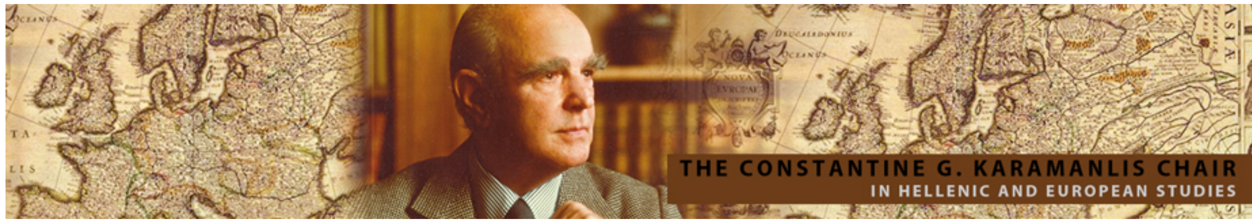

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Fiscal Institutions and the Monitoring of Public Finances: The Case of Greece

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Fiscal Institutions and the Monitoring of Public Finances: The Case of Greece

Georgia Kaplanoglou[1]

Abstract

The lack of effective fiscal institutions and the weak monitoring of public finance developments in Greece has been a major cause of the fiscal crisis that broke out nine years ago. This paper explores aspects of the weak institutional framework that did not prevent fiscal derailment even within the context of EU fiscal rules. As a result, the efforts to build up institutional capacity on the fiscal front in recent years is one of the main challenges ahead. A deeper understanding of the Greek case against valuable experience on the quality of fiscal institutions and monitoring, particularly in the European Union, is crucial in order not only to prevent unsustainable fiscal deficits in the future, but also to support a more efficient allocation of resources in the public sector, and to enhance accountability and democratic control.

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1. INTRODUCTION

The recent global financial crisis has brought forward in the most vivid way the multiple aims that fiscal policy has to reconcile. During the crisis, fiscal policy emerged more forcefully as a key instrument of macroeconomic management, with major stimulus packages being adopted by several advanced countries in order to avert a prolonged depression in economic activity. At the same time, a fiscal framework has to ensure the long-term sustainability of public finances and, therefore, should not accommodate ever increasing levels of public debt. Finally, such a framework has to reflect political priorities being shaped by democratically elected governments accountable to citizens and tax-payers.

The European Union fiscal framework has even further challenges to meet, since one of its primary additional aims has been to serve as a means of avoiding spillover effects from policy actions in one country to another in the context of the supranational currency union. Adherence to sound fiscal policy was thus given top priority and the Stability and Growth Pact included a range of fiscal rules which were meant to be respected by the members of the currency union. However, neither the preventive nor the corrective arm of the Pact seem to have been effective in preventing serious fiscal imbalances in many member states especially during the crisis. Against this background, the European fiscal governance framework has been successively reformed since 2008, but is still heavily criticized on several grounds. Researchers, analysts and policy-makers gradually realize the limits of tools once central to the European fiscal governance architecture. The design and implementation of national and supranational fiscal rules, of medium-term fiscal frameworks and fiscal institutions are all under scrutiny, while the debate on how best to monitor public finances in the EMU context is center-stage and far from conclusive.

The record of Greece in monitoring public finances over the last few decades has not been successful. In the 1990s, in an effort to join the European and Monetary Union, Greece made a major effort to reduce fiscal deficits and control the rise of public debt. Once entrance in the EMU was secured, this effort lost momentum. The fiscal outlook of the country rapidly deteriorated after the outbreak of the 2007/8 global financial crisis. The financial markets' reaction to the perceived threat of sustainability brought the cost of financing to prohibitive levels and the government resorted to financial assistance jointly provided by the International Monetary Fund and the European Union. In exchange, the Greek governments undertook a number of commitments, including among others, major cuts in public expenditure, considerable increases in tax rates and a broad range of structural reforms. Some of these reforms meant to address the weak domestic fiscal governance framework, which underwent a complete overhaul.

Despite the fact the last bailout program followed by Greece officially ended in August 2018, the efforts to build up institutional capacity on the fiscal front in the years to come is one of the main challenges ahead. The country is now being integrated in the European Semester Policy Framework, while the Eurogroup decision of 21 June 2018 provides for enhanced post-program surveillance and conditionality, whereby among others, Greece is committed to run sizeable primary surpluses for many years to come.

Against this background, fiscal monitoring in Greece has to foster reforms that strengthen the domestic fiscal governance framework, since the weak institutional

framework has been one of the root causes that did not prevent fiscal derailment in the past (Kaplanoglou and Rapanos, 2013). As a result of external pressure, Greece has already begun reforming almost every aspect of its fiscal governance framework, but policy making can still benefit from good practices accumulated by international experience. A deeper understanding of the Greek case against valuable experience on the quality of fiscal institutions and monitoring, particularly in the European Union, is crucial in order not only to prevent unsustainable fiscal deficits in the future, but also to support a more efficient allocation of resources in the public sector and to enhance accountability and democratic control. At the same time, the European fiscal governance framework is itself under severe criticism and constantly evolving. Therefore, the domestic policy dialogue should be informed of the relevant issues at stake.

The present paper addresses the main challenges of fiscal monitoring both at the domestic and the European level and is structured as follows. The next section briefly reviews the literature on effective fiscal monitoring, drawing on international experience and the rationale of rules governing the European fiscal framework until the 2007/8 global crisis. The third section highlights the weaknesses of the Greek institutional framework that paved the way for the 2009 fiscal crisis and the main reforms already or pending to be introduced in this framework as a result of external conditionality. Section 4 focuses on the multiple reforms introduced in the EMU fiscal monitoring framework in the aftermath of the global financial crisis and rescue programs to various member states. Section 5 summarizes the main points of criticism of this framework and offers a review of the current debate on proposals for further reforms, while the last section concludes.

2. TOOLS OF EFFECTIVE FISCAL MONITORING AND THE RATIONALE OF THE EUROPEAN FISCAL GOVERNANCE FRAMEWORK

The need for enhancing fiscal monitoring mechanisms in advanced economies governed by democratic regimes has essentially been brought about by the stylized fact that fiscal deficits are emerging in a persistent manner over long periods of time leading to high and occasionally unsustainable levels of public debt. An extensive literature has tried to address the key question of why governments exhibit such a tendency to create fiscal deficits (the "deficit bias" problem) and what mechanisms could deter this behavior. Most reasons that have been proposed lie in the public choice literature and include the "common pool" problem, the tendency of governments to depart from the long-run interests of the society for short-term gain, electoral popularity and sectional interest, or the information asymmetry between the executive and the legislature (see among others, Shepsle and Weingast, 1981, Rogoff, 1990, Tabellini and Alesina, 1990, von Hagen and Harden, 1995, Schick, 2002, Krogstrup and Wyplosz 2006, Krogstrup and Wyplosz, 2010, Wren-Lewis, 2010, Reinhart and Rogoff, 2010 and Rogoff and Bertelsmann, 2010). The rapid rise of public debt levels in many advanced countries during the 2007/8 global financial crisis was perceived as one more manifestation of the deficit bias phenomenon, whereby governments had not taken advantage of the long economic upturn that had preceded the crisis to improve their countries' fiscal position. On the contrary, as Hagemann (2011) notes 'the overall fiscal balance of OECD economies, as well as in the large majority of its member countries, was in deficit throughout virtually the entire three decades to 2007'.

