Essays in Management, Economics and Ethics

Alessandro Giosi, Silvia Testarmata,
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Does the Quality of Public Finance Enhance Fiscal Discipline in the European Union? A Cross-Country Analysis

21

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Does the Quality of Public Finance Enhance Fiscal Discipline in the European Union? A Cross-Country Analysis

Alessandro Giosi [1], Silvia Testarmata [2], Sandro Brunelli [3] and Bianca Staglianò [4]

Abstract

The concept of Quality of Public Finance has become of high importance over time. It focuses on the role that public finance and fiscal policy can play to sustain economic growth, employment and competitiveness in the context of European strategy (Lisbon strategy and, now, Europe 2020).

Stemming from a normative and theoretical framework we built a questionnaire to make an assessment of the Quality of Public Finance disclosure offered by a series of selected European Union members in their Stability and Convergence Programmes, released in 2007, 2009 and 2011. The empirical research allows us to identify an index to evaluate the fairness and reliability of the Quality of Public Finance disclosure provided by the European countries.

The Quality of Public Finance disclosure does not appear satisfactory since any country goes beyond the index average, even though a tendency towards an enhancement emerged in 2011, also enforced by the launch of the European Semester. The correlation analysis showed a weak but positive relation between Quality of Public Finance disclosure and structural deficit.

JEL Classifications: E60, H50, H60

Keywords: Quality of Public Finance, Public Finance Sustainability; Fiscal Governance.

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Editorial notes

Paper presented at the XVI IRSPM Conference *"Contradictions in Public Management: Managing in volatile times"* (University of Rome Tor Vergata, 11-13 April 2012). This paper is part of a wider study that has been carried out by the authors, concerning the analysis of the financial sustainability and quality of public finance in the European Union. This is a revisited and updated edition of the IRSPM paper.

1. Introduction

Financial crisis has generated a great deal of attention on public finance and fiscal discipline in European Union (EU). Nowadays the academic and institutional debate rounds on the Quality of Public Finance (QPF), which focuses on the role that public finance and fiscal policy can play to sustain economic growth, employment and competitiveness in the context of European strategy (Lisbon strategy and, now, Europe 2020).

Despite different definitions given by the academic literature, we could identify several characteristics in order to depict the concept of the QPF. It can be identified, at a first stage, as the level and composition of public expenditure and its financing via revenue and deficits (Afonso *et al.*, 2005); moreover the QPF has been interpreted as a multi-dimensional concept of fiscal policy tools supporting the macroeconomic goals of government policies (European Commission, 2008). So the QPF comprises not only policies ensuring sound budgetary position and long-term sustainability but also those for raising potential production and facilitating the economy to adjust to shocks (Barrios and Shaechter, 2008).

The analysis focuses on the academic and institutional debate concerning the QPF and the content of the Stability and Convergence Programmes (SCPs). The aim is to empirically investigate the fairness and reliability of the QPF disclosure given by the SCPs and the impact that economic and financial crisis has generated on it. In addition, we propose a reliable model to measure the magnitude of the QPF disclosure.

Starting from these aims, the paper is organized as follows: firstly, we split and present the institutional and academic debate about the QPF into two parts. In the first part, the definition of QPF and the institutional debate on QPF are presented; in the second, the academic debate on QPF is reviewed. Secondly, we describe the research design aimed to analyse the SCPs provided by the European countries; thirdly, the research findings are disclosed and supported by a descriptive and statistical analysis. Discussion and conclusions, with some advice for policy makers and the implications for further research, close the paper.

2. The institutional debate

The tie between fiscal policy and macro-economic variables has led the QPF in the context of the economic field and so it became a concept linked to the Broad Economic Policies Guidelines (BEPGs) issued by the Ecofin Council. Until 2004, the QPF has played a secondary role in the debate on SCPs' evaluation process and budget balance.

The little attention given to the QPF seems to be a contradiction because it is not merely an indicator of public finance sustainability, but refers more to a taxation system tool and policy of public expenditure. It allows a stabilization of the economy, responds to economic shocks promptly and assures the correct functioning of the good, service and labour markets (Afonso *et al.*, 2005; Barrios and Schaechter, 2008). In particular "the allocation of resources and the efficient and effective use of those resources in relation to identified strategic priorities" (European Commission, 2004a, p. 7) appears to be a fundamental issue, especially during the crisis.

Therefore, the QPF regards the field of public policy evaluation. Indeed, it concerns, on the one hand, the relationship between public expenditure and economic growth and on the other, the correlations between fiscal policy and political economic targets. Under the first profile, even though there is agreement on the positive correlation between some kinds of expenses (e.g., infrastructure, education and research & development) and economic growth, there is strong debate on the effect of the other classes of expenses (European Commission, 2004b, pp. 186-201). Under the second profile, the long-term relation between budget balance and strategic targets (European Commission, 2010c) gives evidence of the micro-economic aspects of the QPF and involves the issue of the financial and strategic planning of each member state. Therefore the European fiscal rules do not close the budget functions.

Indeed, the budget has at least three main functions (Atkinson and Van de Noord, 2001; Diamond, 2003; Schick, 2002): a) to ensure fiscal discipline and close-to-balance trend; b) to allow the allocation of resources to strategic priorities; and c) to allow an efficient and effective use of public resources. In this context it is evident that the traditional input base budget does not appear in line with the needs coming from the QPF, which requires a shift towards programme budgeting and output-outcome budgeting (Atkinson, 2005; Eurostat, 2001). These budgets enhance accountability for the targets of public policy and strengthen the link between resource allocation and performance (Blondal, 2003; Boyne and Brewer, 2010; Curristine, 2005; Dutta and Reichelstein, 2005; Scheers *et al.*, 2005; Schick, 2007).

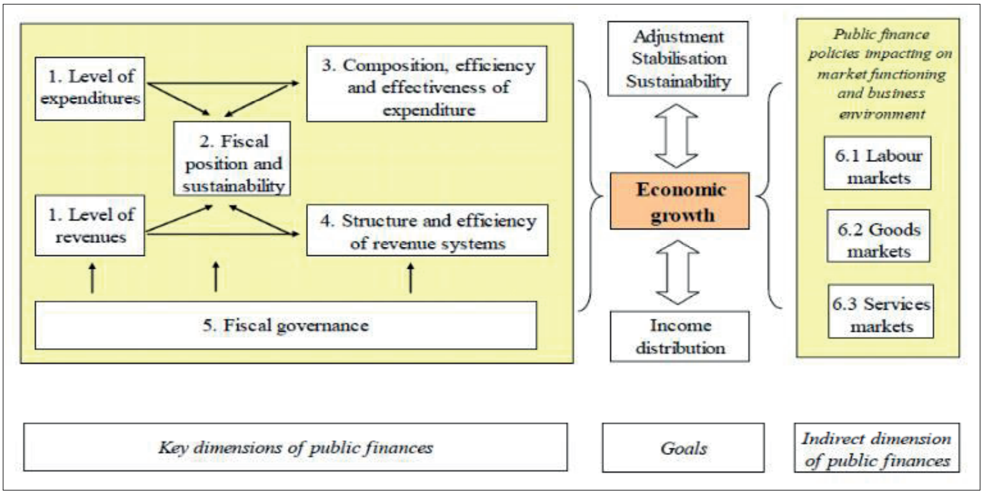
In the light of all those elements, political bodies have given wider attention to the QPF and its components, both in the preventative and corrective phases of Stability and Growth Pact (SGP) (e.g. European Council: 2005a and 2010a; Ecofin Council: 2005a, 2005b and 2010a). Subsequently, the European Commission (EC) published a model that could constitute the referential framework for the QPF (European Commission, 2008, p. 132). The EC underlines that the QPF is complex and multi-dimensional and goes beyond the fragmented mono-dimensional approach often used in literature. As shown in Figure 1 the six dimensions of the QPF proposed by the EC are:

1) The dimensions of the public sector in terms of level of public expenditure and revenues;
2) The public finance stance and the long-term sustainability;
3) The composition of public expenditure and its level of efficiency and effectiveness;
4) The structure and efficiency of the revenue system;
5) The fiscal governance.

