EUROPEAN CENTRAL BANK

EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK

of 18 December 2013

on public finances

(CON/2013/91)

Introduction and legal basis

On 25 October 2013, the European Central Bank (ECB) received a request from the Estonian Ministry of Finance for an opinion on a draft law on the state budget[1] (hereinafter the 'draft law'). The draft law incorporates an amendment to the Law on Eesti Pank.

The ECB's competence to deliver an opinion is based on Articles 127(4) and 282(5) of the Treaty on the Functioning of the European Union and the third indent of Article 2(1) of Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions[2], as the draft law relates to Eesti Pank. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

1. Purpose of the draft law

1.1 The main purpose of the draft law is to adopt the principles on sustainability of public finance as legislative provisions. The draft law transposes Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States[3] and follows the legislative obligations arising from the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union[4] (hereinafter the 'TSCG') and Regulation (EU) No 473/2013 of the European Parliament and of the Council of 21 May 2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit in the Member States in the euro area[5]. The draft law also aims at consistency with Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[6] and Council Regulation (EC) No 1467/97 of 7 July 1997 on

1 State Budget Law of 1999, *State Gazette* 1999 I, 55, 584, is being recast.

2 OJ L 189, 3.7.1998, p. 42.

3 OJ L 306, 23.11.2011, p. 41.

4 The TSCG was signed by 25 Member States on 2 March 2012. It entered into force on 1 January 2013, on the basis that 12 euro area Member States had deposited their ratification instruments by that date. Estonia's ratification law entered into force on 18 November 2012.

5 OJ L 140, 27.5.2013, p. 11.

6 OJ L 209, 2.8.1997, p. 1.

speeding up and clarifying the implementation of the excessive deficit procedure[7], as well as the European system of national and regional accounts in the European Union. The draft law is scheduled to enter into force on 1 January 2014.

Article 4(5) of Directive 2011/85/EU obliges Member States to specify institutions responsible for producing macroeconomic and budgetary forecasts and Article 4(6) requires the macroeconomic and budgetary forecasts for fiscal planning to be subject to regular, unbiased and comprehensive evaluation. The draft law allocates the obligation to produce forecasts to the Ministry of Finance and the evaluation of macroeconomic and budgetary forecasts to Eesti Pank, which must give its evaluation in the form of a non-binding opinion. It must also give its opinion on the objectives of the budget strategy and the actual achievement of those objectives. The balanced budget had been the main guiding principle established in Estonia's state budget strategy. In line with the TSCG, it will now be established by a constitutional law[8]. The draft law also includes an automatic correction mechanism as required under Article 3(1)(e) of the TSCG. With regard to Directive 2011/85/EU, the draft law provides for the minimum requirements for the budgetary framework. Fiscal aspects of the draft law cover the principles for drawing up a budget and strategic governance; it also sets the cost margins for the next four years and regulates the means by which the state may take credit risks.

1.2 The draft law also clarifies that the Special Drawing Rights (SDRs) allocated to the Republic of Estonia by the International Monetary Fund (IMF) belong to Eesti Pank[9].

2. General observations

2.1 In accordance with Article 2(1) of Council Decision 98/415/EC, the relevant Member State authorities shall consult the ECB on any draft legislative provision within the latter's field of competence pursuant to the Treaty, unless the exclusive purpose of such provisions is the transposition of Union legal acts into Member States' national laws. In the context of the implementation of the TSCG and the transposition of Directive 2011/85/EU, Eesti Pank will be given a task in relation to the macroeconomic and fiscal forecasts. The ECB welcomes the opportunity to give its opinion on this draft law, which aims to improve the national budgetary framework in terms of consistency with the reinforced Union governance framework and the sustainability of public finances.

2.2 Although Estonia is not subject to an excessive deficit procedure, enactment of the draft law is important in modernising the Estonian legal framework in relation to the budgetary process.

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7 OJ L 209, 2.8.1997, p. 6.

8 Under Article 104 of the Estonian Constitution, there are a number of laws, which include the National Budget Act and the Bank of Estonia Act, that may only be passed and amended by a majority of the members of the Riigikogu. These laws are commonly referred to as constitutional laws.

9 See also Opinion CON/2011/97. All ECB opinions are published on the ECB's website at www.ecb.europa.eu.

3. Form of implementation of the balanced budget rule and correction mechanism

3.1 Article 3(2) of the TSCG provides that the 'balanced budget rule' takes effect in national law through 'provisions of binding force and permanent character, preferably constitutional, or otherwise guaranteed to be fully respected and adhered to throughout the national budgetary processes'. In accordance with the Communication from the Commission on Common principles on national fiscal correction mechanisms (hereinafter the 'Common Principles')[10] adopted in accordance with Article 3(2) of the TSCG, the legal status of the correction mechanism to be triggered in case of significant observed deviations[11] 'should be such that their provisions cannot be simply altered by budgetary law'.