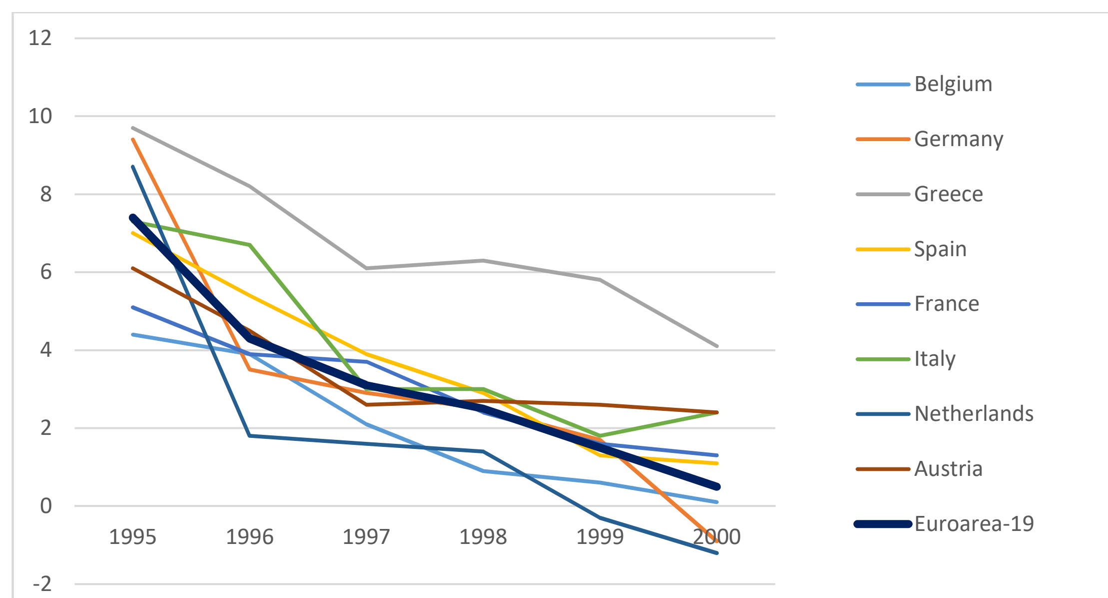
Moral hazard considerations are thought to aggravate the deficit bias problem in the case of monetary unions, like the EMU. Assigning the right of monetary policy conduct to a supranational body reduces governments' incentives to exercise fiscal discipline (Beetsma and Bovenberd, 1999). At the same time, the elimination of exchange rate risk implied by a monetary union renders government bond markets close to perfect substitutes. The high degree of bond yield convergence, of the type observed in the initial stage of the euro area, means that interest rates rise less in response to a single government's expansionary fiscal policy than this country's domestic interest rate would have responded in the case of autarky. With reduced marginal long-run costs of profligate fiscal policy, each government has an additional incentive to expand its domestic fiscal policy in the monetary union. This brings about the need of some form of coordination that would limit spillover effects (Detken et al, 2004).

In response to the "deficit bias" problem, an expanding literature has emerged on how to design a framework for fiscal governance that helps contain the tendency of policy makers for excessive deficits. The main mechanism implemented in most OECD countries is the imposition of various forms of fiscal rules, such as numerical limits to the level of public expenditure, the debt-to-GDP ratio, ceilings or floors to public revenues or the overall level of deficit (for a comprehensive review, see IMF, 2009). Medium term budgetary frameworks (MTFBs) have been proposed as another element of effective fiscal governance. Such a framework allows the government to delineate its policy in a medium-term horizon, under the premise that in each year's annual budget many adopted measures have budgetary implications for the budgets of the following years. MTBFs are usually based on a macroeconomic scenario, like projections for GDP growth, which describe the available government resources in the medium-term to finance policies. Although the objectives included in the MTBF are a weaker form of commitment than a numerical rule, they are considered useful in making more apparent the impact of current policies in the future. In recent years, the idea of establishing non-partisan public bodies acting as "national watchdogs" in the field of budgetary policy is fastly gaining ground as a way of institutionally strengthening domestic fiscal frameworks (see van Riet, 2010 and European Commission, 2009b). The mandate of independent fiscal councils can be indeed broad, ranging from assessing government forecasts on macroeconomic aggregates, motoring adherence to numerical fiscal rules and highlighting possible risks of deviation from the fiscal targets set in the budget to assessing the long-term sustainability of public finances, and especially public debt. Finally, attention is given to the broader political and administrative framework in terms of domestic budgetary procedures that cover the planning, approval and execution of the government budget process. According to e.g. the European Commission (2009a), basic features of a system of sound budgetary procedures are transparency in data and accounting practices, top-down budgeting realistic economic assumptions, performance budgeting and so on.

The architecture of the fiscal framework in the European Union included right from its inception elements of the effective fiscal governance toolkit described above. Numerical fiscal rules were first introduced for EU countries with the Treaty of Maastricht in 1992 (European Communities 1992, 92/C 191/01, Treaty on European Union) imposing the 3 percent deficit rule and the 60 percent debt-to-GDP ratio. In 1997, these rules were embedded into the newly established Stability and Growth Pact (SPG), whose provisions included both monitoring fiscal developments (through its preventive arm) and correcting excessive deficits (through its corrective arm).

The 3% deficit rule had the clear advantage of being simple and transparent, which was widely believed to help enforcement via market discipline and public oversight (Kopits and Symansky, 1998). In view, however, of its pro-cyclical nature, the SGP was reformed already in 2005, when the nominal deficit target was changed to a cyclically-adjusted one and a medium-term budgetary objectives framework was introduced (European Union 2005, Council Regulation 1055/2005). At the same time, budgetary procedures were being evaluated by the European Commission in a comparable fashion across member states (European Commission, 2007). It is true that the European Union's rules-based fiscal framework worked rather well in incentivizing countries to bring fiscal imbalances under control in view of the common aspiration to participate in the euro-area, as manifested in Figure 1.

Figure 1. General government deficit as a % of GDP, selected countries of the Euroarea



Source: European Commission, Statistical Annex of European Economy, Autumn 2018.