In addition, a sixth indirect dimension that has a relevant impact on the QPF is related to the evolution of the main market condition and referred to as labour, goods and services.

In the QPF framework fiscal governance is probably the most relevant dimension due to its rule to provide input to other dimensions. Fiscal governance can be defined as "the institutional side of fiscal policy as it comprises the set of rules and procedures that determine how public budget are prepared, executed and monitored" (European Commission, 2008, p. 128) that leads to sound budgetary position, and supports the structural reform in the middle term. At the beginning, in the context of fiscal governance were included the Medium Term Budgetary Framework (MTBF), the fiscal rules that ensure the budget balance, and the independent fiscal institutions with the aim of evaluating ex ante fiscal policies and ex post its implementation. Subsequently, the framework has been enlarged to encompass the budgeting procedures (OECD, 2002 and 2008), even in consideration of the application of the so-called European Semester. To some extent, fiscal governance seems to be a focal point to make the European surveillance procedures effective, particularly with regard to the preventive arm (Ecofin Council, 2010b; European Commission, 2010b; European Council, 2010a and 2010b; European Council Secretariat, 2010; European Central Bank, 2011). The effectiveness of the SCPs, in fact, depends on the relations between the national fiscal framework and the European one and their reciprocal influences.

Figure 1: QPF Dimensions



Source: European Commission, Public Finance in EMU – 2008, p. 132

At the core, due to its relevance, the QPF affects all the fiscal side of the economic policy of a EU country (the other is monetary and is exclusively exercised by the European Central Bank) and, in particular, all the relative actions and documents produced by the country. In addition, an unaccountable fiscal policy of a EU country member of the monetary union would interfere with centralized monetary policy-making and spill over into other members of the monetary union (European Central Bank, 2004). In this context, the QPF is not only an aspect that deserves to be investigated under different profiles but it seems possible to qualify the QPF of a EU country as a proxy of its rating in terms of solvency and economic and financial sustainability.

The reform process of the SCPs has influenced the QPF (European Council, 2005b and 2005c) and has been pursued through the introduction of the European Semester, the Six Pack and the last Treaty on Stability, Coordination and Governance (TSCG) in the Economic and Monetary Union, the so-called "Fiscal Compact". These actions represent the most relevant steps to enforce fiscal discipline across the European Union (European Central Bank, 2012).

The European Semester reformed the EU public finance planning and control system and put in relation the drafting of the strategic policy document (National Reform Programme, NRP) with the accounting data provided by SCP. The cycle of European Semester begins with the Commission's Annual Growth Survey, which gives broad guidance on priority actions to be taken at EU and national levels. Member States then submit Stability or Convergence Programmes on their fiscal plans and NRPs on structural reforms and measures to boost growth and jobs. The Commission assesses these reports based on an integrated analysis covering fiscal, macroeconomic, and structural policies and on that basis proposes concrete policy recommendations for each country. In June the European Council discusses annually the recommendations and adopts them. On this basis each country, in autumn, makes its economic and financial decisions.

The Six Pack, composed of five regulations and one directive, is entered into force in November 2011. It is aimed at improving fiscal discipline through a reinforcement of debt criteria and macro-economic surveillance.

Finally, in March 2012 there was the adoption of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union through which Member States agree to introduced European balanced budget rule in their national legal systems, preferably at the constitutional level. The Fiscal Compact will enter into force following ratification by at least 12 euro area Member States.

3. The academic debate

The QPF dimensions have been analysed at an academic level too. The academic literature is very fragmented and transversal. There are a series of studies that focus their attention more to the single relation between some dimensions (e.g. the size of government and long-term sustainability) and financial and macro-economic performances.

With regard to the relationship between the size of government and long-term growth, in general terms, a high public expenditure level implies an enlargement of fiscal pressure, with a negative effect on private investment, on consumer behaviour and on the factor productivity (Bassanini *et al.*, 2001). Even though economists have found negative correlations between size of government and growth over time (Afonso and Furceri, 2008; Dar and Amir Khalhali, 2002; Fölster and Henrekson, 1999), it must be realised that the issue is very complex. First, public expenditure is affected by the electoral cycle and political system, so it tends to be time inconsistent and biased toward higher deficit and bigger public sector (Persson and Tabellini, 1999). Second, the size of government reflects political choices related to social cohesion issues, different welfare models and public service provisions (European Commission, 2008). Finally, it must be considered that public expenditure represents an economy stabilization factor (Martinez-Mongay, 2002).

The relationships among fiscal stance, long-term sustainability and economic growth are at the core of the QPF multi-dimensional model. Scholars have identified six transmission channels between fiscal position and long-term growth (Tanzi and Chalk, 2002), giving evidence of the crowding out phenomenon of private investment and the negative impact of the unsustainable fiscal position on the economic agents' expectations.

Other authors have paid attention to the structure and efficiency of the revenue system, giving evidence that the shift from labour to consumption taxation has had a positive effect on growth, but the link between taxation and growth is very complex (see Heady, 2005 for a mapping of different types of taxes and drivers of growth; and Padovano and Galli, 2001 and 2002, for an analysis of the effect of the different direct taxes).

The effectiveness of public expenditure is considered to be the relation between the level of expenditure and public policy impact on the economy. Over time, economists' attention has been exclusively focused on the measurement of technical efficiency (Afonso and St. Aubyn, 2006). However the efficiency and effectiveness of public expenditure establishes the relationships among inputs (public resources), outputs (efficiency) and outcomes (effectiveness), which, in turn, imply the adoption of performance management tools (Crain and O'Roark, 2004; Sutherland *et al.*, 2007).

Fiscal governance encompasses all the elements limiting the trend of deficit enlargement (deficit bias) caused by policy-makers' behaviour (Alesina and Perotti, 1994; Buti and van De Noord, 2004; von Hagen and Hallerberg, 1999).

With regard to fiscal governance elements, the EC defines MTBF as "an institutional device allowing fiscal authorities to extend the horizon for fiscal policymaking beyond the annual budgetary calendar typically based on macro economic scenario [...] on this basis the fiscal authorities provide medium term projections for the main aggregates of government finances based on public resource available in the mid term" (European Commission, 2007, p. 152). An appropriate MTBF makes the fiscal rules more reliable and leads the decision making process by offering an alternative to the short-term orientation that has often led policy makers to accept deficits (Persson and Svensson, 1989). However, to be effective the MTBF needs to be designed according to some characteristics generally accepted in the literature (Moulin and Wierts, 2006). In particular, the MTBF should be based on reliable macro-economic forecasts and prudent assumptions in order to limit the effect of overly optimistic forecasts (Larch and Salto, 2005; Strauch *et al.*, 2004).

The fiscal rules are defined as a permanent constraint on the fiscal policy expressed by a performance index or with reference to an intermediate aggregate, such as current expenses, capital expenditures, or primary balance (Hallerberg *et al.*, 2007). The fiscal rules framework constitutes an important element to make fiscal policy effective and ensure political commitment with the aim of avoiding pro-cyclical policies by influencing budgetary policies (Anderson and Minarik, 2006; Ayuso-i-Casals *et al.*, 2009; Brzozowski and Siwińska-Gorzelak, 2010; Debrun *et al.*, 2008; Krogstrup and Wälti, 2008).

