FISCAL-BUDGETARY RESPONSIBILITY AND IMPLICATIONS ON THE EUROPEAN BUDGETARY FRAMEWORK IN THE CONTEXT OF THE COVID-19 CRISIS

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Abstract

The aim of this paper is to analyse fiscal-budgetary responsibility and the implications for the European budgetary framework in the context of the COVID-19 crisis. The study incorporates retrospective analysis of the European institutional framework, presentation of concepts and typologies of institutional organization in direct relation to the fiscal responsibility. The research hypotheses are based on the demonstration of inconsistency in the European working framework, regarding budgetary fiscal responsibility, as well as on the foundation of the institutional levels of organization and the demonstration of the existence of warning indicators regarding the vulnerabilities of the budgetary framework. The results of the study confirm the working hypotheses. Therefore, there is a need to establish responsibility mechanisms, which allow the replacement of arbitrary rules with clear directions to be followed by policy makers, so that interference between different institutional levels directly impacts the coordinates of fiscal risk management. The path of combating an economic crisis caused by the COVID-19 pandemic involves coordination, responsibility and common frameworks for action, so that the test of European unity to be passed successfully. The study exemplifies the importance of perceiving fiscal risk in relation to specific vulnerabilities and reveals a number of challenges to fiscal responsibility in the context of the COVID-19 crisis.

Keywords: fiscal-budgetary responsibility, fiscal risk, European budgetary framework, COVID 19 pandemic, economic crisis, fiscal institutions, policy makers.

JEL Classification: E62, H87, H12, H7

Introduction

Fiscal-budgetary responsibility and implications for the European budgetary framework in the context of the COVID-19 crisis are a research topic for both policy makers or economists, and researchers, as it is absolutely necessary to conduct fiscal-

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budgetary policy prudently and to manage resources and budgetary obligations, as well as fiscal risks in a way that ensures the sustainability of the fiscal position in the medium and long term.

The research aims to demonstrate the inconsistency in the European framework of work regarding fiscal-budgetary responsibility, as well as on the basis of institutional levels of organization. This also aims to demonstrate the existence of warning indicators on vulnerabilities in the context of the economic shocks caused by the pandemic.

The scientific approach is developed through the following sections: Section I reviews the scientific literature on fiscal responsibility; Section II presents the research methodology; Section III examines the Fiscal Councils of the EU-28 states, retrospectively; Section IV deals with the suspension of fiscal rules in the context of the COVID-19 crisis and its economic implications; and Section V presents the conclusions of the study.

1. Literature review

Fiscal responsibility is most often defined in the literature as institutional arrangements in support of government actions to achieve a responsible, sustainable and transparent fiscal policy (Lienert, 2010). In this context, the implementation of fiscal responsibility laws requires the application of instruments such as budgetary procedures, numerical tax rules and the existence of independent fiscal institutions (Dziemianowicz and Kargol-Wasiluk, 2015, Cavallo et al. 2018). In this regard, Pettinger (2016) considers that fiscal responsibility requires a national government to pursue the appropriate level of government spending and taxes to: maintain sustainable public finances; ensure that fiscal policy aids the optimal rate of economic growth; maintain an adequate level of public investment.

The essence of fiscal-budgetary responsibility derives from the legal framework applicable to budgets, which involves the creation of a solid system of principles, which guides the way in which public financial resources are formed and used in order to support sustainable development (Lienert and Fainboim, 2010). Thus, the quality of governmental and political institutions is essential and derives from the coherence of the political doctrines assumed and based on which they implement national development strategies, influencing the implementation of budgetary processes and fiscal results (Alesina and Perotti, 1996, 1995, Mejía Acosta and Coppedge, 2001) .

2. Research methodology

In order to analyse the implications of fiscal rules on the European budgetary framework in the context of the COVID-19 crisis, the coordinates of the subject proposed for debate were taken into account and the research dimension was corroborated with methods to substantiate judgments in accordance with the literature. Thus, the nature of the research subject positions the study in the field of qualitative working methods, in which case a model of interpretation of the institutional coordinates of the European framework of fiscal-budgetary responsibility was approached, in relation with the retrospective and prospective analysis of economic and fiscal which suffered deviations from the implications of the COVID-19 pandemic.