Despite making an impressive start in containing public deficits, the European fiscal framework does not seem to have worked equally effectively after 2000, once countries secured their entrance into the Eurozone. The SGP envisaged that member states were expected to have budgets that were "close to balance" or in surplus over the medium term, meaning that surpluses were to be run when the economy was doing well, in order for deficits to be allowed in bad times. In practice, fiscal buffers were not being built in good times and the Pact was prone to pro-cyclicality. Before the crisis, during downturns many euro area countries appear to have responded to the 3% limit imposed by the SPG by offering over-optimistic macroeconomic forecasts when they were most in danger of breaching the limit. Interestingly, what the literature has also established is that the bias in fiscal forecasts was less among Eurozone countries that had adopted certain rules at the *national* level (Frankel and Schreger, 2013).

At the same time, the implementation of the Stability and Growth Pact provisions even in cases of clear breaches of its rules was rather lax. Baerg and

Hallerberg (2016) criticize the failure of the SGP to prevent the euro fiscal crisis in terms of the ability of the Member States to undermine its operation. Following a political economy perspective, the authors focus on the "preventive" arm of the Pact and measure the variation between the European Commission's assessments of Member States and final ECOFIN's (Council of Economic and Finance Ministers) opinions of the Stability and Growth Programs. The rationale is that although the Commission acts as a "watchdog" to monitor fiscal performance, it is the Council's recommendations that leave governments open to criticism in the public sphere. The authors examine various versions of Member States' assessment, from the original text written by the European Commission to the final text approved by the Council, to detect political factors that facilitated the editing and weakening of the Commission's original recommendations. They conclude that politically powerful Member States (at least as measured by votes in the Council) and Member States with euroskeptic populations were more likely to weaken the Commission's recommendations against them, while small, euro-friendly states (like Greece) also had the Commission's text weakened when the big states were receiving milder EU–level surveillance. The breakout of the 2007/8 financial crisis found most Member States fiscally unprepared. States that adopted fiscal stimulus packages were soon faced with escalating public deficits and debt, other states didn't have enough fiscal space to run counter-cyclical policies, while several states found themselves in need for financial aid. Greece not only belongs to the last group of countries, but it is also a complete outlier in terms of its fiscal derailment. Although the weaknesses of the European fiscal surveillance architecture impacted on Greece's fiscal performance, the size and accumulation of fiscal imbalances are also a result of the national fiscal monitoring capacity, to which we now turn.

3. GREECE'S DOMESTIC FISCAL MONITORING CAPACITY BEFORE THE CRISIS AND SUBSEQUENT REFORMS

In Greece, the system of budget surveillance and fiscal rules imposed by the 1992 Maastricht Treaty and the 1997 Stability and Growth Pact acted as a catalyst in reducing deficits with the primary aim of becoming a member of the Eurozone. However, the underlying economic, political and institutional factors did not underpin the credibility of fiscal plans. Despite the fact that the Greek economy attained high growth rates throughout the decade preceding the fiscal crisis in 2009, fiscal imbalances were never effectively brought under control. Many explanations can be put forward to explain high deficits, but the most fundamental reasons lie within the weak domestic institutional framework of fiscal governance. A detailed analysis is beyond the scope of the present paper,[2] but it is worth highlighting the basic weaknesses of this framework.

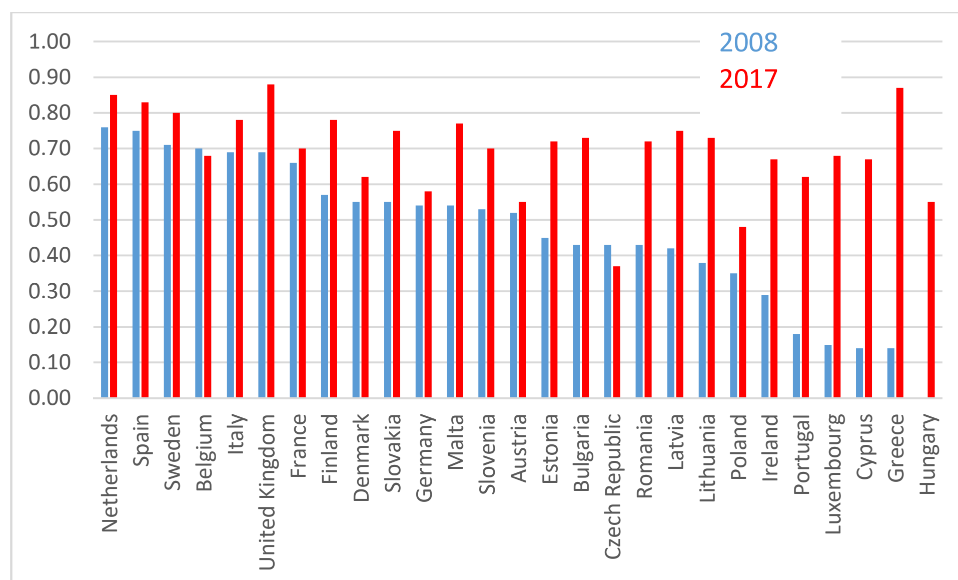
Perhaps the most important weakness of the Greek fiscal system, even within the EU rules-based framework, has been the poor mechanism of setting up the budget and the lack of any systematic monitoring of its implementation. Regarding legislative control, the Parliament has a very powerful constitutional role in voting the state (central government) budget, but it did not have any kind of mechanism to follow up on budget execution, and to monitor developments in public expenditures and revenues. Data on budget execution were available with long delays, while the fiscal

[2] For such an analysis, see, for example, IMF (2006), Rapanos (2007), OECD (2008), Vraniali (2010), Kaplanoglou and Rapanos, (2011).

aggregates monitored within the European fiscal framework (general government data) were disjoint from those approved by the Parliament (central government data). The lack of effective legislative control over the budget is also manifested in a study by Wehner (2008), who constructs a composite index of legislative budget institutions, aimed at assessing the budgetary power of national legislatures. The index is based on the institutional arrangements that give the legislature power to scrutinize and influence budget policy and to ensure its implementation. The value of the index depends, among others, on the formal powers of the legislature granted to amend the budget, the flexibility of the executive to alter spending choices following the approval of the budget by the legislature, the time available for meaningful legislative scrutiny, the existence of a well-developed committee system and the access to comprehensive, accurate and timely budgetary information. Greece non-surprisingly ranks 26th among the 27 OECD countries covered in the study, which suggests that legislator control was a constitutional artefact.

Despite the drafting of medium-term programs in order to comply with the requirements of the Stability and Growth Pact, the quality of the medium-term budgetary framework at the national level before the fiscal crisis was exceptionally low, at least as judged by the criteria adopted by the European Commission, see Figure 2. The assessment criteria include the existence of such a framework, the connectedness between multiannual and annual targets, the involvement of national parliaments or the monitoring and enforcement mechanisms. The drafting of the medium term Stability and Growth Program apparently did not guarantee its effective operation, since Greece just before the fiscal crisis ranked one but last (see Figure 2).