The independent fiscal institutions are defined as nonpartisan public bodies, other than the central bank, government, or parliament, that prepare macroeconomic forecasts for the budget, monitor fiscal performance, and/or advise the government on fiscal policy matters (Alt and Lassen, 2006; Ayuso-i-Casals *et al.*, 2009). The relevance of fiscal institutions is due to the fact that they may provide macroeconomic forecasts for budget preparation which do not suffer from the optimistic biases often found in official government forecasts, they may monitor the implementation of budget plans and, finally, they can assess whether fiscal measures are appropriate in terms of respect of rules, sustainability of public finances, and stability-oriented fiscal policies (Hallerberg and Wolff, 2008; Jonung and Larch, 2006). Therefore, the presence of independent fiscal institutions, particularly for forecasting, makes the design of annual and multiyear budgets more credible (von Hagen, 2010). Obviously if the independent fiscal institutions have only advisory and monitory tasks, their influence on government behaviours will be lower (Hallerberg and Yläoutinen, 2010).

The budgeting procedures constitute the last element of fiscal governance. It must be remembered that there is a strong linkage between budgeting procedures and other elements of fiscal governance, since budgeting procedures must be intended as procedures regarding the preparation, approval and execution of budgets (European Commission 2007, p. 132). An abundant amount of empirical literature exists on the effectiveness of budgetary procedures in improving fiscal performance (e.g., Fabrizio and Mody, 2006; Robinson and Brumby, 2005).

It is evident that fiscal governance plays an essential role and completes the European fiscal rules based on the SCP and EDP (Pina and Venes, 2011). Finally, many empirical studies have shown a direct relationship between elements of fiscal governance and fiscal stance (European Commission, 2006a, 2007, 2008, 2009 and 2010a; von Hagen and Harden, 1994; Poterba and von Hagen, 1999; Strauch and von Hagen, 2000; Hallerberg, 2004).

4. Research design

On the basis of the literature systematization and the analysis of EU documents, the empirical analysis aims to answer the following research questions:

i. *Is the information provided by EU countries in the SCPs useful to assess the QPF both for each country and in a comparative manner?*
ii. *Are there any dimensions of the QPF that are taken into account more than others? If so, why?*

iii. *Is the information provided in the SCPs useful to improve fiscal discipline and, more generally, to respect the rules imposed by the SGP?*

To this end, qualitative and quantitative research methods are used through the analysis of documents (the SCPs) and behaviours of selected countries (Kuhn, 1962; Eisenhardt, 1989; Yin, 1994; Partington, 2002; Popper, 2002).

The magnitude of the QPF in the SCPs' issued annually by European countries is investigated through a questionnaire set up on a theoretical basis (Ecofin Council, 2001, 2005b and 2010c). It is composed of a set of "desirable information" to assess the QPF disclosed by the SCPs. Specifically, it is composed of 37 questions divided into six dimensions (*Size of Government (Level of Expenditures and Revenues)*; *Level and Sustainability of Public Finance; Composition, Efficiency and Effectiveness of Expenditure*; *Structure and Efficiency of Revenue System*; *Fiscal Governance*; and *Market Efficiency*) according to the EC framework (see Figure 2).

Every question has been evaluated on a scale from 0 to 10 related to the quality and type of information disclosed for that specific element. As reference, 0 has been given in case of total absence of any piece of information, 5 when the data are disclosed concisely and without any comment or further elaboration, 10 when the description has been considered as the best and most complete possible. This evaluation is also supported by a descriptive analysis of the SCPs content.

The research has been conducted for eight selected Member States. The selection of countries comes from a rational sampling. The countries chosen are the PIIGS (Portugal, Ireland, Italy, Greece and Spain) that are characterized by financial problems and Germany, France and the UK for their relevance in terms of population, political power, and fiscal weight across the EU.

Moreover, for the empirical analysis the SCPs of three years have been taken into consideration (2007, 2009, 2011) related to three keys scenarios: the year just before the first economic crisis, the first recovery year after the crisis and the year in which a new financial crisis has hit all western countries. This is a strength for the research purposes because the disclosure concerning the QPF has to be enforced during the financial crisis.

This allows us to obtain a ranking of the QPF disclosure given by the selected countries through a definition of a general index on the fairness and reliability of the QPF disclosure – the "QPF index".

Figure 2: The questionnaire for the assessment of QPF

Size of Government (Level of Expenditures and Revenues)
1) Public expenditure analysis
2) Service provision analysis (PPP vs. Privatization)
3) Whole of Government accounting data
4) Coordination procedure with lower level of government (Internal Stability Pact)
Level and Sustainability of Public Finance
1) Maastricht parameter's figures and illustration
2) Composition of debt and deficit
3) S1 and S2 indicators
4) Age related expenditure overview and other contingent liabilities
5) Structural reform analysis
6) Structural reform scheduling and past results achieved
Composition, Efficiency and Effectiveness of Expenditure
1) Classification of public expenditure
2) Qualitative analysis of public expenditure composition
3) Quantitative analysis about "productive" public expenditure (R&D, education, infrastructures)
4) One-off expenditure policies' effects
5) Quantitative and qualitative analysis of public expenditure linked to the traditional welfare system
6) Use of public expenditure efficiency indicators
7) Public expenditure rationalization policies
8) Public servant policies
9) Use of spending reviews
10) Indication to enhance public procurement
Structure and Efficiency of Revenue System
1) Analysis of fiscal burden composition and size
2) Linkage between fiscal burden and macroeconomic variables
3) Linkage between taxes and expenditure
4) Effect of institutional factors influence (tax evasion, labour participation rate, shadow economy, etc.)
5) Analysis of a one-off income
6) Efficiency of tax administration system
Fiscal Governance
1) Illustration of fiscal rules
2) Disclosure about the main medium term budget items
3) Sensitivity analysis and prudent assumptions
4) Fiscal institutions role
5) Information on budget procedures characteristics
6) European fiscal framework references
Market Efficiency
1) Illustration about labour market policies
2) Financial market rules
3) Policies for market condition improvement
4) Administrative streamlining procedures
5) Green Economy policies

Source: Our elaboration.

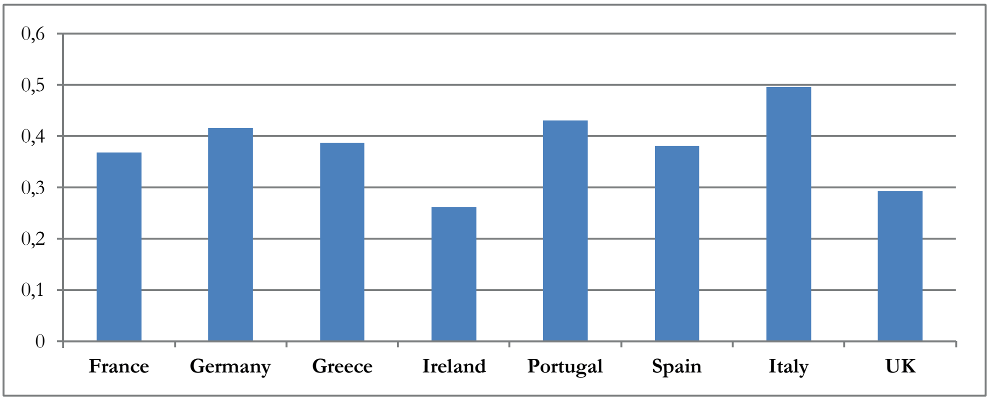
At first the QPF index was calculated simply as the sum of the score given for each question, thus, it was merely an absolute value. Later, it was decided to convert the QPF index to a percentage value, since each dimension is not composed by the same number of questions, although the theoretical weights are the same. Thus, in order to obtain an unbiased index, everything has been converted into a 0 to 1 indicator. Furthermore, this permits highlighting some best practices and the discriminating dimensions. Therefore, the QPF index tends to catch the fairness and reliability of the disclosure of the QPF given by the European countries in their yearly SCPs.