The research aims to prove two hypotheses; a first hypothesis that it considers is based on the demonstration of inconsistency in the European working framework, on the chain of budgetary fiscal responsibility, and on the foundation of the institutional levels of organization. The second hypothesis that the paper aims to demonstrate is the existence of warning indicators regarding the vulnerabilities of the budgetary framework, in the context of the economic shocks caused by the pandemic. In order to ensure the coherence of the scientific approach, the qualitative dimension of the objective relative knowledge is based on the observation and analysis of documents for collecting information on the status of the Member States of the European Union regarding the institutional framework of fiscal and budgetary responsibility, analysis of scientific studies, in order to build the theoretical framework and validate the scientific approach. Specifically, the study follows three stages:

Stage I. Retrospective analysis of the European institutional framework related to the dimension of budgetary fiscal responsibility, theoretical validation of the importance of approaching coordination mechanisms, able to establish a common framework for action.

Stage II. Analyses of the general escape clause implications of the Stability and Growth Pact on fiscal discipline.

Stage III: Identifying challenges regarding vulnerabilities specific to the European institutional framework.

3. Retrospective analysis of Fiscal Councils in the EU

The results of the qualitative analysis highlighted in table no. 1 indicates not only variability in terms of institutional specificity but also a delimitation of three models, which in accordance with the opinions provided by the European Parliament (2019) are based on the heterogeneity and characteristics of each country. Thus, in accordance with the first model, we consider the independent fiscal institutions, in which the direct interdependence with the political factor is weak, and based on the legal framework related to budgetary fiscal responsibility, decide on the mechanisms of nomination and responsibility. In this institutional pattern, one can include Germany with 8 and Sweden with 6 board members, respectively Romania and Portugal (5 board members), Greece (4 board members), Cyprus, Slovakia, Malta (3 board members) and Hungary (which has 2 board members). In the second institutional model, the Fiscal Councils are under the subordination of the executive or the legislature authorities and have clear directions for action. In this model, one can include Belgium and Denmark (which have the most board members: 24 and 21 respectively), the Netherlands, which has the largest technical staff in Europe (117 members), Croatia (7 members), Ireland (5 members), Greece (4 members) or Slovenia, Italy, with 3 members on board. The latest institutional model is characterized by the association of fiscal institutions with some independent institutions, such as Austria (with 15 board members) or Estonia (with 5 board members), where fiscal institutions cooperate with central banks, or France (11 board members), Finland (5 board members, Italy (3 board members), where collaboration is with audit institutions.

The retrospective of the Statute of Fiscal Councils in the European Union creates the premises to establish the efficiency of these bodies in fiscal consolidation and counteract the effects of possible crises, such as the current one, which impact not only the health system but the whole economic environment, indicating, of course, the need to create plans to restart the economy. This highlights the need for accountability mechanisms to replace arbitrary rules, with clear directions for policy makers to ensure that interference between different institutional levels directly impacts the coordinates of fiscal risk management and supports the fight against economic crises. The results validate the first working hypothesis and demonstrate the inconsistency in the European working framework, both in terms of fiscal-budgetary responsibility and on the basis of institutional levels of organization.

