggests that IFIs' presence in the public debate should not be taken for granted and needs to be nurtured.

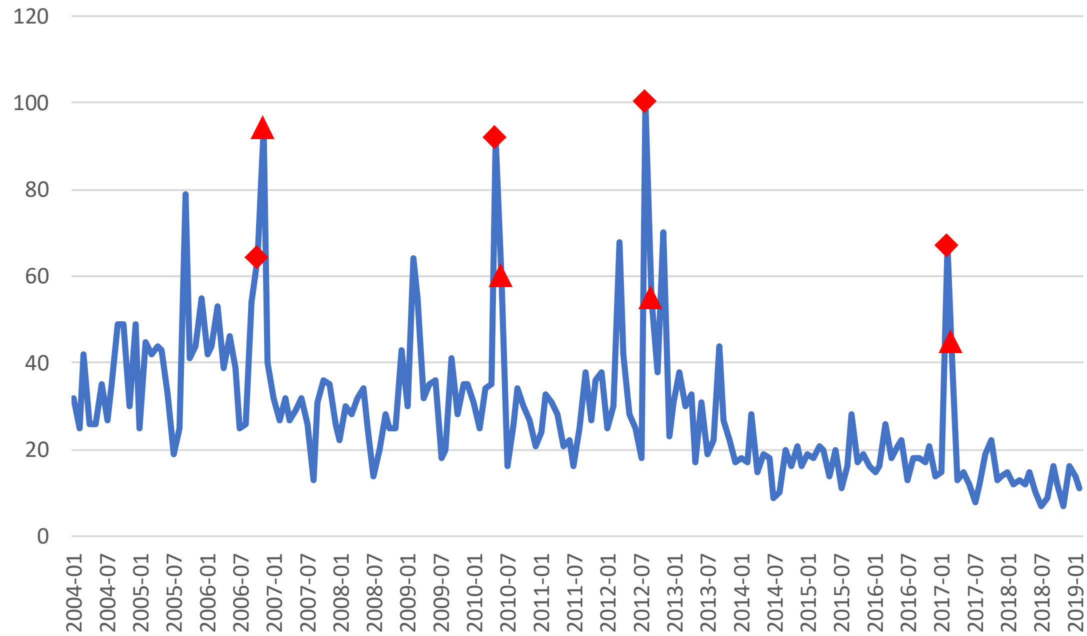
Unlike the CPB, the AIReF is a rather new institution that had to quickly step up to a broad mandate, including the surveillance of Spain's complex web of subnational governments. And unlike the OBR, the AIReF is mandated to publish a large and varied portfolio of reports falling into no less than 11 different categories.[9] These features may explain the fairly fickle pattern of AIReF cyber presence displayed in Figure 6.

The risk associated with high frequency interventions in the public debate is that information overload can erode the signal-to-noise ratio of IFI communication. For instance, Curristine et al. (2013, p. 36) warn that "[…] *a fiscal council constantly out in the public with a running commentary, disconnected from important parliamentary budget preparation deadlines would raise doubts about its ability to contribute to the debate, when it is most needed.*" Such risk seems unlikely to have materialized for AIReF, however. The Google metric for internet users' interest has steadily risen, doubling since AIReF's creation (according to the 6-month moving average of the indicator). This may suggest that AIReF outputs (and the way it communicates about them) make its interventions in the public debate sufficiently distinct to dispel the impression of a "running commentary" and to attract more attention over time.

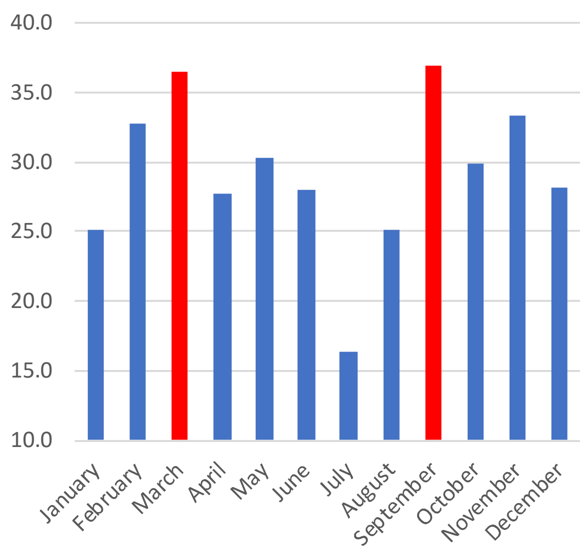
[9] These include: Opinions, Studies, Spending Reviews, Recommendations, Working Papers, Occasional Papers, Speeches by the President, Annual Report and Strategic Plan, Minutes, Resolutions, and Focus.