6. Findings and discussion

Taking into consideration the QPF index, calculated for each European country as a simple mean of the score attained in the single dimension, we now proceed to illustrate the main empirical results.

The first result is the QPF Average Index in each country (see Figure 3), obtained as the mean between the indices in the three years considered. At first glance it seems that the range of the (average) index goes from 0.26 (Ireland) and 0.49 (Italy). Given that we are dealing with a percentage measure, it is easy to understand that the width is quite low (all the countries are comprised of a 0.23 width), leading to a highly homogeneous sample.

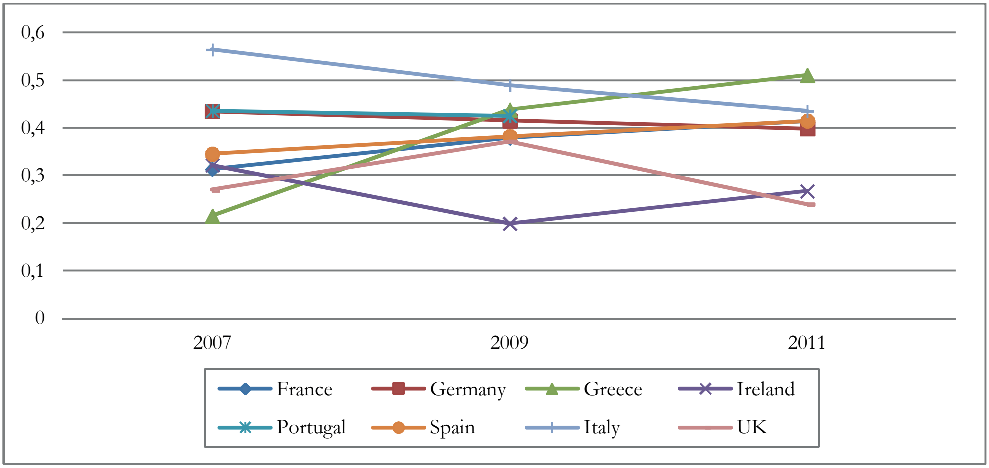
Figure 3: QPF Average Index



Source: Our elaboration.

Deepening the empirical analysis we could study the trend of the QPF index, from now on considered exclusively in percentages, and then "open up" the QPF index to closer analyse its components. Figure 4 shows the evolution of the QPF index from 2007 to 2011 in the sample countries.

Figure 4: QPF index trend



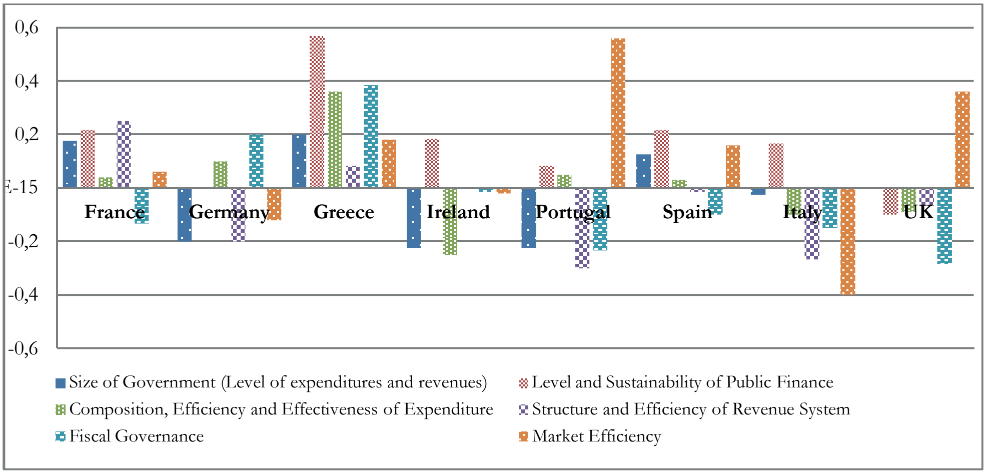
Source: Our elaboration.

The overall performance is quite bad. Countries performed low scores during the period considered, in particular Ireland, with a maximum score in 2007 of 0.32 without any improvement in the following years. All the scores are below the mean (0.5), except Italy in 2007 – with a score of 0.56 – but this is still far from an outstanding performance.

In general, despite all the growing attention to the QPF and the various upgrades and advices from the EC, the QPF index did not improve in the last SCPs. The information disclosed by the European countries are still not sufficient with reference to the QPF. The only three countries with a growing performance are Greece (from 0.2 to 0.51), France (from 0.31 to 0.41) and Spain (from 0.34 to 0.41). Germany keeps a quite stable trend, while Italy is the country where the QPF index decreases most.

Another analysis that could be done is to study the trend of the single components of the QPF index. Figure 5 illustrates the variation of each QPF dimension, obtained as the difference in its value between 2011 and 2007, for each European Member State.

Figure 5: Temporal variation of the QPF dimensions from 2007 to 2011



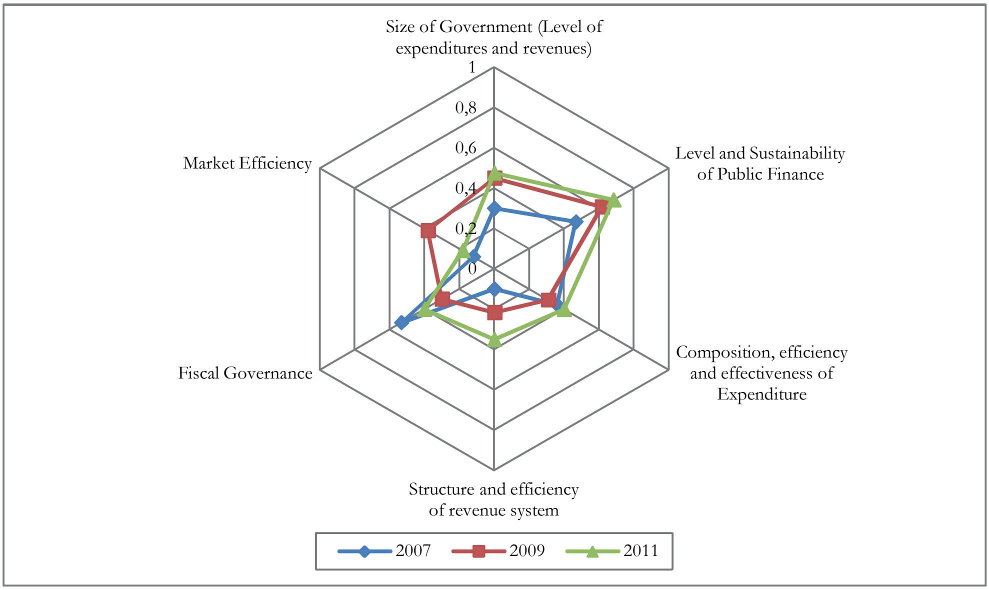
Source: Our elaboration.