3.2 The ECB notes that the draft law has been designed as a constitutional legal act, which represents a ranking in the Estonian hierarchy of laws in line with the requirements of the TSCG.

4. The nature of the correction mechanisms

4.1 Article 3(1)(e) of the TSCG requires the automatic triggering of a correction mechanism in the event of significant observed deviations from the medium-term objective or the adjustment path towards it. This correction mechanism shall include the obligation to implement measures to correct the deviations over a defined period of time. Common Principle 4 further provides that pre-determined rules shall frame the size and timeline of the correction, thereby limiting, though not entirely ruling out, the scope for discretion in devising the response to a significant budgetary deviation. In addition, a Member State is expected to restore the medium-term objective as fast as is reasonably possible, which generally means either in the year immediately following the occurrence of the deviation or the subsequent year.

4.2 The ECB welcomes that the draft law provides for an automatic correction mechanism to be triggered if there is a deviation from the balanced budgetary position requirement. It requires the Minister for Finance to send a report to the government, including the proposal for the correction. In the event of a minor deviation, this correction mechanism will be triggered at the government's discretion. However, if there is a deviation of more than 0.5% of the GDP, the correction mechanism is mandatory.

4.3 The draft law also sets out an escape clause where the correction mechanism is not necessarily triggered if there are extraordinary circumstances, as provided for in the Stability and Growth Pact. Common Principle 6 defines 'exceptional circumstances' in line with the same definition in the Stability and Growth Pact. However, it makes clear that any suspension of the correction mechanism due to use of an escape clause shall only be temporary and once the escape clause no longer applies, the correction mechanism shall provide for a minimum of structural adjustments, with the Stability and Growth Pact's requirement being the lower limit. In addition, once the escape

10 COM (2012) 342 final.

11 See Article 3(1)(e) of the TSCG.

clause no longer applies, Member States shall adopt a corrective plan over the budgets that must be adhered to during the correction period. In finalising the draft law, the requirements in Common Principle 6 need to be given more attention.

5. Assumption of additional tasks by Eesti Pank

5.1 The draft law entrusts Eesti Pank with the task of giving its opinion regarding the macroeconomic and budgetary forecasts. A corresponding article will be introduced in the Law on Eesti Pank, which states in more detail that Eesti Pank must give its opinion on national macroeconomic and budgetary forecasts within two weeks of their publication. Eesti Pank must also give its opinion on how the government aims to achieve its objectives, as reflected in the budget strategy and stability programme, taking into account the balanced budget rule established in the draft law. Eesti Pank must also give its opinion on how the government has achieved its structural budgetary objective after the national annual report has been finalised. The opinion published by Eesti Pank will not be legally binding; however, the government must justify any deviations from the opinion.

5.2 Without prejudice to the Governing Council's powers under Article 14.4 of the Statute of the European System of Central Banks and of the European Central Bank (hereinafter the 'Statute of the ESCB'), national central banks (NCBs) may perform functions other than those specified in the Statute of the ESCB provided that such functions do not interfere with the objectives and tasks of the ESCB and do not infringe upon the independent execution by the NCB of its ESCB tasks[12].

5.3 Eesti Pank's role provided for in the draft law pursuant to Article 3.2 of the TSCG would imply, in accordance with Common Principle 7, that Eesti Pank, in order to support the credibility and transparency of the correction mechanism, would monitor compliance with the numerical fiscal rules incorporated in the national budgetary processes, as well as with the medium-term budgetary objectives included in the multiannual financial planning and provide public assessments with regard to: (a) the occurrence of circumstances warranting the activation of the correction mechanism; (b) whether the correction is proceeding in accordance with national rules and plans; (c) the occurrence of circumstances for triggering, extending and exiting escape clauses. Similarly, Eesti Pank's role provided for in the draft law pursuant to Article 5(2) of Regulation (EU) No 473/2013 would imply that Eesti Pank, in addition to monitoring compliance with the fiscal rules identified in this Article, must provide assessments, *inter alia*, on fiscal matters broadly equal to those contained in Common Principle 7[13]. Furthermore, the draft law gives a general

12 See paragraph 2 of Opinion CON/2013/56.

13 According to Article 5(2), these assessments would cover '(a) the occurrence of circumstances leading to the activation of the correction mechanism for cases of significant observed deviation from the medium-term objective or the adjustment path towards it in accordance with Article 6(2) of Regulation (EC) No 1466/97; (b) whether the budgetary correction is proceeding in accordance with national rules and plans; (c) any occurrence or cessation of circumstances referred to in the tenth subparagraph of Article 5(1) of Regulation (EC) No 1466/97, which may allow a temporary deviation from the medium-term budgetary objective or the adjustment path towards it, provided that such a deviation does not endanger fiscal sustainability in the medium term'.

responsibility to Eesti Pank to assess macroeconomic and budgetary forecasts established for the purpose of general government fiscal planning.