Figure 5. Internet Presence of the CPB in Google Searches (monthly, 2004-2018)

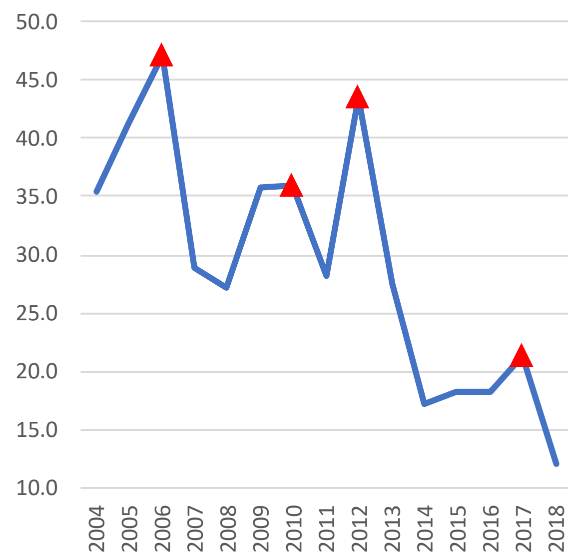
A. Search for “Bureau for Economic Policy Analysis” in the Netherlands



B. *Monthly pattern*

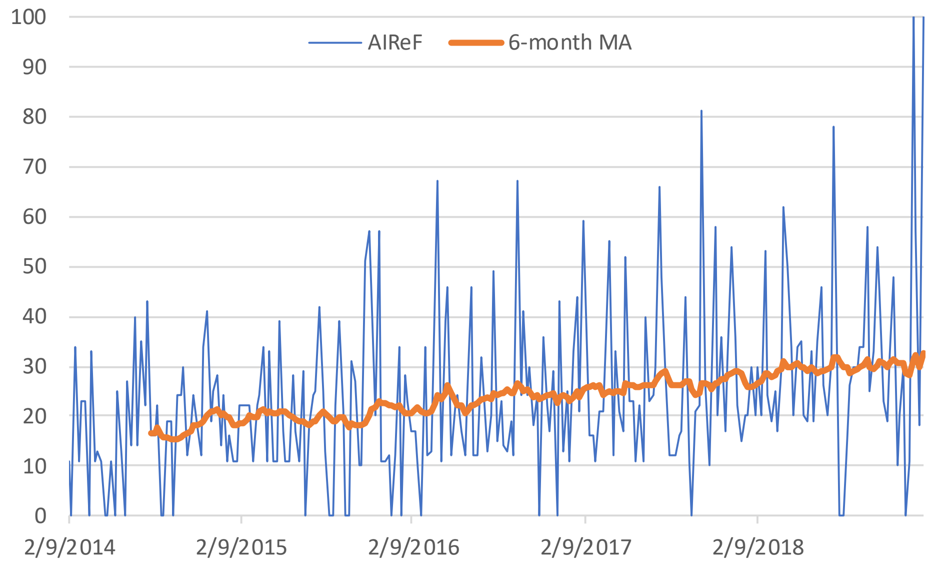


C. Yearly average



Note: Numbers expressed in percent of the maximum number of Google searches over the period.
Source: Google Trend (February, 2019).

Figure 6. Internet Presence of the AIReF in Google Searches (weekly, 2014-2018)



Note: Numbers expressed in percent of the maximum number of Google hits over the period.
Source: Google Trend (February, 2019).

D. Summary

The ultimate goal of IFIs is to strengthen governments' commitment to fiscal responsibility, which, in the EU, is enshrined in formal fiscal policy rules.[10] To do so, IFIs perform a range of activities that raise the costs for governments to breach those rules. Tasks include providing direct inputs to the budget process (e.g. unbiased macroeconomic and budgetary forecasts, estimates of structural balances, costing of certain legislative initiatives), public assessments of fiscal performance (including a formal monitoring of compliance with fiscal rules, evaluations of the likelihood to reach official goals with announced policies, or assessment of long-term sustainability), and other non-partisan inputs to the public debate about fiscal policy (including sometimes specific policy recommendations to deliver on official objectives).