Firstly, Greece seems to be the only country with a positive variation in every dimension. Thus, in this case, the general improvement of the index is due to an increase of the score for each QPF dimension. Secondly, France performed quite well, upgrading its position in every dimension except that of *Fiscal Governance*. Thirdly, the UK appears to be in an opposite situation with decreasing scores in every dimension except *Market Efficiency*. Finally, from the analysis it seems clear that *Fiscal Governance* is the dimension where the trend of the EU countries has been the worst ever. In six countries out of eight there has been a decrease in the disclosure about this kind of information, due basically to the scant attention paid by Member States to the information about budgeting procedures, often absent or treated very synthetically.

Now we propose the research results and findings coming from an in-depth analysis of the selected European countries (France, Greece, Germany, Ireland, Italy, Portugal, Spain and the UK) using a spider's web graphic to show the score of the single QPF dimensions for each country.

In the France case there has been a gradual improvement in some QPF dimensions through the years considered (see Figure 6). The highest upgrade has been registered for the *Level and Sustainability of Public Finance* and *Structure and Efficiency of Revenue System,* given mostly by the presentation of the S1 and S2 indicators with proper explanatory notes and the punctual description of the legislative framework thanks to the structural reform analysis. With regard to the *Structure and Efficiency of Revenue System,* the major improvement came from the in-depth analysis of fiscal burden composition and size and their effects on macro-economic variables. In relation to the *Composition, Efficiency and Effectiveness of Expenditure*, the absence must be noted of any information about one-off measures effects, procedures to enhance public procurement and the use of spending review. In addition, the analysis of productive expenses appears to be quite poor. Finally, the *Market Efficiency* disclosure is very low; we found only references to green economy and administrative reforms.

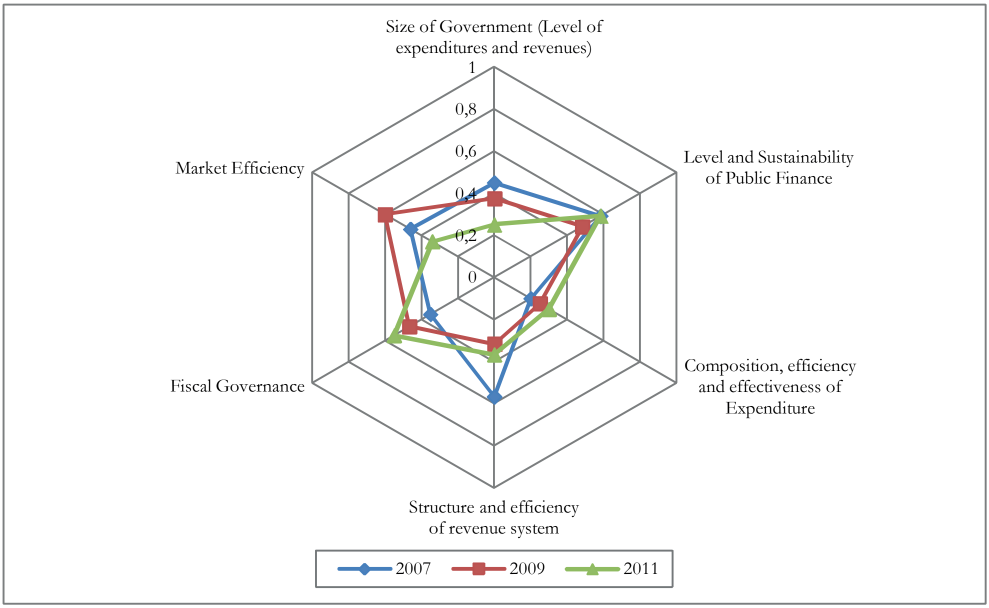
Figure 6: France



Source: Our elaboration.

During the three years analysed, Germany retained a quite stable level of QPF disclosure (see Figure 7). Even if the QPF index stayed around 0.40 every year, internally there have been some changes. The worst development has been registered in the *Structure and Efficiency of Revenue System*, given over mainly to the absence of the one-off income analysis, and scant attention given to the institutional factors' influence as tax evasion, labour participation rate, etc., that went from 6/10 in 2007 (for example with a brief explanation of the policy aims to contrast fiscal paradise) to 0 in 2011. In contrast, the *Fiscal Governance* disclosure showed a quite good improvement due to the punctual illustration of fiscal rules adopted with information about legal basis, monitoring process and enforcing mechanism and the introduction in 2011 of some elements of the role of the Stability Council.

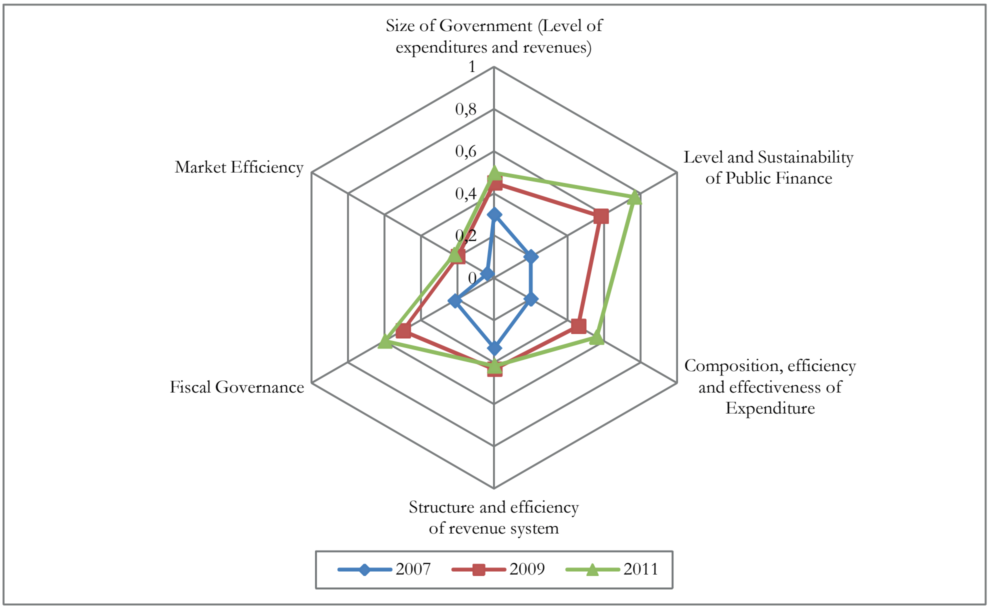
Figure 7: Germany



Source: Our elaboration.

Greece is the country that showed the most evident upgrade from 2007 to 2011, involving all the QPF dimensions (see Figure 8). The best results have been achieved for the *Level and Sustainability of Public Finance*, with a score improvement from 0.2 to 0.76 and for *Fiscal Governance*, with a score upgrading from 0.21 to 0.6. With respect to the *Level and Sustainability of Public Finance* this has been obtained mainly because of the better information disclosed about the Maastricht Parameters, with punctual details about the composition of debt and deficit. Moreover, the *Composition, Efficiency and Effectiveness of Expenditure* have been enforced by qualitative analysis with specific explanations organized by sector and offering a quantitative analysis of the welfare expenditure. Lastly, particular attention has been given to public servant policies and public procurement. This is linked to the strong pressure coming from the EC following the crisis of the Sovereign debt which exploded in 2011 and all the measures undertaken by the Greek Government as, for example, the mass lay-off in public administration structures. Huge evidence of this phenomenon is given in the section of the questionnaire about structural reform. From 2009 on, high attention has been addressed to the illustration and clarification of the various policies undertaken by the Government. Especially in 2009 a lot of detailed information about the Greek national health system reform, pension reform and social security are disclosed. In addition, in 2011 the structural reforms are presented in an apposite paragraph that shows the in progress reforms and the forecasts about further projects and plans supplied with appropriate and punctual legislative references. With respect to *Fiscal Governance*, again linked to the economic and financial crisis, a wide upgrade has been registered.