Table no. 1. Characteristics of Fiscal Councils in the EU-28

Country	Institutional framework and the year of starting the activity	Term of mandate / No. limitations on the renewal of the mandate	No. of board members and technical staff / Nomination of members *
Austria	Fiscal Advisory Council (FISK)-1970	6/0	MB=15, TS=6/ Guvern, A*
	Parliamentary Budget Office (PBO)-2012	5/0	TS=8/ Guvern, A*
Italy	Parliamentary Budget Office (PBO)-2014	6/ Mandatul nu se poate reînnoi	MB=3, TS=24/Lege Constituțională, Parlament
Croatia	Fiscal Policy Committee-2013	5/0	MB=7,TS=0/Decizia Guvernului.Parlament
Belgium	High Council of Finance (HRF/CSF)3-1936	5/0	MB=24, TS=15/Lege, Guvern
Bulgaria	Fiscal Council-2015	6/n.a	MB=5/Lege,Parlament
Hungary	Fiscal Council-2011	6/0)	MB=2,TS=3/Lege Constitutională,A*
Czech	Czech Fiscal Council (CFC)-2018	6/1	MB=3, TS=8/Lege
France	High Council of Public Finance (HCFP)-2013	5/1	MB=11, TS-=2.5/Lege organică, Parlament, A*
Denmark	Danish Economic Council-1962	6/1	MB=21, TS=30/Lege, Guvern
Germany	Independent Advisory Board to the Stability Council-2013	5/0	MB=8, TS=1/Lege, Guvern,A*
Estonia	Fiscal Council of Estonia-2014	5/0	MB=5, TS=1.5/ Constitutional Law, A*
Romania	Romanian Fiscal Council-2010	9/ The mandate is not renewable	MB=5, TS=10(6)/ Law, Parliament
Finland	Finnish Economic Policy Council (EPC)-2014	5/0	TS=2/ Law, Government

Country	Institutional framework and the year of starting the activity	Term of mandate / No. limitations on the renewal of the mandate	No. of board members and technical staff / Nomination of members *
Ireland	Irish Fiscal Advisory Council (IFAC)-2011	4/1	MB=5, TS-6/ Law, Government
Netherlands	Netherlands Bureau for Economic Policy Analysis (CPB)-1945	7/1	TS=117/ Law, Government
Portugal	Portuguese Public Finance Council (CFP)-2012	7/1	MB=5, TS=18/ Organic law, Government, A*
Slovakia	Council for Budget Responsibility (CBR)-2012	7/ The mandate is not renewable	MB=3,TS=15-20/ Constitutional Law, Parliament
Slovenia	Slovenian Fiscal Council-2017	5/1	MB=3, TS=4/ Law, Parliament
Sweeden	Swedish Fiscal Policy Council (FPC)-2007	3/1	MB=6, TS=5/ / Law, Government
Cypru	Fiscal Council of Cyprus-2014	6/1	MB=3, TS=6/ Law, Government
Greece	Hellenic Fiscal Council-2015	5/ The mandate is not renewable	MB=4, TS=13/Law
Spain	Independent Authority of Fiscal Responsibility-2014	6/ The mandate is not renewable	TS=35/ Organic law, Parliament
Lithuania	Budget Policy Monitoring Department – National Audit Office of Lithuania (BPMD)-2015	5/1	TS=7/ Constitutional Law
Louxemburg	National Council of Public Finances (CNFP)-2014	4/0	MB=7, TS=2/ Law, Parliament, Government, A*
Letonia	Fiscal Discipline Council-2014	6/1	MB=6, TS=4/ Law, Parliament
Malta	Fiscal Advisory Council-2014	4/1	MB=3, TS=4/Law

Source: Own processing based on data provided by the OECD (2019)
*Notes: Nomination of members: * A-Others, such as, for example, the Central Bank.*

Undoubtedly, although the retrospective of the status of fiscal rules in EU countries indicates a number of dysfunctions in the institutional architecture and substantiation of the fiscal governance framework, emphasizing the lack of coordination mechanisms capable of establishing a common framework for action and eliminating inconsistencies in approach, the contribution of the specialists from the board of the Fiscal Councils, whose ex-ante and ex-post evaluation of the fiscal policies consolidate the dimension of the good practices in the fiscal-budgetary field. Thus, the focus should be not only on addressing numerical fiscal rules, but also on strengthening the role of fiscal institutions and their independence. Of course, the process of legislative harmonisation, and not only, involves difficulties among Member States and even constitutional changes, but in line with the views of Xavier Debrun (2019), our results reveal the need for real coordination between different institutional levels (national, supranational).