In the end, as fiscal councils do not control any policy lever and often do not benefit from direct involvement in decision-making, their influence on the public debate is paramount to affect policy outcomes. If they can be ignored at no cost for the government, chances are that they will be ignored and hopelessly ineffective. Although IFIs' realm is by essence as local as fiscal politics, EU membership gives a transnational dimension to their activities, raising the risk of costly coordination failures. The next section discusses these potential failures, building a case for some form of EU-wide coordination among IFIs.

[10] Note that coexistence of rules and IFIs is a global norm, not just an EU-specific phenomenon (Debrun and Kinda, 2017).

III. IFIs in the EU context: Cooperation vs. Coordination

In the EU, IFIs' success in fostering political commitment to harmonized rules-based frameworks has a public good dimension. The argument is especially relevant in the euro area, where the stability of the common currency requires sustainable and stabilizing fiscal policies in every single member state. It is important to recall at the outset of this section that we use the term coordination in a broad sense that includes "soft" forms of voluntary cooperation such as regular exchanges of views.

Two broad types of coordination failures could undermine the effectiveness of fiscal policy oversight by national IFIs and the Commission. The first is an insufficient harmonization of IFIs' objectives, functions and capacities across countries. A system where only a fraction of IFIs perform as intended would negate the public good dimension of effective national frameworks at the EU level. The second type of coordination failure would take the form of recurrent, meaningful, and, by definition, public disagreements between the Commission and local IFIs. Such cacophony would not only weaken the signaling power of IFI communication, but also undermine the Commission's role in implementing the Stability and Growth Pact and orchestrating fiscal coordination in the context of the European Semester, notably through country-specific recommendations.

A. Insufficient IFI Harmonization

Achieving some convergence among national IFIs towards best international practice would be desirable for all. The Commission would appreciate stronger national commitments to EU-compatible fiscal frameworks, and IFIs would gain broad acceptance and credibility more quickly, which is particularly valuable for new institutions.

However, there are signs that harmonization may be too low. The 2011 Directive and the Two-Pack only mandated some key elements of independent bodies' remits but failed to flesh out even the most basic elements of best practice in designing and operating IFIs, including guarantees of non-partisanship and independence, access to information, ringfenced funding, and staffing commensurate to tasks (see von Trapp and Nicol, 2018). A draft Directive of December 2017 "for strengthening fiscal responsibility" comes across as an official acknowledgement that more could indeed be done to bring every "independent body" closer to a best practice IFI (see Art. 3, par. 7). However, at the time of writing, there appears to be no political appetite for the draft Directive.

Despite the convergence in remits sought through EU law, the EFB (2018) recently observed that capacities to deliver may vary significantly across countries. Horvath (2017) documents the great heterogeneity among EU IFIs in key dimensions usually thought to shape their effectiveness. While local constraints and preferences can partly explain such heterogeneity—a healthy manifestation of national ownership—they cannot explain it all. A cursory look at the data suggests that several recurring issues could undermine IFIs' effectiveness, including insufficient capacities (funding and staff), gaps in guaranteed access to information, and a lack of formal avenues for engagement with policymakers (executive of legislature).

As illustrated in Figure 7 (panel A), the median staff size (including management) of an IFI in the EU does not exceed 12 full-time equivalents, with the largest numbers explained by historically broad mandates in some of the older institutions in the Netherlands, Denmark, and Belgium. *De jure* guarantees on access to relevant information—consisting of a memorandum of understanding backed by specific legal provisions—are also lacking in many countries. Specifically, 5 countries have no guarantee at all (score 0 in Figure 7-panel B), 4 rely on a memorandum only (score 1), and 5 benefit from legal safeguards but have no specific memorandum in place to flesh out the legal provision (score 2). Finally, a third of EU IFIs cannot count on any structured channel of engagement with policymakers, such as an effective comply-or-explain provision[11] and regular hearings, while both mechanisms are simultaneously available to only a quarter of them (Figure 7, panel C).