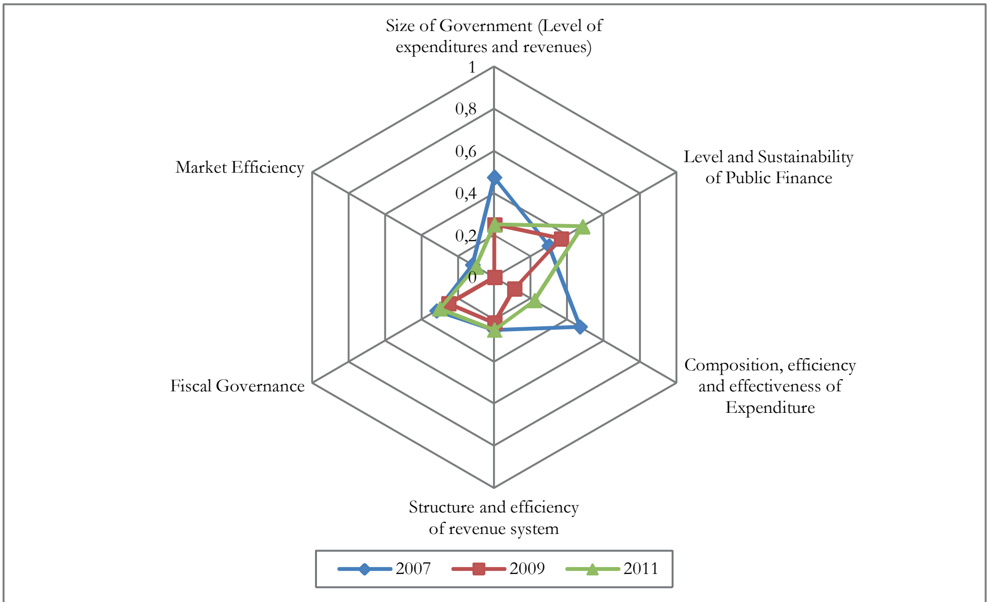
Figure 8: Greece



Source: Our elaboration.

Ireland is the country that performed worst among our sample; on average it scored the lowest value in the QPF index (see Figure 9). Except for the *Level and Sustainability of Public Finance*, Ireland is constantly under the mean in each dimension. In particular, this poor performance came from the low result achieved in the disclosure of information about *Market Efficiency*. The Irish SCP is quite insufficient in giving information about improvements and policies to enhance the situation for the labour market, financial market, competition and so on; in a few words it is not a valid instrument to understand if, and under which terms, Ireland is a safe country in which to invest and to develop economic activities. Another bad score has been registered in the *Composition, Efficiency and Effectiveness of Expenditure*. In particular, with reference to the analysis and classification of the various expenditure items, Ireland has been characterized by the absence of any information about welfare system expenditure, even if in 2007 it reached 10/10, and productive expenses, such as infrastructure, education and research & development. Moreover, any reference to public servant policies is absent and, over time, we lost information about public procurement. This is one of the countries where a decrease in the QPF index value over time has been registered.

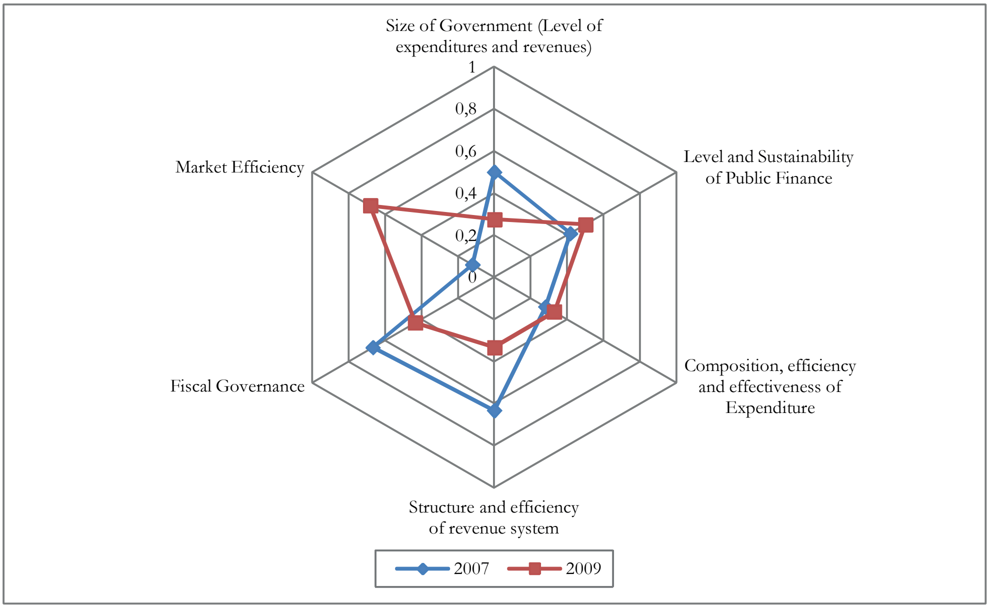
Figure 9: Ireland



Source: Our elaboration.

With regard to Portugal, the data are available only for 2007 and 2009 because the Portuguese Government has not supplied the final version of the 2011 pact yet. However, in the two years considered nothing relevant changed in the score of the QPF index but there is a wide change within its composition. In particular, a drastic decrease occurs in *Size of Government*, *Structure and Efficiency of Revenue System* and *Fiscal Governance,* counterbalanced by a high increase for what concerns *Market Efficiency* (see Figure 10). Indeed, with reference to the *Structure and Efficiency of Revenue System* in 2011, the disclosure is lacking in the analysis of the linkage between fiscal burden and macro-economic variables, on the one hand, and public expenditure on the other. In addition, nothing is said about the efficiency of tax administration. As regards *Fiscal Governance*, the information about fiscal rule and fiscal institution role disappeared completely, while in the *Market Efficiency* dimension remarkable improvements have been achieved, for example all the procedures disposed to strengthen the information disclosure and transparency obligations of financial institutions, and the policies to revise the punishments in the financial sector with a clear and punctual description of the legislative framework have been disclosed. Moreover, a good disclosure about measures to protect employment and to reinforce the social protection mechanism has been provided.

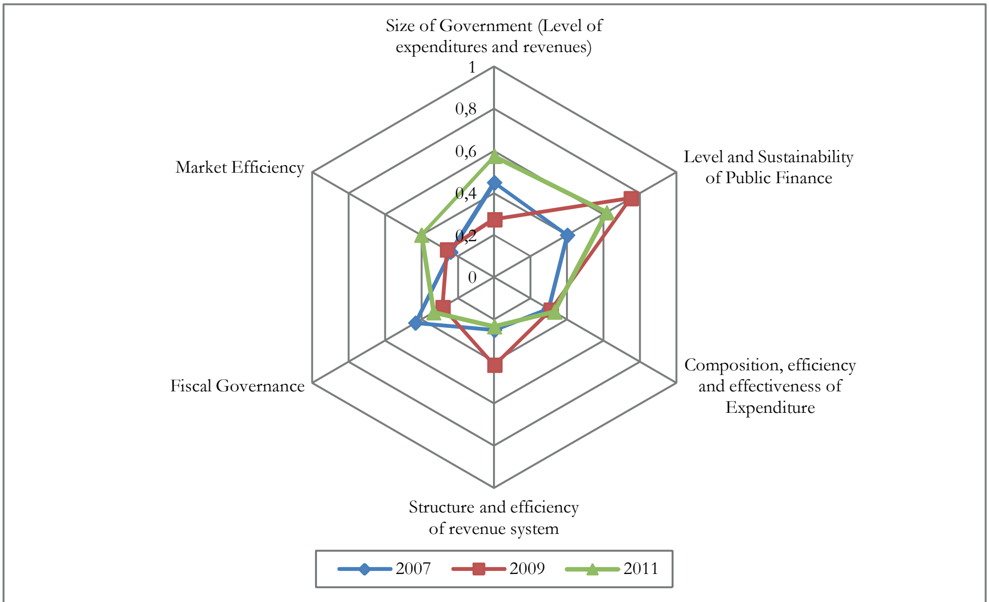
Figure 10: Portugal



Source: Our elaboration.