Figure 2. Index on the quality of medium-term budgetary framework in EU Member States, 2008 and 2017



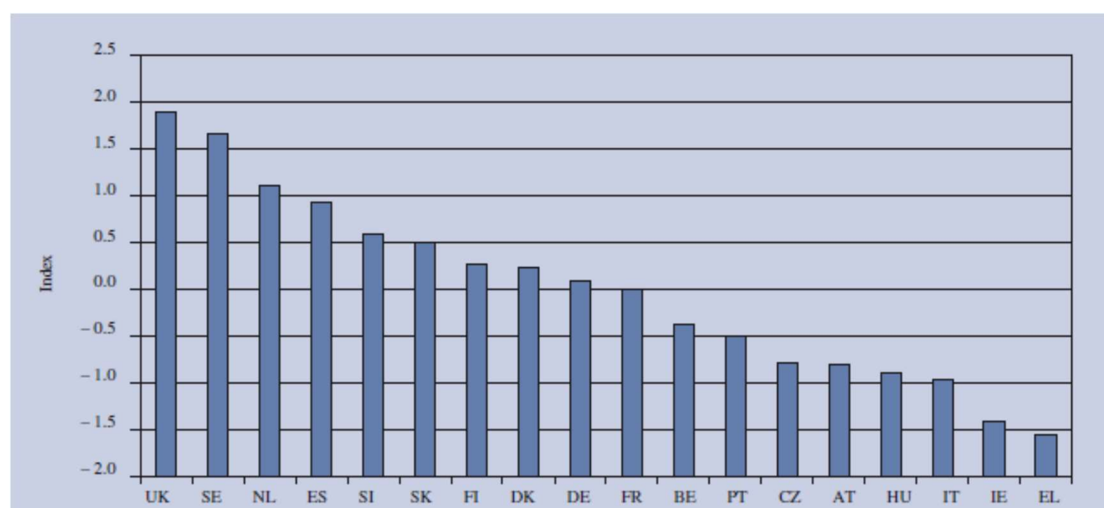
Source: European Commission, Database on Medium-term budgetary frameworks (available at https://ec.europa.eu/info/business-economy-euro/indicators-statistics/economic-databases/fiscal-governance-eu-member-states/medium-term-budgetary-framework_en)

Figure 3 presents another index developed by the European Commission to evaluate the quality of budgetary procedures identified in the previous section which cover the planning, approval and execution of the government budget process. This

overall index incorporates a number of sub-indices that refer to: budget transparency, multi-annual planning horizon, centralization of the budget process, top-down budgeting, prudent economic assumptions and performance budgeting. The scores of the index for a number of EU countries are presented in Figure 3, where Greece ranks last.

Transparency in the budget would require systematic and timely releases of budget proposals and budget reports, comprehensive and accessible budget documentation, economic assumptions on forecasts being made explicit and an active role of the legislature and other stakeholders in scrutinizing the budget. Centralization of the budget process and top-down budgeting both aim at containing the "common pool" problem leading to deficit bias. The idea is that a fragmented budget involving autonomous decisions made by a large number of participants can lead to excessive spending. Centralizing the budget process by delegating budgetary power to e.g. the Finance Minister and to start the budget planning procedure with a binding decision on the total amount of the budget (top-down budgeting) can reduce upward pressure on spending. Once hard ceilings on the total budget are set, the detailed allocation of resources within sub-areas is to be left to the line ministers, so that the ownership and more efficient use of funds is strengthened. Making prudent macroeconomic assumptions to build budgetary projections is also considered a critical factor in the budget process, so as not to justify a higher level of spending. Finally, performance budgeting is meant to strengthen the link between resources used and the output achieved, as a way of improving the effectiveness and efficiency of public expenditure.

Figure 3. Overall index of budgetary procedures, 2006



Source: European Commission (2007).

Greece's low ranking in the index of budgetary procedures is easily reconciled. Transparency of fiscal data was hardly possible given the organizational weaknesses of public sector accounting and information systems. Many public entities simply lacked standardized accounting systems, while the General Accounting Office had no coherent on-line information system that would enable it to have an overview of total public revenues and expenditures at any point in time. Furthermore, the budgeting system followed a bottom-up approach, whereby requests were being made by

spending ministries without clear indications of spending ceilings or financial restraints. The Ministry of Finance intervened at all stages of the budget process at a very detailed level, eliminating any sense of ownership of the line ministries budget and weakening their accountability in the management of public funds. Regarding performance budgeting, the control and accountability framework of public expenditure was characterised by a lack of policy objectives, which would assess the quality of expenditure and address money-for-value issues. It rather focused on excessive and overlapping ex ante controls, while ex post controls inclined towards compliance with the legality of procedures (Vraniali, 2010).

Combined with the instability of global financial markets, poor domestic fiscal governance finally led Greece to the brink of financial collapse. As documented in Kaplanoglou and Rapanos (2013), budget balance targets were being missed by a wide margin throughout the decade preceding the outbreak of the fiscal crisis in 2009. There is a growing literature aimed at identifying the sources of deviations from fiscal plans, which identifies the strategic use by governments of optimistic growth assumptions as the most frequent economic determinant of fiscal forecast errors (e.g. Jonung and Larch 2006, Von Hagen *et al.* 2009, Pina and Venes 2011, Frankel 2011, Cimadomo, 2011). For countries operating within the EU rules-based fiscal framework, weaker than expected growth rates often served as a good argument for fiscal outcomes turning worse than planned. This pattern does not fit the Greek case. Despite the fact that the economy did appear to grow in line with what the government (and other international organizations) had assumed, budgeted revenues did not find their way into the public purse, while expenditures (especially primary expenditures) were not kept under planned control. This feature was systematically not being picked up either by the Greek government or by the Commission or by the other two international organizations (the IMF and the OECD) that were monitoring the Greek economy. While the inadequate surveillance within the EU fiscal governance framework is also partly to blame, the primary reason for the fiscal derailment from a fiscal monitoring perspective has been weak domestic fiscal institutions.

The bailout program agreed with Greece's EU partners and the IMF in May 2010 imposed heavy front-loaded austerity policies, which were complemented by broad-ranging structural reforms. The latter included a complete overhaul of the domestic fiscal governance framework with the aim of aligning it with what was described above as international best practice (see, for example, Rapanos and Kaplanoglou, forthcoming). Numerous reforms in the budgeting framework were introduced by two broad amendments of the Greek Organic Budget Law in 2010 (Law 3871/2010) and 2014 (Law 4270/2014). The two laws, combined, describe a raw model of procedures and institutions that ensure efficient fiscal monitoring and effective implementation of sound fiscal policies of the type analyzed in the previous section. Although it is hardly possible to go through all the provisions of the laws, their declared aim is to promote sound fiscal governance, namely ensuring the principles of economy, effectiveness, efficiency and accountability.