5.4 It is acknowledged that an NCB commonly monitors various types of information in order to properly assess current and prospective developments that are relevant for monetary policy. Monitoring fiscal developments is a task that an NCB carries out on a regular basis in order to properly assess the stance to be taken in monetary policy. Moreover, NCBs may present their views on relevant fiscal developments on the basis of their monitoring activity and the independence of their advice, with a view to also contributing to the proper functioning of European Monetary Union. In this respect, the monitoring of fiscal developments by Eurosystem central banks for monetary policy purposes should be based on the full access to all relevant public finance data. Eesti Pank should retain any role it may already have regarding the production and quality control of government finance statistics in accordance with Council Regulation (EC) No 479/2009 of 25 May 2009 on the application of the Protocol on the excessive deficit procedure annexed to the Treaty establishing the European Community[14], Guideline ECB/2013/23 on government finance statistics, and the memorandum of understanding on the cooperation between the members of the European Statistical System (ESS) and the members of the ESCB, dated 24 April 2013[15].

5.5 However, as indicated by the ECB in a recent opinion, an NCB's role should not go beyond monitoring activities that result from or are linked – directly or indirectly – to the discharge of their monetary policy mandate[16]. The ECB is of the view that the monetary policy mandate, as well as an NCB's independence, run the risk of being undermined, if the NCB takes up the monitoring activities set out in Article 5 of Regulation (EU) No 473/2013 and Article 4 of Directive 2011/85/EU. This would likely pose risks to the discharge of its monetary policy mandate, *inter alia*, for the following reasons. First, as regards involvement in macro-economic forecasting in accordance with Directive 2011/85/EU, an NCB could become subject to guidelines or scrutiny by national or European authorities under Article 4(5) of Directive 2011/85/EU[17]. As a result, an NCB might be required to disclose its view of the economic outlook according to principles and/or a schedule different from that for publishing the economic projection it deems relevant for monetary policy purposes. This would represent an impairment of the independence of the NCB. Second, as regards the provision of assessments of fiscal policy[18], the formal mandate to scrutinise government policies in the form of public opinions would put the NCB in a position that could regularly

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14 OJ L 145, 10.06.2009, p. 1.

15 Available on www.ecb.europa.eu. The Memorandum of Understanding facilitates close cooperation between the ESS and the ESCB in areas of shared responsibility or common interest, thereby increasing the potential synergies in the production inter alia of government finance statistics.

16 See paragraph 4.3 of Opinion CON/2012/105.

17 See also the Specifications on the implementation of the 'two-pack' and Guidelines on the format, content of draft budgetary plans, economic partnership programmes and debt issuance reports of 1 July 2013 (hereinafter the 'Specifications'). Available on the European Commission's website at www.ec.europa.eu.

18 Particularly those provisions relating to, *inter alia*, circumstances taking place that lead to the activation of the correction mechanism, the budgetary correction and medium term objectives or adjustment path deviations. It also includes considerations provided for in the escape clause according to which the deviation from the balanced budget rule may surpass the anticipated limit in the case of extraordinary circumstances.

conflict with fiscal policy-making. The economic assessment of fiscal and macroeconomic developments is never entirely mechanical and always contains an element of judgement. It is thus easily subject to political controversy. This, in turn, could affect the working relations between the NCB and the government, affect the public perception of the NCB, as well as possibly undermine its independence. More generally, a formal mandate for an NCB to assess forecasts and fiscal developments implies a function for the NCB in the fiscal policymaking process. As an NCB is thus entrusted with a share of the responsibility for fiscal policy, the institutional separation between fiscal and monetary policy becomes blurred.

5.6. The ECB notes that since the obligation to produce forecasts would be assigned to the Ministry of Finance under the draft law, it is unlikely that Eesti Pank would become subject to guidelines or scrutiny by national or European authorities under Article 4(5) of Directive 2011/85/EU. As far as other activities under Article 5 of Regulation (EU) No 473/2013 and Article 4 of Directive 2011/85/EU are concerned, the ECB considers that these tasks complicate the fulfilment of Eesti Pank's primary mandate on the grounds referred to in the previous paragraph.