B. Cacophony

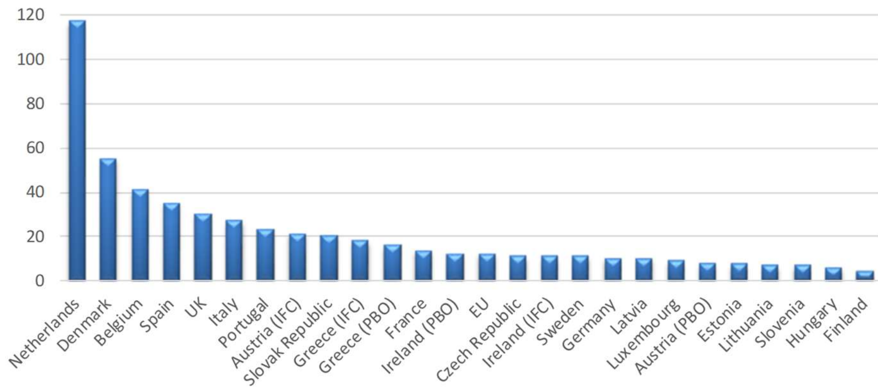
The limitations on direct means of political traction for IFIs put a premium on their ability to shape the public debate through strong media presence and effective communication. This is precisely where the second type of coordination failure can arise because the European Commission and each national IFI share the responsibility to oversee national fiscal policies.

Any oversight function involves a significant dose of judgment and uncertainty, making divergences of views beyond honest disagreements among independent experts quite likely. Indeed, the Commission and local fiscal councils work with different information sets, and fulfill specific mandates giving them different perspectives on political objectives and constraints facing national policymakers. Unlike national IFIs, the Commission is the core player in annual policy coordination in the context of the European Semester, not to mention the enforcement of the Stability and Growth Pact, whose provisions are reflected in one way or another in national fiscal rules. Thus, compared to a local institution, the Commission might pay greater attention to Union-wide considerations such as the euro area fiscal stance and its impact on the area’s balance of payments, the exchange rate of the euro, and ultimately, its possible repercussions of the common monetary policy.

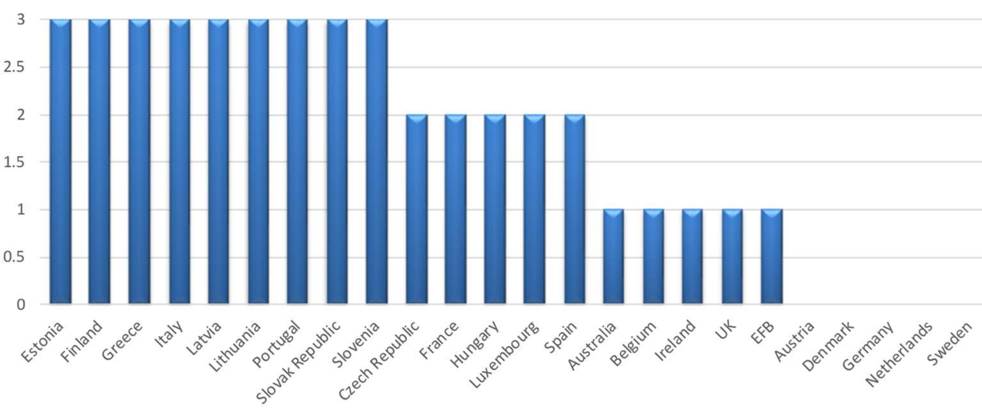
[11] Jankovics and Sherwood (2017) offer a somewhat more benign view on comply-or-explain practices than ours, which rely on IMF data. See also EFB (2017).

Figure 7. EU Fiscal Councils: Same Expectations, Heterogeneous Means

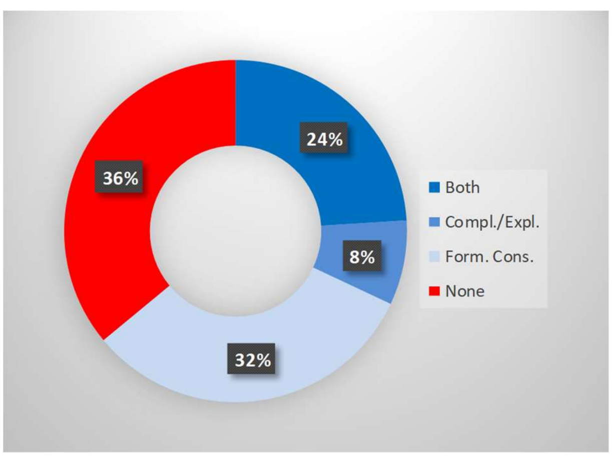
A. Staff resources (number of FTE, including management)