The Spanish QPF index registered a slight and moderate increase in each year, attaining a maximum score of 0.41 in 2011. To be noted is the total absence of some fundamental elements such as the composition and classification of public expenditure, the use of a spending review and the effect of institutional factors' influence on the efficiency of revenue systems (see Figure 11). With regard to *Fiscal Governance* serious deficiencies also appear for information on budget procedures and European fiscal framework references. On the other hand, worth highlighting is the outstanding performance gained in *Level and Sustainability of Public Finance*, with good and valuable details for the Maastricht Parameter figures and illustrations both for deficit and for debt. In addition, the main drivers of public finance are explained. Very good also is the disclosure about the structural reforms classified and analysed in-depth, and the overview on age related expenditure, where the description has been really complete and well organized with a dedicated paragraph for each entry.

Figure 11: Spain

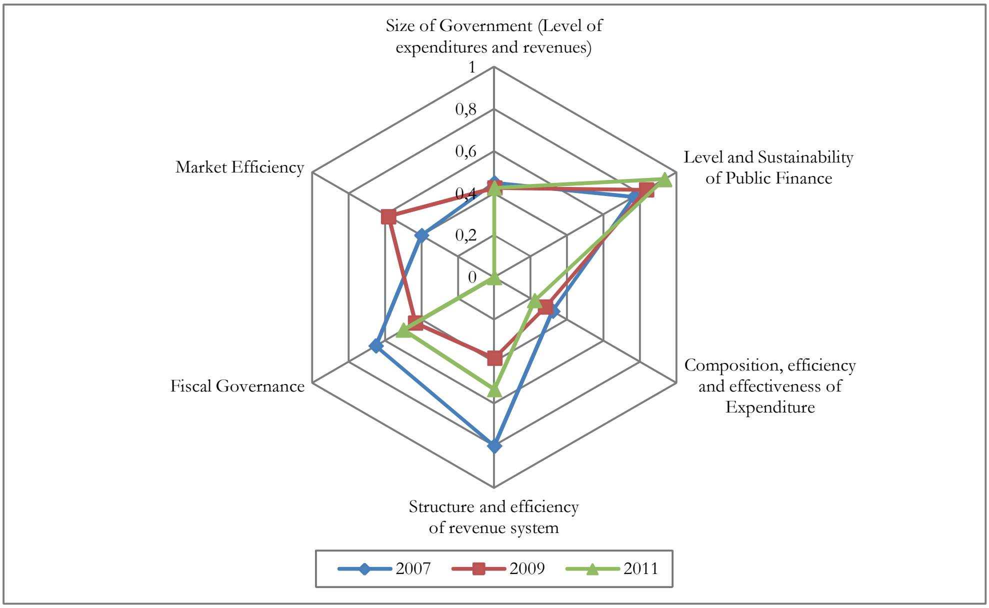


Source: Our elaboration.

Italy is the country with the worst performance in terms of variation from 2007 to 2011. Its score went from 0.56 to 0.44, losing 12 percentage points.

One of the drivers of this decrease is clearly the absence of information about *Market Efficiency* (see Figure 12). In 2011, Italy did not provide any data, or disclose any policy in order to understand what the Government was doing in order to improve market, labour and fiscal conditions. The final score was, in fact, 0 even though in the past SCPs it performed quite well (on average 0.45). Outstanding performances have been registered again in the *Level and Sustainability of Public Finance*, with the maximum (10/10) scored in each question of the dimension, except structural reform scheduling and past results achieved. To be underlined is the fact that this dimension is the one where only Italy, Greece and Spain reached very high scores, probably due to the disruption of the sovereign debts led by the severe financial crisis still being faced.

Figure 12: Italy

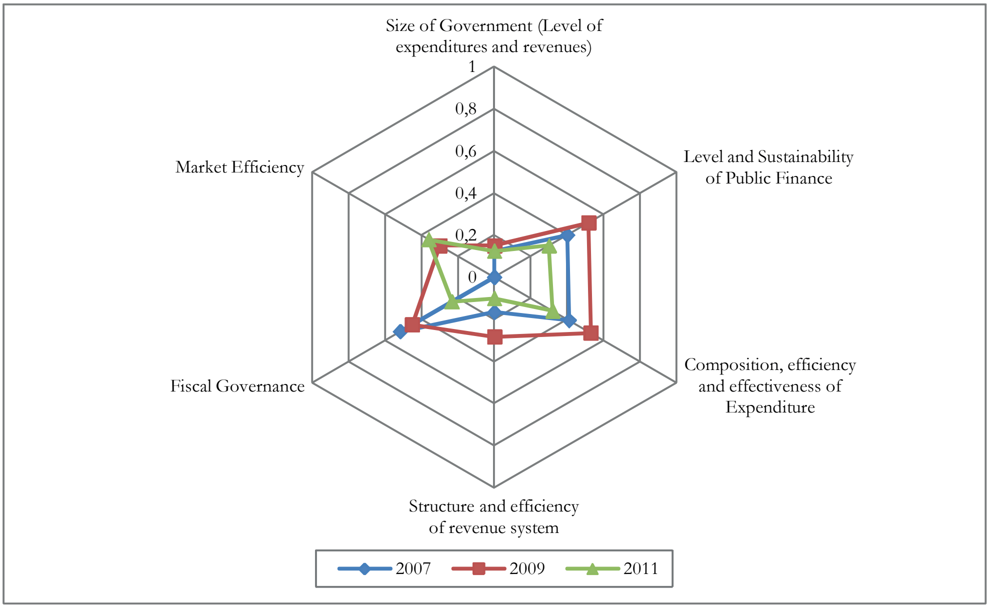


Source: Our elaboration.

The last country to be analysed is the UK. This is a case where a general decrease (from 2007 to 2011) appears in every dimension except for *Market Efficiency* (see Figure 13). Despite the QPF index having reached an average score in the years analysed, all round it has been quite poor in terms of single QPF dimensions. Differently from the other countries, the UK performed badly in

Size of Government. In particular there was no explanation about service provision, as PPP or similar, a total absence of the whole of Government data, despite the Code of Conduct explicitly requiring them, and no information about the Internal Stability Pact and procedure of coordination with lower levels of Government. Particularly bad has also been the performance in 2011 for the *Structure and Efficiency of Revenue System*, with 0 scores in several questions. To be underlined is the excellent score for the spending review analysis, not really surprising considering the Anglo-Saxon origins of this public finance tool.

Figure 13: UK



Source: Our elaboration.

The previous research results highlight some interesting tendencies at the European level that are useful to answer the research questions and to give some policy implication.