5.7 The ECB therefore recommends that the consulting authority reconsiders the assignment by the draft law of the new tasks to Eesti Pank. In this context, the ECB reiterates that the Specifications recommend the preparation of an all-encompassing code of practice, gathering all the relevant legal provisions and procedural elements that are part of the framework for the production and/or endorsement of independent macro-economic forecasts[19], including the timely provision of forecasts to support the relevant stages of the national budgetary process. The draft law would need to separate the responsibilities between the government, which is exclusively competent for compliance with the TSCG and Regulation (EU) No 473/2013, and the NCB, which should not go beyond what is necessary for monetary policy purposes as regards fiscal policy monitoring.

6. Financial independence of Eesti Pank and prohibition of monetary financing

6.1 Without prejudice to the observations on the new tasks entrusted to Eesti Pank by the draft law as concerns Eesti Pank's discharge of its existing monetary policy tasks, the ECB reiterates that, from an operational and financial point of view, any new task allocated to an NCB should not affect that NCB's ability to carry out its ESCB-related tasks. Financial independence, which is an element of the principle of central bank independence referred to in Article 130 of the Treaty, requires an NCB to have sufficient means not only to perform its ESCB-related or Eurosystem-related tasks but also its national tasks, e.g. financing its own administration and operations. Such financial independence is assessed from the perspective of whether any third party is able to exercise either direct or

19 See the Specifications, p. 41: 'The national procedures should provide an important element, fostering accountability and transparency and defining the different tasks allocated to every actor in the forecasting exercise and the milestones to be met within the annual budgetary cycle. They should also set out practical steps leading to the production and/or endorsement of the forecast and principles of cooperation between the relevant institutional stakeholders'.

indirect influence not only over an NCB's tasks, but also over its ability to fulfil its mandate both operationally in terms of manpower and financially in terms of appropriate financial resources[20].

6.2 Further, it is important to safeguard compliance with the monetary financing prohibition pursuant to Article 123 of the Treaty. The prohibition is essentially designed to prevent central banks from providing overdraft facilities or any other type of credit facility to the public sector. National legislation should not require an NCB to finance the performance of tasks incumbent on the government, without stipulating that the government will compensate the NCB for the discharge of such tasks. The ECB notes that the draft law does not provide for such compensation and this aspect would need to be addressed, if the national legislature decides to keep the draft law as currently drafted on this particular point.

7. Ownership of SDRs

SDRs are international reserve assets created by the IMF to supplement the existing reserve assets, which represent a right to purchase freely usable currency in exchange for SDRs. National laws and arrangements concerning IMF transactions need to comply with Union law, in particular with the monetary financing prohibition[21]. Pursuant to Article 7 of Regulation (EC) No 3603/93, the financing by NCBs of obligations falling upon the public sector with regard to the IMF is not regarded as a credit facility within the meaning of Article 123 of the Treaty. If the payment of a Member's quota is made from central bank resources pursuant to Article 7 of Regulation (EC) No 3603/93, the related SDRs become part of the foreign reserves held and managed by the central bank, and are therefore shown on the central bank's balance sheet. Usually central banks record SDR allocation as a long-term liability.

8. References to the European system of national and regional accounts in the European Union

The references in the draft law to Council Regulation (EC) No 2223/96[22] should be replaced with references to Regulation (EU) No 549/2013 of the European Parliament and of the Council[23].

20 See the ECB's Convergence Report 2012, p. 26.

21 The monetary financing prohibition is laid down in Article 123(1) of the Treaty and replicated in Article 21.1 of the Statute of the ESCB, which prohibits overdrafts or any other type of credit facility with the ECB or the NCBs in favour of Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States, and the purchase of debt instruments directly from these public sector entities by the ECB or NCBs. The precise scope of application of the monetary financing prohibition is further clarified by Council Regulation (EC) No 3603/93 of 13 December 1993 specifying definitions for the application of the prohibitions referred to in Articles 104 and 104b(1) of the Treaty, (OJ L 332, 31.12.1993, p. 1).

22 Council Regulation (EC) No 2223/96 on the European system of national and regional accounts in the Community (OJ L 310, 30.11.1996, p 1).

23 Regulation (EU) No 549/2013 of the European Parliament and of the Council of 21 May 2013 on the European system of national and regional accounts in the European Union (OJ L 174, 26.6.2013, p. 1).

This opinion will be published on the ECB's website.

Done at Frankfurt am Main, 18 December 2013.

[signed]

The President of the ECB

Mario DRAGHI