B. Guarantees on access to information



C. Structured engagement with policymakers



Sources: OECD IFI Database (2018), IMF Fiscal Council Dataset (2017), and author's calculation.
Notes: In Panel B, a score of 1 indicates the existence of a memorandum of understanding only, a score of 2, a legal guarantee but without such memorandum, and a score of 3, a memorandum backed by legislative guarantee. In panel C, the figure shows the percentage of EU IFIs benefitting from formal consultations with policymakers ("Form. Cons."), a comply-or-explain requirement ("Compl./Expl."), and a combination of the latter two ("Both").

Diverging views between a fiscal council and the Commission on the adequacy of fiscal policy could create undesirable cacophony in national public debates, possibly undermining the credibility of both institutions and jeopardizing the implementation of fiscal rules. For national IFIs, cacophony could blur the public signals they rely on to influence policy outcomes. Certain conflicts could carry the suspicion that the IFI is either an agent of Brussels or a loyal subject of its sovereign (i.e. under local political influence). Either way, its independence would be questioned. For the Commission, recurrent public disputes with IFIs could weaken its traction at the national level, working against the initial intent to increase EU rules ownership through EU-friendly national frameworks.

Several sensitive areas can easily be anticipated as possible battlegrounds. First, cacophony could arise from diverging assessments of the quality of macroeconomic and budgetary forecasts, notably if the Commission and the fiscal council do not communicate in synch and/or use divergent methodologies. Particularly damaging would be a situation where the forecasts produced by an IFI and used by the government would be deemed overoptimistic by the Commission. Second, different perspectives on policymakers' incentives and binding constraints could feed differences in assessing the need, magnitude and timing of activating correction mechanism, escape clauses, or invoking "other relevant factors" in case of significant deviation from agreed objectives. Again, this could not only loosen the link between the EU rules and their national counterpart, but also undermine IFIs independence by subjecting them to a form of comply-or-explain relationship with the Commission. Third, conflicts could arise in the context of the policy recommendations emanating from the European Semester annual policy coordination exercise. They could be particularly damaging for national IFIs mandated to formulate normative assessments and recommendations. Once again, divergences in available information and different emphasis—e.g. a greater role for euro-area fiscal stance considerations on the side of the Commission—could put IFIs and the Commission on a collision course.

Now, it bears emphasizing that "cacophony" in this context means *preventable noise* stemming from different information, methodologies or communication strategies, not substantiated disagreements emanating from different preferences, degrees of risk-aversion, or other factors shaping one's judgment. The political nature of the Commission/Council tandem has the potential to create divergences with independent institutions at the national level; and IFIs—including the EFB—should be expected to disagree from time to time with national and supranational political bodies. In the end, the idea is to avoid conflicts that obfuscate the public debate and weaken democratic accountability, not those that are inherent to rich and well-informed discussions about fiscal issues.[12]

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[12] I am grateful to Cinzia Alcidi for encouraging me to clarify this point.

C. Evidence

While conceptually plausible, there is only anecdotal evidence about the concrete relevance of these coordination issues, and the extent to which they can undermine the role of IFIs in EU fiscal governance. On the lack of harmonized practice, the EFB (2018) noted significant differences in the remit and constraints faced by IFIs in critical areas such as the preparation of macroeconomic and budgetary forecasts, the timing and coverage of IFI assessments, and their access to information. This results in varying levels of IFI activity, with certain institutions remaining largely silent regarding the implementation of fiscal rules and the related compliance risks, while others are more vocal, although not necessarily effective.

On the risk of cacophony, the EFB (2018) noted information asymmetries between the IFIs and the Commission and identified as a "coordination issue" the fact that IFIs were not directly involved in discussions between the Commission and national governments. Whether this would be desirable or even feasible is not the point. The fact is that conditions are in place for IFIs and the Commission to create unhelpful noise in the public debate. Jankovics and Sherwood (2017) provide one clear example of cacophony that could be symptomatic of more to come. In a November 2016 report, the Irish IFI had pointed out a risk of non-compliance with the EU expenditure benchmark, only to be sternly reminded by the Finance Minister that the Commission had already deemed the expenditure plans in questions "*broadly compliant with the SGP*."