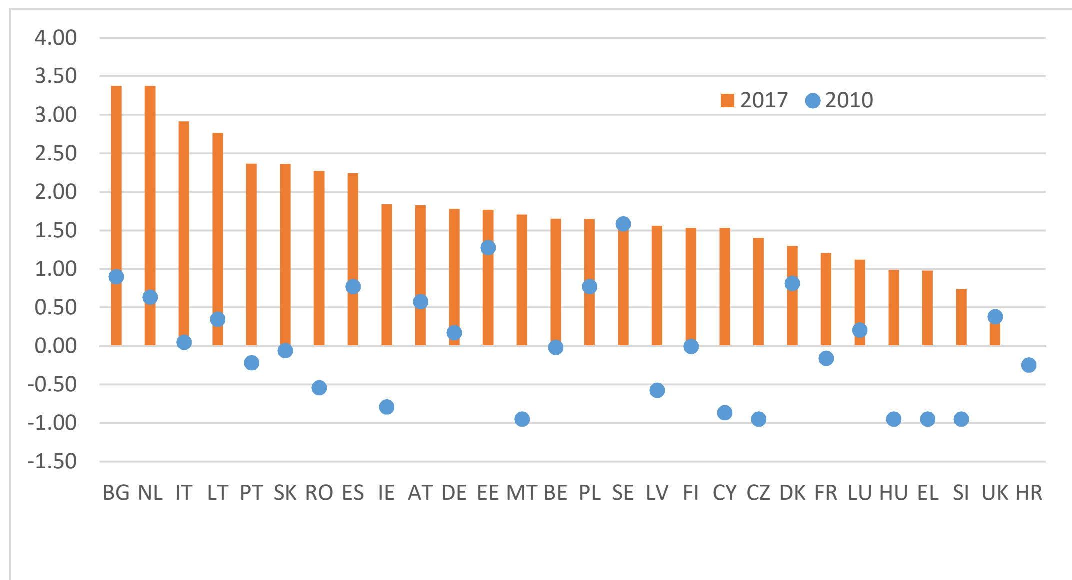
According to Law 9871/2010, the medium-term horizon of fiscal plans was strengthened through the establishment of a Medium Term Fiscal Strategy which has to be approved by Parliament. The medium term framework sets targets for the fiscal balance and the level of debt of the general government, and for spending ceilings for the state and balanced targets for the budgets of local governments, social security funds and other general government entities. The assumptions underlying macroeconomic and other projections have to be clearly spelled out and be

accompanied by sensitivity analysis of upside risks. Top-down budgeting has been introduced, with spending limits being set for State entities. Accountability and budget ownership is thus strengthened, while the oversight role of the Ministry of Finance has been expanded and made more effective. Fiscal reporting is also strengthened, since all government entities are required to set monthly and quarterly targets for budget execution, reports are produced regularly. Finally, a Parliamentary Budget Office (PBO) is set up, with the task of monitoring the implementation of the budget and of producing reports to assist the work of two parliament committees regarding the compliance to the targets set in the Medium-term Fiscal Strategy framework. The PBO thus performs part of the role of an independent fiscal institution, as analysed in e.g. van Riet (2010).

Law 4270/2014 enshrines in law all requirements for budgetary frameworks included in the Council Directive 2011/85/EU, which was adopted in order to strengthen national ownership and have uniform requirements as regards rules and procedures forming the budgetary frameworks of Member States. The Directive and the Greek law among others foresee the introduction of complete and reliable accounting practices for all sub-sectors of the general government, the publication of timely and reliable fiscal data, transparency, the production of realistic macroeconomic and budgetary forecasts, the adoption of strong numerical fiscal rules for deficit and debt equipped with well-specified target definitions together with mechanisms for effective and timely monitoring. Finally, law 4270/2014 establishes the Hellenic Fiscal Council, entrusted with the role of providing an independent opinion on the budget proposal and execution, and monitoring compliance with EU fiscal rules and lays down in great detail its responsibilities, its relations with other government entities, the rules for selecting the members of its Board of Directors, etc.

The legal fiscal governance framework in Greece now incorporates both many elements of what is considered best practice worldwide and the requirements of the EU fiscal framework. A full evaluation of the implementation of what is foreseen in law is perhaps too early to make and the evidence is yet sparse. Nonetheless, the quality of the medium-term budgetary framework, as judged by the European Commission, has impressively improved, with Greece being outperformed just by the UK among 27 EU Member States (see Figure 2). The Commission also evaluates the design strength of fiscal rules, in the sense that fiscal rules need to be equipped with the appropriate characteristics within the institutional framework of budgetary policy in order to be effective in containing fiscal imbalances. Characteristics like the legal base, the binding character, the monitoring bodies or correction mechanisms are institutional features that determine whether the fiscal rule will be respected or not. According to the Commission's numerical indicators, Greece ranks very high in terms of the rule covering the primary deficit, but its overall rank among EU countries is low in view of the absence of respectively strong rules for other fiscal aggregates, e.g. debt or public expenditure. Data availability has also drastically improved, enhancing government capabilities for evidence-based policies, which were clearly missing in the recent past (Spanou, 2018).

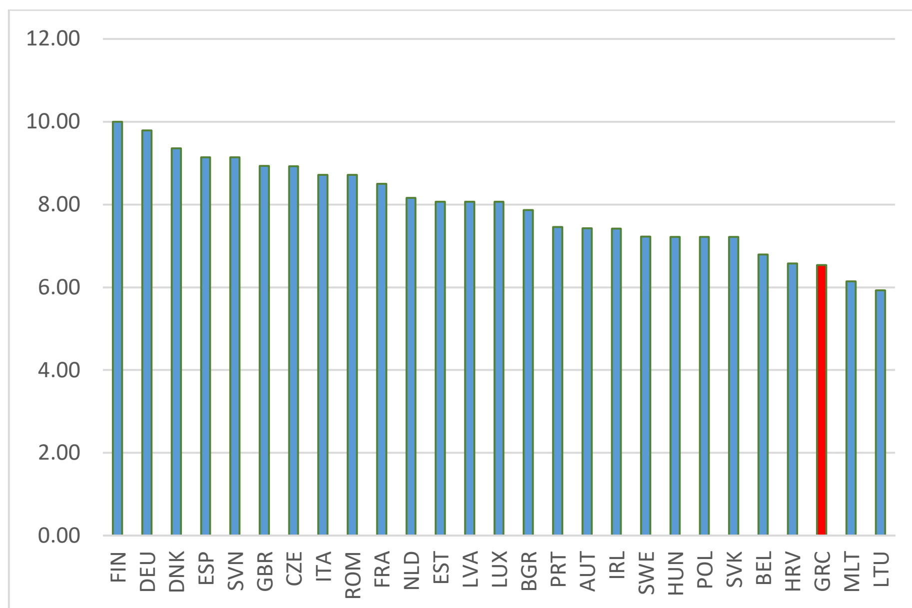
Figure 4. Fiscal Rules Index, by Member State



Source: European Commission, Fiscal Rules Database (available at https://ec.europa.eu/info/publications/fiscal-rules-database_en)

Nevertheless, it is true that institutions and procedures are not easy to reform. To give a few examples, reliable fiscal data rely on the implementation of a comprehensive accounting system for the entire general government. A new single Chart of Accounts is planned to be introduced in the entire public sector (Miliakou et al, 2017), but implementation is not easy and takes time to materialize. In terms of transparency, data based on the extent and quality of public accessibility of the executive's budget proposal presented in Figure 5 show that there is still significant room for improvement.