Although since 2015, the institutional framework at European level is completed by the establishment at supranational level of the European Fiscal Board, which is involved in the viable substantiation of the mechanisms of the budgetary framework and intervenes through prospective analysis on what budgetary guidance in the euro area and at European level means, in line with the requirements set out in the Stability and Growth Pact. However, coordination and harmonization mechanisms are completely lacking and diminish the implications for mitigating the shock of a crisis, such as the COVID-19 crisis.

The importance of fiscal councils in strengthening the sustainability of public finances is revealed through the specific channels of influence that allow a responsibility of decision makers and, implicitly, a transparency of the budgetary process. Thus, we mention the implications of public reports that contribute not only to the exemplification of fiscal policy decisions, but also establish a form of responsibility of policy makers through the impact from the media.

Although the formal obligation of governments to consult the Fiscal Councils in the budgetary process strengthens and supports the legal framework on the need to explain publicly the deviations from the forecasts of the Fiscal Councils and, in some cases, may reside in the possibility of improving the budgetary process in the context of a crisis such as the current one (COVID-19), however, we realize that they have a soft power of influence and in conjunction with approaches based on political stakes, are unable to influence the extent of the effects of the pandemic on the economy. We find that Poland is the only country that is not in our analysis, and this is due to the specificity of fiscal conservatism on which each Member State decides whether or not to base itself. Specifically, although we do not identify the presence of an independent Fiscal Council, Poland has constitutional regulations on the nature of the budgetary fiscal process and a legal framework for fiscal responsibility in accordance with the provisions of the Maastricht Treaty, which states that public debt can no longer be higher than 60% of GDP. The case of Poland may indicate a possible judgment in agreement with the views of Asatryan *et al*., (2018), which highlights the importance of introducing rules on the budget balance based on a constitutional legal basis. Moreover, the prudent approach of economic policies and the inclination towards the absorption of European non-reimbursable funds allowed Poland to be the only country in Central and Eastern Europe that did not have an economic recession, which shows that the countercyclical fiscal policy and implicitly, the stabilisation of the economic cycle, also depends on the coordinates of fiscal prudence.

According to International Monetary Fund statistics (IMF, 2017), fiscal councils were set up in the context of the global financial crisis of 2008, a phenomenon that still does not present empirical evidence regarding the outcome of the implications, which indicates the possibility that the situation in the context of the COVID-19 crisis to establish major permutations in the legislation specific to fiscal-budgetary responsibility. As can be seen in figure no. 1, most of the Fiscal Councils are in the EU, and corroborated with the institutional background mentioned above, it is revealed that in the absence of European unity, their role in stabilizing fiscal policy depends directly on the particularities of each country and the conjuncture of fiscal conservatism.

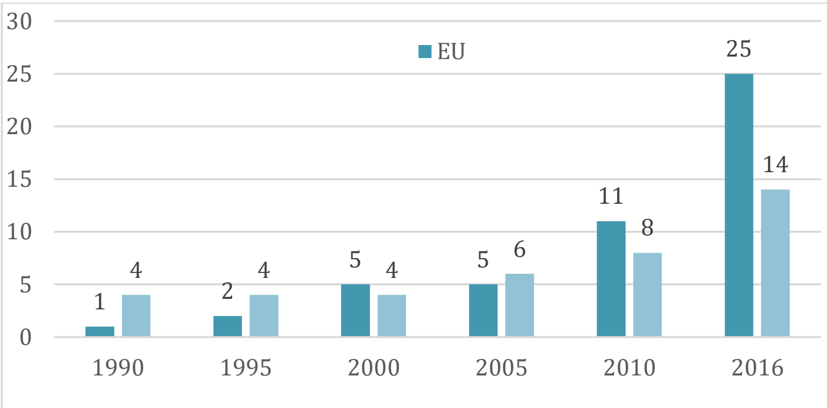

Figure no. 1. The evolution of the number of Fiscal Councils in the world, 1990-2016

Source: own processing based on data on Fiscal Councils of IMF (2017)

4. Suspension of fiscal rules in the context of the COVID-19 crisis and economic implications

The specific context of the coronavirus pandemic and the framework of the created economic stress pose major challenges among EU states and, implicitly, test European unity, in terms of fiscal and political responsibility requirements. As mentioned in the previous paragraphs, fiscal diligence takes different forms of approach, which is why now, more than ever, there is a need to manage the risk exposure. Exposing governments to major changes in revenues and expenditures, especially pension and public health spending, poses a real threat to the economic and social context. The current global crisis is different from the 2008 event, which occurred mainly from the financial sector, which is why the consequences may be more severe and the economic recovery period more difficult (Bénassy-Quéré *et al.*, 2020, Benmelech and Tzur-Ilan, 2020).