IV. Coordination and its Forms

The potential coordination failures discussed above are significant. Should they materialize on a regular basis, the EU would not draw the full potential of the 2010 reform of fiscal governance, and at the national level, many IFIs could be perceived as part of the noise around fiscal issues, with a clear risk to fall into irrelevance. This section first discusses desirable forms of coordination, noting that they involve a horizontal and vertical dimension. We then turn to a brief discussion as to how such coordination could be organized concretely.

A. Forms of Coordination

Policy coordination can take many forms. At one end of the spectrum, decisions are explicitly centralized. At the other end, players exchange relevant information about their respective objectives and constraints based on a common understanding of spillovers and interdependencies, the hope being that cooler (and better-informed) heads prevail before a preventable conflict erupts. The choice for a specific coordination model is dictated by the trade-off between the intensity of spillovers (and/or scale economies associated with centralization) and the preferences of each player. For instance, monetary policy was centralized because the spillovers from misaligned exchange rates and egoistic monetary policies were too strong to be compatible with a single market; but tax policies, which are distributive by nature and close to national politics remained in national hands, subject to more limited harmonization. Sometimes also, national sensitivities are so acute that policies that should be centralized by virtue of any rational economic argument remain hopelessly national: defense is a case in point.

In the case of EU IFIs, the terms of the trade-off unambiguously call for soft forms of coordination. First, national anchorage is paramount. Effective IFIs must be as local as fiscal politics. At the same time, they must be fiercely independent to be credible and audible in the national public debate. Thus, perceived pandering to either national politics or the central agenda of EU institutions would be toxic for any IFI.

Second, given the nature of the link between IFI activities and fiscal policy outcomes, conflict avoidance or mitigation can go a long way through soft forms of coordination, including regular and structured information sharing, benchmarking (e.g. in terms of distance from best practice), and peer pressure. Because a central function of IFIs is to shape the public debate on fiscal issues, substantiated disagreements are inherent to any debate, and coordination should not mean suppressing disagreements altogether. The bottom line is that mitigating coordination failures could be done by establishing explicit channels of information exchanges and by forging a consensus on aspects of international best practice that EU IFIs should aim at.

Two dimensions of coordination are relevant and should be made mutually consistent. First, information should flow *vertically* between each national fiscal council and the Commission, to the benefit of both institutions. Unless obvious confidentiality issues arise—such as for certain micro-simulations models of tax revenues or market-sensitive material on debt management strategies—all information deemed relevant for effective fiscal oversight should be shared. Preventing major informational asymmetries between the two institutions is indeed essential to reduce the risk of cacophony.[13] Bilateral memorandums of understanding could govern the timing and contents of such regularly scheduled exchanges. Lower-frequency and more ad-hoc dialogue on methodologies and approaches could also be organized to further reduce the risk of cacophony. For instance, the Commission could clarify how it implements surveillance of the country in the context of the fiscal governance framework, whereas the Commission's own oversight work could benefit from the council's deeper knowledge of local constraints, customized statistical methodologies, and institutional specificities.

Second, information should flow *horizontally* among IFIs. With many new institutions taking on key responsibilities in a complex governance system, there are obvious benefits to disseminating good working practices both as regards internal processes as well as the interactions with key stakeholders (i.e. the national government, the Commission, the general public, investors,…). Absent a centralized effort to further harmonize the role of IFIs,

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[13] One would presume that the Irish example of cacophony mentioned earlier could have been avoided had an open discussion about the expenditure benchmark taken place between the IFI and the Commission staff.

a network gathering all officially recognized independent bodies could offer a formal forum for such exchanges, and beyond that, a venue for sui generis peer pressure (emulation) and for benchmarking good practice in the specific context of EU (Calmfors and Wren-Lewis, 2011).

The overall consistency of the system would require regular dialogue between IFIs as a group and the Commission. This is where the EFB could facilitate coordination, acting as a neutral umpire to organize regular engagement with the Commission. Through these interactions, IFIs could provide first-hand, granular advice on ways to plug eventual gaps in the national leg of the fiscal governance framework, including the possible need for centrally-driven harmonization of IFIs' remits, operational independence (including resources), and modes of engagement with national governments. Beyond suggesting institutional reforms, the group could also share common problems encountered in the implementation of budgetary surveillance and bring it to the Commission's attention.