Figure 5. Index of Budget Transparency in EU countries, 2017



Source: European Research Centre for Anti-Corruption and State-Building, Hertie School of Governance, Berlin (https://integrity-index.org/)

Regarding the operation of the independent fiscal council, the existence of two such councils is perhaps redundant. The Hellenic Fiscal Council does not seem to have gained much visibility despite the fact it receives rather adequate funding, compared to corresponding fiscal councils in the EU (see OECD, 2018). The Parliamentary Budget Office is more active in the public debate, although it is bi-partisan (since its members are appointed on the basis of party affiliation) instead of non-partisan (not affiliated to any party) and this partly undermines its presumably impartial role and authority (Anderson, 2009). Nevertheless, the Greek PBO is ranked around the middle among independent fiscal institutions in EU countries according to a set of OECD principles like breath of mandate, access to information, public awareness and relationship with Parliament (Horvath, 2018).

Having officially exited the European Stability Mechanism stability support program on 21 August 2018, Greece is now included in the European Semester for economic policy coordination, while being subject to the enhanced surveillance procedure. The first country report in the context of the 2019 European Semester was published at the end of February 2019 and itself acknowledges that "deep institutional and structural reforms initiated in recent years to modernize the economy and the State require many years of sustained implementation for their impact to fully unfold" (European Commission, 2019). The current EU fiscal governance framework as it emerged from several reforms after the 2007/8 financial and economic crisis sets the boundaries of the supranational fiscal monitoring framework which Greece now has to respect. The evolution of this framework, as well as the debates at the EU level regarding its effectiveness and limits are crucial to understand and perhaps have not attracted the attention of Greek policy makers and the public at large. These issues are discussed in the next section.

4. THE EVOLVING EUROPEAN FISCAL GOVERNANCE FRAMEWORK

The fact that the SGP as was reformed in 2005 did not prevent 14 out of 17 euro area countries from violating the deficit rule by 2011, while at the same time the crisis had pushed debt to historic heights, led to successive reforms of the EU fiscal governance framework. The SGP was thus amended in December 2011 with five new EU regulations and one EU directive (the "Six-Pack") designed to strengthen the SGP by including new rules, new and earlier sanctions and additional escape clauses. In 2013 fiscal governance was again strengthened when agreement was reached on the "Two Pack" which added two new EU regulations to reinforce surveillance and coordination for the euro area, reflecting the higher risk of spillovers within the single currency area. Additional commitments were taken by member states through the intergovernmental Treaty on Stability, Coordination and Governance in the EMU, whose fiscal provisions (known as the "Fiscal Compact") transpose elements of the reformed SGP into national legislations. As noted by the European Fiscal Board (EFB) (2018), the current EU fiscal framework is the result of successive legislative reforms coupled with a series of agreements on how to interpret existing provisions.

In order to enhance the clarity of the revised fiscal governance toolbox, the European Commission issues since 2013 a 200-page long yearly document (the Vade Mecum on the Stability and Growth Pact), with the aim of improving transparency about the way the Commission applies the rules of the Stability and Growth Pact. As explained in the latest edition of this document (European Commission, 2018), the

amendments aimed at increasing the economic credibility and the flexibility within the rules of the Pact, while at the same time increasing national ownership which seemed to be missing in the provisions of the original SGP. The main reforms include the following:

- *Revised fiscal rules in order to better align fiscal targets with the fiscal sustainability objective and to make the rules more flexible*. According to the Fiscal Compact, national legislation should include a structural budget balance rule, an automatic correction mechanism to be triggered in the event of deviations from the rule and escape clauses for exceptional economic circumstances. The structural budget balance rule must limit annual structural deficits to a maximum of 0.5 percent of nominal GDP and ensure convergence towards the country's medium-term budgetary objective (MTO) assessed by the European Commission. The Pact also puts renewed focus on public debt, requiring from countries with debt above the 60 percent of GDP limit to continuously reduce their debt levels by at least $1/20^{th}$ of the distance between the current level and 60 percent of GDP until the latter is reached. Not respecting the debt reduction benchmark becomes a possible trigger of the Excessive Deficit Procedure. Stronger focus on debt was deemed necessary in view of the fact that earlier SGP provisions regarding just public deficit proved insufficient in preventing debt from escalating and raised serious concerned about debt sustainability. Finally, an expenditure benchmark is also introduced, whereby countries which have reached their MTO are required to keep annual growth of primary expenditure (excluding unemployment benefits) at or below long-term nominal GDP growth. The Fiscal Compact also tries to deal with the problem of past experience that too rigid rules are often disputed or quickly suspended. It thus extends the scope of escape clauses and allows deviations from targets when structural reforms are adopted or investment expenditures are undertaken, provided that these entail short-term budgetary costs in exchange for long-term gains.
- *National budgetary frameworks are reformed.* The Fiscal Compact requires improvements in the domestic budget institutions, including making medium-term budgetary frameworks more binding (by translating the MTO concept into national law through provisions of binding force and permanent character), preparing budgets in a more top-down sequence and producing frequent, timely and comprehensive reporting on general government fiscal data and risks.
- *Surveillance and monitoring are improved.* Official macroeconomic forecasts should be either produced or endorsed by a national independent institution which will also monitor compliance with the fiscal rules and the automatic correction mechanisms in case of significant deviations at a national level. More effective surveillance requires not only increasing the intensity of monitoring of budget plans, but also ensuring coordination among member states *before* these plans are put to national parliaments. All euro area countries must therefore submit their draft budgets to the European Commission to ensure appropriate integration of euro area policy recommendations. If the Commission assesses that the draft budget is not compliant with the SGP, it will issue an opinion to inform the national debate and possibly ask for revisions before it is enacted.

- *Enforcement is enhanced.* In case of non-compliance with a euro area country with the deficit rule, a recommendation by the Commission is approved by the Council unless a qualified majority of member states votes against it. In this way, sanctions become more automatic, since it is more difficult for the Council to go against the Commission's advice, as has repeatedly happened in the past. Finally, the European Court of Justice can impose a financial penalty up to 0.1 percent of GDP if a country fails to properly implement the legislative changes required by the Fiscal Compact.