First, the QPF disclosure does not appear satisfactory as, on average, any country goes beyond 0.5 threshold in the period considered. This fact could create problems for the EC in the functioning and revision of the SGP and related SCPs. In fact, in the last two years, political and executive committees have remarked on the importance of the preventive arm. Moreover, it must be underlined that, after the introduction of the European Semester, SCPs appear more related to the NRPs. This tends to link numbers with strategies, therefore we were expecting an improvement of the content of the SCPs, but we did not find any. In addition, this has been a negative influence in the financial market, especially in the light of the rating opinion issued by the most famous agencies (i.e. Standard & Poor's, Fitch, Moody's).

Most of the authors, as well as the EC framework, highlight that a good QPF should aim to enhance budget and financial performances. If we briefly analyse the potential linkage between QPF index and financial performance, and if we consider also the potential influence of the EC through the EDP, as shown by Figure 14, interesting evidences emerge.

Figure 14: Financial performance data

Country	Years	Index	Deficit (structural)	Debt	GDP (national currency)	Gross domestic product volume*	EDP
France	2007	0.31	-3.8	63.9	1887.00	2.30	no
	2009	0.37	-5.6	78.3	1889.00	-2.70	yes
	2011	0.41	-3.9	84.7	1988.00	1.80	yes
Germany	2007	0.43	-1.2	64.9	2429.00	3.30	no
	2009	0.41	-0.8	73.5	2375.00	-5.10	yes
	2011	0.39	-1.4	82.4	2567.00	2.60	yes
Greece	2007	0.21	-6.8	105.4	222.80	3.00	no
	2009	0.43	-14.0	127.1	231.60	-3.20	yes
	2011	0.51	-7.4	157.7	217.80	-3.50	yes
Ireland	2007	0.32	-1.6	25	189.90	5.20	no
	2009	0.19	-10.0	65.6	160.60	-7.00	yes
	2011	0.26	-9.5	112	156.10	0.60	yes
Portugal	2007	0.43	-3.1	68.3	169.30	2.40	yes
	2009	0.42	-5.4	83	168.60	-2.50	yes
Spain	2007	0.34	1.2	36.1	1053.00	3.50	no
	2009	0.38	-8.6	53.3	1048.00	-3.70	yes
	2011	0.41	-4.3	68.1	1075.00	0.80	yes
Italy	2007	0.56	-3.2	103.6	1554.00	1.70	yes
	2009	0.48	-3.9	116.1	1527.00	-5.10	yes
	2011	0.43	-2.7	120.3	1586.00	1.00	yes
UK	2007	0.26	-3.9	44.5	1406.00	3.50	no
	2009	0.37	-8.9	69.6	1394.00	-4.40	yes
	2011	0.23	-6.5	84.2	1511.00	1.70	yes

* Percentage change on preceding year

Source: Index, our elaboration; Deficit, Debt and GDP (% change), Public Finance in EMU 2010 and 2011; GDP (National Currency), General Government Data, European Commission, Autumn 2011; EDP, European Commission, 2012 (http://ec.europa.eu/economy_finance/economic_governance/sgp/deficit/index_en.htm).

In general, the presence of an EDP does not appear as fundamental. In particular, in the years 2009 and 2011 all analysed countries have been under EDP. Conversely in 2007 Italy and Portugal scored a QPF index higher than other countries even if they were under EDP, whereas Germany, that was not under EDP, had the same score of Portugal. Thus, the adoption of the EDP procedure does not affect the QPF index.

About the relation with financial performance, there is a general tendency for which a higher QPF index is linked to higher financial performance (or a reduction if the country is in deficit) and vice versa. Only in two cases (Italy and the UK) this relation has not been confirmed.

The correlation analysis between QPF index and structural deficit shows the following results: in 2007 a correlation index of 0.3504; in 2009 a correlation score of 0.3231; and, in 2011 a correlation measure of 0.4063. Therefore, from the analysis carried out, a weak positive correlation between QPF index and structural deficit emerged.

However, strong reasons are given to explain this weakness, such as the financial crisis and the sovereign debt pressure that since 2008 has affected the European Union. This is the reason why in such cases, despite a quite good QPF index, European countries have not had a sound financial performance. Indeed, we underline that the weak positive correlation is probably due to the efforts pursued by the European Commission and Council in recent years.

Moreover, with regard to the QPF dimensions, some questions arise about the lack of information coming from the SCPs analysis about the *Size of Government*, such as the service provision analysis (PPPs and Privatization policy), and, in some cases, the coordination procedure with lower levels of government.

The *Level of Sustainability of Public Finance* is quite developed in some countries, in particular those countries characterized by a high debt level (i.e. Greece and Italy over all). The only missing information, in some cases, is the analysis of S1 and S2 indicators.

Regarding the *Composition and Efficiency of Public Expenditure*, the SCPs present important deficiencies and omissions. There is no evidence about the use of indicators able to analyse the efficiency of public expenditure, and, even if rationalization policies are declared there are no reasonable explanations for them except for the UK (e.g., the spending review process). In addition, public procurement is not taken into consideration.

Furthermore in the expenditure analysis, it must be considered that the information, both quantitative and qualitative, of one-off measures is not given. This fact appears quite relevant. As a matter of fact, the evaluation of the expenditure one-off measure, also for the revenue side, is an important issue to calculate structural balance. The EC gives particular attention to the one-off income, with the aim of avoiding that non-current revenue financing capital expenditures determines an increase of structural deficit. However, the problem of how to manage one-off expenditure arises. In particular there is a risk to include the capital expenditures in the one-off categories without any audit by the EC.

With regard to the *Structure and Efficiency of Revenue System,* there are some relevant missing values. Examination of the linkage among taxes, expenditure and the effect of the institutional factors (e.g., tax evasion and shadow economy) often are not taken into consideration.

Fiscal governance is the dimension that received the highest attention during the last year by the European Commission and Council. In some cases we found information about national budgeting procedures and their link with the European fiscal framework. The latter is very relevant in the light of the scope of the European Semester.

The last dimension taken into consideration is *Market Efficiency* which shows the worst performance in our analysis. Probably, this is due to the fact that market policies (such as liberalization) are matters of the NRP in the view of Europe 2020 targets, even though they can have an influence on fiscal stance through the effect on potential growth. Finally it must be underlined that SCPs' European regulation requires information on the linkage between SCP and NRP of the single European country.

7. Conclusions and implications for future research

In this paper we analysed the QPF as a concept that increased in importance during recent years. Most authors and institutional bodies have given attention to different aspects of the QPF using different approaches and methods. The EC tried to define a common framework, released in 2008, into which it gathered many contributions from academia and practice.

Our analysis has been conducted on the SCPs, as key documents of the European budgetary surveillance procedure. We investigated the QPF disclosure provided by the SCPs and its relationship with financial performance. To this end a rationale sample of eight European countries has been used.

The main results obtained showed that the QPF disclosure does not appear satisfactory since any country went beyond the 0.5 threshold of the QPF index, (that could assume a value between 0 and 1) even if we noted a general tendency toward an enhancement in 2011, also enforced by the entry of European Semester. In addition, the correlation analysis showed a positive relation between the QPF index and structural deficit, even if weak (just 0.4 in 2011).

Regarding the QPF's dimensions, we underlined some deficiencies the most important concern the efficiency of public expenditure, the analysis of the effect of one-off measures (both from the revenues and expenditures sides) and the development degree of strong and homogeneous fiscal rules across the European Union.

However, the behaviour that the European Members States will adopt in the near future for saving their public finances as a consequence of the introduction of measures such as the European Semester and the reform of the SGP, through the so called "Six-Pack Pack" and "Fiscal Compact", seems fundamental to give an in-depth judgement on the QPF.

Finally, further research can be directed toward an extension of the sample to all European countries, an evaluation of the compliance of SCPs to the content of the Code of Conduct and an interrelation study between SCPs and NRPs.

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