That said, there is only so much dialogue, information sharing, and peer pressure can do. One specific area that may call for somewhat "harder" forms of coordination concerns formal recommendations to national governments. Not all IFIs issue such recommendations and they may not necessarily overlap with those prepared in the context of the European Semester. However, it is not hard to imagine that conflicting or sufficiently differentiated recommendations to national governments could weaken their traction on policymakers. Given the rather low take-up of recommendations issued at the end of the European Semester (Darvas and Leandro, 2015) and the need for many new IFIs to establish credibility, avoiding ex-ante divergences on recommendations would seem particularly important. This may require the IFI and the Commission to agree ex-ante on a division of labor in the formulation of such recommendations or on a rule specifying the circumstances in which one institution must align its fiscal recommendations on the other. Of course, should the Council ultimately choose not to follow the agreed recommendations submitted by the Commission, conflict could still arise, but its genesis would be transparently political.

To conclude, Table 1 disaggregates coordination issues by task typically assigned to IFIs. As their remit can vary depending on the source of deficit bias they are expected to tackle, the extent and nature of the vertical dialogue with the Commission would have to be tailored to each country.

Table 1. IFI Coordination in the EU: A Granular View

Cause of deficit bias	Task of IFI	Coord. failure	Goal of coordination	Form of coordination
Growth optimism	Make/assess forecasts	Low capacities Cacophony	Funding guarantees Sharing information (data, models, etc)	Centralized (Directive?) Vertical dialogue
Uncertain competence	Oversight/analysis Recommendations	Cacophony Different from Semester	Explain judgments. Converge (division of labor)	Vertical dialogue Vertical negotiation
Fiscal illusion	Sustainability analysis	Low capacities No engagement Cacophony	Funding guarantees Effective comply/explain; hearings Sharing information (data, models, etc)	Centralized (Directive?) Horizontal dialogue (peer pressure) Vertical dialogue
Impatience/electoral uncertainty	Oversight/analysis Recommendations	Cacophony Different from Semester	Explain judgment Converge (division of labor)	Vertical dialogue Vertical negotiation
Common-pool/budget Centralization	Oversight/analysis	Cacophony	Converge on fiscal space assessment.	Vertical dialogue

B. Status Quo and Way Forward

Some elements of the cooperative system envisaged above are already in place, at least in embryonic form. As regards horizontal coordination, the idea of creating a platform for regular exchange of views and forging common views on joint areas of concern has already materialized. In fact, two overlapping networks exist. The EU network of Independent Fiscal Institutions was created by a signed agreement in September 2015. It is voluntary, self-organized and open to all IFIs operating in the EU. The Network usefully pools analytical capacities from its members to produce short pieces that include (i) an analysis as to how IFIs perform some of their tasks (e.g. forecast endorsement), (ii) advice on further reforms of EU fiscal governance, and (iii) a position on the minimum standards IFIs should follow to be effective.

A separate network gathers the officially recognized independent bodies by virtue of EU law. It has been in place since 2013 and operates under the aegis of the European Commission, with DG ECFIN acting "*as a kind of secretariat*." (Jankovics and Sherwood, 2017). That second forum explicitly incorporates the vertical dimension of coordination as it provides a platform for IFIs and the Commission to engage on areas of common concern.

The third and last element of the still embryonic cooperative system is the EFB which is vaguely mandated to cooperate with national IFIs. The EFB annual report does good on that mandate by providing an informative review of how IFIs play (or do not play) their expected role in EU fiscal governance. The report also identifies areas of concern regarding the effectiveness of IFIs, such as discrepancies in information sets available to the Commission and the IFIs and the lack of vertical dialogue between IFIs and the Commission. Finally, the EFB's task to assess EC even-handedness in applying the EU framework could in principle discourage the Commission to pander to local politics ("because this is France"), thereby directly reducing the risk of cacophony.