Among the many reforms introduced in the European fiscal monitoring framework, one can identify the emphasis placed upon two core elements; the quality of fiscal reporting and the role of national independent fiscal institutions. Regarding the former, improving the quality of the upstream data sources (the accounts of public entities) has been a long-standing issue amidst fears that fiscal monitoring was being ineffective.[3] Good fiscal reporting is a key element of fiscal transparency, without which the Fiscal Compact will not bring about the budgetary discipline sought by its designers. In this context, in recent years there has been a growing effort to promote the convergence of accounting standards with the aim of enhancing the international comparability of general government financial statements (Christiaens et al, 2015). The International Public Sector Accounting Standards (IPSAS) are being promoted as a tool that will complement government accounting systems by focusing on accruals accounting. In the EU, harmonizing public sector accounting at micro level is envisaged to bolster the quality of macro fiscal reporting under the Excessive Deficit Procedure. One of the elements of the Six Pack thus calls for the European Commission to carry out an assessment of the suitability of the IPSAS for EU Member States. The idea is to convert IPSAS into EU regulation to form harmonized European Public Sector Accounting Standards (EPSAS), based on the principles of accrual budgeting and accounting.

Regarding the latter, the literature on the possible role of national independent fiscal institutions (NFIs) is becoming voluminous,[4] while there is increasing empirical evidence that one of the factors explaining when countries stick to their fiscal plans is independent monitoring and enforcement bodies (issuing real-time alerts) primarily at a *national level* (e.g. Beetsma, et al, 2018, Reuter, 2019). Independent fiscal institutions are thought to address some of the presumed causes of deficit bias, including information asymmetry (both between voters and politicians and between the legislature and the executive), economic forecasting bias (of the type identified in Section 2) and time inconsistency produced by the electoral cycle (Viney and Poole, 2018, Debrun and Kinda, 2017). The IMF also places increasing emphasis on the watchdog role of IFIs which are expected to "raise the reputational and political costs of financially irresponsible choices" (Beetsma, et al, 2018). At the supranational level, the advisory European Fiscal Board (EFB) was established with the primal goal of offering a comprehensive and independent assessment of the implementation of the Stability and Growth Pact from an economic perspective. The EFB can make specific recommendations under the rules of the SGP if it sees risks to the proper functioning of the EMU. The EFB together with the newly created horizontal network of national

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[3] Balassone et al (2007), for example, referring to the reliability of EMU fiscal indicators, argued that a detailed analysis of the reconciliation account between deficit and change in debt is crucial to effectively monitoring public finances.

[4] See, for example, Rapanos and Kaplanoglou (2010), Wruuck, P. and Wiemer, K. (2016), Beetsma and Debrun (2018), OECD (2019).

fiscal councils exchange best practices and perhaps could provide the technocratic basis for further fiscal integration in the future.

5. THE NEW EU FISCAL GOVERNANCE FRAMEWORK: CRITICISMS AND PROPOSALS FOR REFORM

Despite the fact that the new EU fiscal governance framework has been the outcome of a long procedure which sought to internalize the lessons learned from the financial and economic crisis, it is still subject to harsh criticism, which can be grouped along two major strands. The first strand is more of a technocratic nature. The design of fiscal rules is inherently problematic, since the three basic properties of "good" fiscal rules, namely simplicity, flexibility and enforceability, cannot be easily reconciled (Debrun and Jonung, 2017). Making the rule flexible (i.e. contingent on a broader set of circumstances), compromises its simplicity and makes it harder to enforce. The more refined the rule, the harder it is to determine whether deviations are justified and the more the rule becomes subject to political manipulations.

As already mentioned, in order to make the rules of the game clear, the European Commission produces an annual document, the Vade Mecum on the Stability and Growth Pact, which specifies various aspects of the implementation of the EU fiscal rules. Although formally strengthened, enforcement remains challenging. The Vade Mecum extends to over 200 pages, clarifying in detail how compliance to numerous potentially inconsistent caps and benchmarks can be assessed. Subsequently, a deviation from the adjustment path towards the medium-term objective may be excused by referring to one or more exceptions, whose number is increasing over time. For example, structural reforms and investment expenditure can be taken into account under certain circumstances, with the aim of facilitating structural reforms that increase long-term growth potential and therefore enhance sustainability in public finances. A positive impact on sustainability is, however, difficult to verify, especially when reforms are in the planning stage and the granting of an exception inevitably comes with considerable discretionary scope. The 2018 Annual Report of the European Fiscal Board itself recognizes that the quest to adjust EU fiscal rules to a complex economic reality has resulted to both rules and processes being made increasingly detailed at the cost of transparency and credibility. The overly complex new EU governance framework may indeed be flexible, but suffers from weak compliance. Darvas and Leandro (2015), for example, show that the implementation of the European Semester recommendations was poor at the beginning of the Semester in 2011 and has deteriorated since.

Furthermore, the problem of pro-cyclicality seems to have remained in the new framework (Darvas et al, 2018). According to Määttänen and Alcidi (2018), at the heart of this problem lies the difficulty to distinguish between cyclical and structural components in economic growth *in real time*. Although the structural budget balance is a valid theoretical concept, it suffers from large measurement problems. Key variables like the output gap and the structural deficit cannot be accurately measured in real time.

Critics of the technocratic side put forward proposals for further reforming the new EU fiscal governance framework in order to address the main shortcomings of the existing structure. In general, they call for some form of simplification of existing rules in order to enhance implementation. Darvas et al (2018) for example, argue in favor of substituting all existing rules with a rule on public expenditures, which

should not grow faster than long term nominal growth, and at an even slower pace in countries with excessive levels of debt. Putting more emphasis on public expenditure rather than the budget balance is a view also shared by the European Fiscal Board (2018), which proposes a ceiling on the growth of primary expenditure net of discretionary revenue measures. Christofzik et al (2018) propose yet another version of an expenditure rule supplemented by a debt-correction factor. Finally, Debrun and Jonung (2018) put forward the idea of imposing a fiscal Taylor rule, where the only costs of deviating would be strictly reputational.

Some of the proposals additionally argue for further depoliticizing fiscal surveillance, by e.g. transferring the surveillance of budgets and of compliance with the rules away from the Commission to a new specialized independent institution (of the European Stability Mechanism type), so that political influence on budget adjustment requirements is avoided (Deutsche Bundesbank, 2017, European Fiscal Board, 2018). Another proposal along similar lines is to delegate the stabilization function of fiscal policy to national independent fiscal councils, which would set a ceiling for the budget deficit and would be accountable to parliament. Even in the current settings, empowering national IFCs through delegating to them the role of implementing existing fiscal rules, while being coordinated by the European Commission, is a common theme of proposed reforms (Larch and Braendle, 2018). In general, the idea of strengthening national IFCs is attractive among several thinkers, who see these institutions as means of implementing the EU fiscal framework without compromising national sovereignty. These institutions would therefore minimize tensions between fiscal policies at the national level and the joint fiscal governance framework by e.g. raising alarm, encouraging reactions from parliament and educating the voting public and market participants on what constitutes "good fiscal behavior".