According to Eyraud *et al.*, (2018), there is a need for fiscal rules not to be rigid, in order to efficiently manage possible economic shocks. The current context positions Europe in such a period, in which case temporary deviations from the rules are allowed, but in the assent of the study, we believe that the suspension of fiscal rules must be based on a broad process of responsibility, transparency and proactivity.

Although at the level of the European Union the general escape clause of the Stability and Growth Pact decides to temporarily suspend the fiscal rules and relies on economic recovery scenarios, some elements related to coordination at European level are lost. Also, the background of some countries is omitted, those characterised by a dual nature of deficits, respectively countries that are followers of fiscal conservatism and struggle with some experience of managing public money and countries that focus on both the burden of the past and current measures to combat pandemic. In line with this clause introduced as part of the Six Pack reform of the Stability and Growth Pact, the European Commission stipulates that its introduction was based on proactivity criteria in the fight against a possible crisis and is stipulated that it was introduced to allow a coordinated and orderly temporary deviation from requirements for states in widespread crisis (European Commission, 2020). The aspects related to "coordination and order in the approach", implies wide valences of both institutional and legislative nature and reveals real challenges to the states that start the fight to restore the economic context with a previous negative baggage (high levels of public debt and deficit over 3%). As we can see in Figure 2, a strong European stimulus is needed to support economic recovery mechanisms and avoid economic fragmentation as much as possible. In line with the developments presented in Figure 2, we note that under the suspension clauses of fiscal rules, measures to combat the crisis effectively are expected, but then the emphasis is on strengthening prudent fiscal positions and ensuring sustainability.

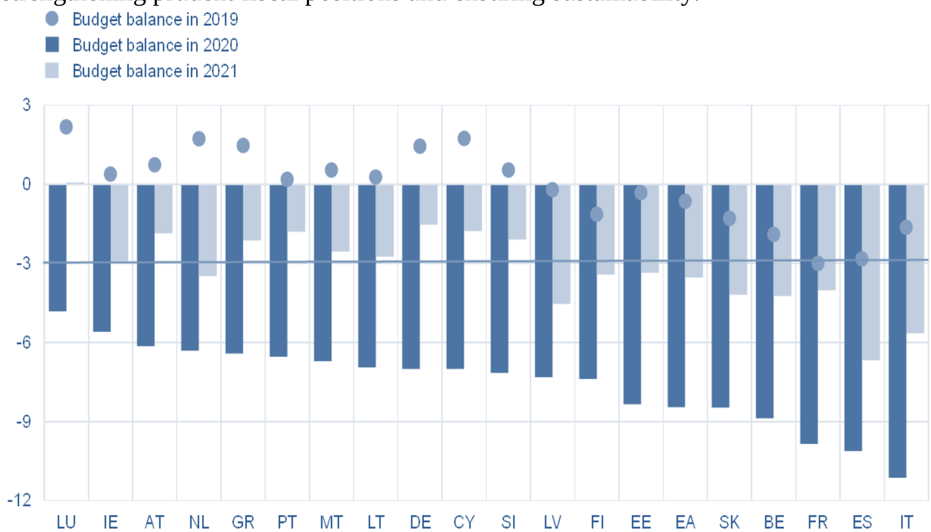

Figure no. 2. The balance of the public budget in the period 2019-2021 (% of GDP)
Source: European Commission (2020) and ECB (2020)

For the economic recovery and implicitly, actions to strengthen the European Union's position lie in a series of challenges to fiscal responsibility in the context of the COVID-19 crisis and the fact that economic effects place us in the context of a phenomenon that engages plenary a causal analysis to find remedies, we identify the following:

1. The possibility that in the context of the suspension of the legal framework, countries will severely deviate from fiscal adjustment requirements and affect the sustainability of public debt;

2. The lack of coordinated approaches at European level may lie in the lack of transparency in the budgetary process, may lead to a loss of credibility and, implicitly, to the abandonment of the revision of fiscal rules;
3. The fiscal space for each country dictates the extent of the deviation from the rules and can create problems in the application of mechanisms and common frameworks for coordination at European level;
1. Even if more than 50% of European countries have activated their general derogation clause (the escape clause is applied in some countries such as: Austria, Bulgaria, Croatia, Czech Republic, Germany, Estonia, France, Greece, Italy, Lithuania, Latvia, Portugal, Romania, Slovenia) and in some cases activation is done either automatically by integrating EU rules into the national legal framework (the case of Italy, Portugal, France), either through its own rules and escape clauses (Germany approved in Parliament the suspension of debt rules and expanded the area of the fiscal package), due to different degrees of approach and flexibility, there may be difficulties in balancing returns to fiscal rules and avoiding quick corrections .
4. Uncertainty about the economic impact is high and may exceed the limits of this general derogation clause (escape clause), being the risk that countries that do not rely on additional forecasts and plans will face major problems in fiscal risk management and the whole governance framework;
5. Expansionary fiscal policies can deepen the specific problems of budgetary frameworks, by increasing public debt beyond limits and can determine a revision of fiscal rules, which increases the risk of determining unrealistic directions of action if the background of fiscal prudence and diligence does not exist.

Undoubtedly, the post-pandemic period will determine major changes in the European governance framework, with emphasis both on the institutional framework and on the size of fiscal-budgetary rules. The coronavirus pandemic tests not only the resilience of fiscal rules but also the mechanisms for enforcing them, and ultimately reveals the vulnerability of governments to the commitment to fiscal prudence and the sustainability of public finances. In practice, countries have different approaches, with an orientation to supranational mechanisms, or the approach of additional budgets, or the use of structural rules, all of them revealing the importance of strengthening institutional coordination and cooperation mechanisms at European level.

If the research allowed, in a very modest way, the construction of theoretical frameworks capable of identifying the burden of the past and the vulnerabilities of the present in terms of fiscal prudence, it is necessary to identify at least one line of action in consolidating a sustainable approach. Thus, we consider that the most important form of responsibility consists in the creation of a common framework at institutional level, corroborated with the delimitation of some steps to be followed in the field of fiscal risk management. First, each country needs to identify its risks or potential sources of fiscal risk, calculate the risk exposure and to generate a cost-benefit analysis on the intervention. In step two, the possibility of integrating these risks into the draft budget is identified, in order to avoid shocks on the economy through the impact at the budgetary level. The third stage of fiscal risk management should be based on risk mitigation, by a possible transfer of risks and, of course, by strengthening the applicable legal framework. At this stage, it is necessary to address proactive policies, macroeconomic strategies that reduce the vulnerability of countries to the crisis and stabilize the economic context. Ultimately, the focus should be on future directions of action, which require the integration of risk typology into fiscal policy objectives and create a specific framework for monitoring their impact in the future.

Conclusions

The COVID-19 pandemic exemplifies another source of vulnerabilities that can lead to an economic crisis, creating uncertainty and strengthening the premises for new challenges, while taking unprecedented fiscal action. In these conditions of uncertainty, political responsibility, fiscal diligence and the ability of governments to respond proactively, dictate the path of economic recovery. This analysis of the implications of budgetary responsibility on the European budgetary framework in the context of the COVID-19 crisis, confirms the research hypotheses according to which there are a number of indicators of inconsistency in the European framework in the field of fiscal responsibility and the institutional levels, and demonstrates the existence of warning indicators on vulnerabilities in the budgetary framework.

The results of the research highlight the importance of perceiving fiscal risk in relation to specific vulnerabilities and emphasise that the path of combating an economic crisis caused by the COVID-19 pandemic involves coordination, responsibility and common frameworks for action, so that the test of European unity is passed.

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