While these initiatives signal awareness of the need for a more cooperative approach to the work of IFIs, the lack of coherence shows the difficulty to bring together generally new and untested institutions bound to be touchy on their independence. Most IFIs are understandably still very much focused on affirming independence from any political body, be it a national government or the Commission itself. A distinct risk, however, is that whatever arrangement is in place today can take a life of its own and stay beyond its point of objective irrelevance. It thus seems important, if not urgent, to gather energies for the common good of building and maintaining strong IFIs that effectively support commitments to sound fiscal policies.

Economic analysis has not much to say on the details of the transition towards a coherent and effective cooperative system. We would nevertheless suggest the following steps to facilitate the emergence of such a system:

1. A genuine cooperative regime can only emerge and thrive if players are well identified and recognize each other as peers. Thus, an EU-wide agreement on what constitutes an independent fiscal institution is a must. Today, some of the officially recognized independent bodies are not proper IFIs; and some well-established IFIs are not associated with the formal network aimed at bringing them together.

2. A better alignment of the EFB on best-practice IFIs would greatly facilitate its role in fostering cooperation among IFIs and between them and the Commission. Independence cannot depend exclusively on the temporary appointment of highly talented management and staff, as these come and go. Expanded responsibilities coming along with a cooperative system would also call for reconsidering EFB limited resources, including staff size and permanent management appointments. Nesting the EFB in the Commission itself is also a clear departure from best practice. Ways to plug that gap include erecting the EFB is a stand-alone body or nesting it in a non- or less political institution.[14]

3. To the extent that issues 1 and 2 can be solved, the architecture of the final system should be straightforward. First, a network of national fiscal councils (with mandatory participation of all IFIs recognized as such) would organize horizontal cooperation. Operationally, the existing EU network of IFIs has already established a significant track record and work practice that could usefully be built upon. Second, the revamped EFB could be the neutral umpire of the system, teaming up with national IFIs in their bilateral dialogue with the Commission, and enabling productive interactions between the network of national IFIs and the Commission. One could

[14] Experience shows that the central bank or the audit court can be favorable habitats for IFIs.

think of many ways the EFB could be integrated to the network, but this is beyond the scope of this paper.

The sticking point remains the potential risk that any institutionalized network involved in structured interactions with EU political bodies could be perceived as a channel of influence of the supranational authority on national fiscal councils. Clearly, preserving IFIs' independence is instrumental to ultimately boost national ownership of fiscal policy rules. Therefore, coordination can be a win-win strategy if two main conditions are met. First, as described above, coordination itself must not be designed to tie the hands of national IFIs. Second, placing the EFB in a neutral umpire position requires aligning its architecture on best international practice.

Let us conclude by noting that the system sketched above is far more respectful of the subsidiarity principle than more ambitious proposals, such as the creation of an EU-wide fiscal council reporting directly to the European Parliament (Fatás and others, 2003). It is fully consistent with the goal of greater national ownership of fiscal rules, which is where the legitimacy of fiscal choices will ultimately sit for the foreseeable future.

V. Conclusion

We looked at the international coordination issues related to the operation of independent fiscal councils in the EU fiscal governance framework. IFIs play a central role in the reformed fiscal governance because they are expected to foster commitment to national fiscal rules designed to be consistent with the supranational standards of fiscal discipline.

Coordination issues arise because in a currency union, fiscal responsibility is a public good. Thus, IFIs should be effective everywhere, requiring harmonization in remits, tasks and capacities. Another important aspect relates to the nature of IFIs. These institutions influence policy outcomes mostly through their ability to better inform the public debate on fiscal policy. Hence, their activities overlap with regular surveillance conducted by the European Commission in the context of the European Semester and with the implementation of the Stability and Growth Pact.

We argued that without coordination among national fiscal councils and between them and the center, two risks threaten the effectiveness of EU fiscal framework. First, some IFIs might fail to strengthen government's commitments to national fiscal rules (and through them, EU standards of fiscal discipline). Second, the risk of cacophony would loom large in national public debates on the adequacy of fiscal policy, which IFIs should in principle avoid.

Explicit coordination could mitigate such risk. Both the nature of potential coordination failures and the need to preserve national ownership and IFI independence suggests that coordination should take the form of structured exchanges of information and discussions, ideally with the support of a reformed EFB. By contrast, we see no case for "hard," institutionalized coordination aimed at muting ex-ante any divergence of views, as it would fatally undermine independence and national ownership of fiscal councils.

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