The second strand of criticism of the prevailing EU fiscal governance framework belongs to the political sphere. Many political scientists are pointing out that especially after the crisis numerous decisions of lasting consequence are being taken undercutting public debate. Faced with exceptional circumstances, the idea has been implemented that decision making can no longer be exercised within existing legal frameworks and institutional procedures. This is the case of "emergency politics" in crisis Europe, in which actions departing from conventional practice are rationalized as necessary responses to exceptional and urgent threats, "rescue packages" being their most clear manifestation (White, 2015). To take this point even further, the whole deficit-bias theory in effect asserts that politicians cannot be trusted with making the "right" decisions about the economy and that their choices lead to sub-optimal outcomes for the society. In a world where politicians are perceived to be moved by self-interest, those who can claim non-political status can present their judgement as impartial. However, this claim is not necessarily a valid one. As admitted by the Director-General for Economic and Financial Affairs of the European Commission "the coordination (of national fiscal entities) can hardly be organized without some elaborate underpinning framework. And one must also recognize, as a political reality, the attachment within influential constituencies to ordo-liberal settings." (Buti, 2016). Ordo-liberal economics precisely rest on the idea that electoral democracy must be tamed and constrained by the law and through independent and non-majoritarian institutions that will safeguard "sound policies" (Ferrera, 2018).

Transparency International has very recently released a report assessing Eurogroup's accountability (Braun and Hübner, 2019). According to this report, although under EU law Eurogroup is just a consensus-building organ, in practice

decisions pre-agreed by the Eurogroup are adopted by the Council without further debate and therefore it emerges as the executive headquarters of euro area governance. Its role in coordinating fiscal and economic policy among member states has been strengthened by reforms of the EU fiscal governance framework since the crisis, but no proportionate increase of democratic accountability has been ensured. As a result, the EU's "democratic deficit" is widening and so is the gap between populations and leaders at the EU or the national level. This has led some authors to claim that the EU has moved to a stage of post-democracy, whereby the supranational decisions to institutionalize austerity, enforced by budgetary oversight by the Commission, removes alternative policy options at the domestic level (Glencross, 2018). The repercussions on democratic legitimacy and responsiveness are serious. Ruiz-Rufino and Alonso (2018) find evidence that the growing gap in the levels of satisfaction with democracy between bailed-out economies and the rest of the countries in the Eurozone is linked to citizens' perceptions on whether external constrains reduce their government's autonomy and, therefore, democratic choice. Häusermann et al (2018) study electoral turnout in 28 European countries before and after the crisis by education level and show that electoral turnout among highly educated citizens in crisis countries has strongly declined during the crisis. The authors claim that when these citizens see that governments are severely constrained, they anticipate that the hands of future governments will be tied and abstain from elections. A more general impact is the rise of the appeal of anti-system parties.

This problem has been particularly acute in the Greek case. The adjustment programs were an opportunity to push through hard constrains, since even recently adopted EU directives were immediately included as conditionalities in the programs, no matter their relation with the crisis challenges (Spanou, 2018). Hard austerity policies and reforms which gravely affected people's lives were imposed with the Parliament being side-lined, eliminating any sense of legitimacy or national ownership of policies. The political consequences have been a sharp decline in voter turnout (from 74 per cent in the elections of September 2007 to 56 per cent in the elections of September 2015), five parliamentary elections only in the 2009-2015 period and the rise of political radicalism (Sotiropoulos, 2019).

If we accept that stronger EU fiscal governance has not been accompanied by concomitant increase in accountability, there is an apparent problem of democratic legitimacy and a need to reform the framework in order to enhance democratic oversight. Thus, according to this view, further empowering institutions like the European Fiscal Board, would create further legitimation challenges on normative grounds (Begg, 2016). However, enhancing democratic control is a knotty issue since the elected bodies, namely the European Parliament and the national parliaments, appear to have a rather limited role in the process. Ultimately the question becomes one of the kind of balance between risk control and risk-sharing within the EU. Hard rules and depoliticized fiscal monitoring are backed by those who believe that risk must be reduced in a stable monetary union. Promoting democratic oversight and perhaps more active fiscal policies supported by additional fiscal capacity at the EU level is backed by those who believe that risks need to be shared in order to achieve more balanced growth trajectories throughout the Union (Begg, 2018). The debate has strong supporters on both sides and is far from conclusive.

6. CONCLUSIONS

Ineffective fiscal monitoring due to weak domestic fiscal institutions has been among the root causes of Greece's severe fiscal derailment of 2009. Expenditure overruns and revenue shortfalls were being built up for more than a decade before the outbreak of the fiscal crisis, with no effective alerting mechanism in place. Since 2010 and as a result of external conditionality, on top of severe front-loaded fiscal consolidation measures, Greece proceeded with a complete overhaul of its domestic fiscal governance framework, enshrining in law both what is perceived as best practice in institutions and procedures and what is envisaged in the evolving EU fiscal governance framework. In this respect, the domestic legal framework promotes effective fiscal monitoring, not only in terms of avoiding "fiscal surprises" in the future, but also even more importantly in terms of improving transparency and supporting a more efficient allocation of resources in the public sector. Having the legal framework in place does not guarantee automatic results. It therefore remains an ongoing challenge to further improve the institutional capacity of implementing beneficial policies.

Furthermore, since Greece is now included in the European Semester for economic policy coordination, Greek policy makers have a lot to gain from closely following the European debate on further reforming this framework, which is being under attack from several fronts. Advocates of institutionalized fiscal discipline argue mainly in favor of further depoliticizing fiscal monitoring and assigning more power to non-political domestic or supranational fiscal institutions. However, it is becoming increasingly clear that credible commitment by governments at the international level presupposes political legitimacy at the domestic level. In democratic regimes, the latter presupposes that commitments may be modified or altered through political processes (Bellamy, 2015). During the crisis and in order to satisfy the European policy making agenda, several European governments (with Greece being an extreme example) have endorsed policies that were seen by the public as being imposed by unaccountable bodies. This has weakened trust in government. Not surprisingly, according to Eurobarometer data, the percent of citizens who trust their national government in Greece has plummeted to almost one-digit levels since 2010, while the respective EU-average has never returned to pre-crisis levels. This is no good news even for the advocates of strict fiscal discipline, since there is evidence that a rules-based fiscal framework aimed to anchoring expectations of responsible fiscal policies may have a greater chance to emerge and survive in countries with public trust in governments and the rules (Debrun and Jonung, 2019). And, unlike policies, trust cannot be externally imposed; it is the gradual outcome of the proper functioning of a participative democracy.

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