

Underlying Risks to Sustainable Public Finances

Parallel Audit Report to the Contact Committee of the heads of the Supreme Audit Institutions of the Member States of the European Union and the European Court of Auditors by the Supreme Audit Institutions of Finland, Latvia, the Netherlands, Portugal, Slovakia and Sweden

Summary

Mandate

The Supreme Audit Institutions (SAIs) of Finland, Latvia, the Netherlands, Portugal, Slovakia and Sweden have co-operated in a parallel audit on underlying risks to sustainable public finances. The parallel audit project was endorsed by the Contact Committee at its meeting in June 2015. The Swedish National Audit Office has chaired the parallel audit working group. The participating SAIs followed an agreed broad common audit approach allowing them to conduct their audit work according to their national mandates. Each SAI was free to decide the scope, audit questions and methods for their respective audit while recognising the common approach. This parallel audit report is thus a synthesis of six audits conducted independently by SAIs at the national level. It contains general observations and conclusions but no common recommendations.

Aim and audit approach

The aim of the parallel audit was to draw attention to risks to sustainable public finances and to audit how governments deal with such issues within three similar processes involving recommendations from international organisations. This audit is based on reviews of country-specific reports and recommendations from the European Union (EU), the Organisation for Economic Co-operation and Development (OECD) and the International Monetary Fund (IMF) issued in the period 2011–2015, (the audited period). The participating SAIs have mapped the various recommendations to their respective country as well as the government responses to these recommendations. They have furthermore audited the public availability of the recommendations at national level as well as national follow-up procedures. A number of SAIs have moreover assessed the effectiveness of government measures.

General observations and main conclusions

The audit conclusions build upon findings from each participating SAI as reported in separate country papers, presented at a seminar in Stockholm in December 2016. A general observation of the parallel audit working group is that recommendations issued by the three international organisations tend to overlap within each country. This might indicate that the international organisations have pinpointed relevant areas of concern. The overall conclusion is that multilateral surveillance of economic policy, even when the recommendations are not binding, constitutes good opportunities for governments to learn from best practices and to improve their policies.

Another general observation from the analysis of recommendations from international organisations is that risks to fiscal sustainability are interconnected. Measures aimed at addressing short term challenges may therefore at times conflict with measures aimed at achieving long term fiscal sustainability.

The findings of participating SAIs demonstrate that all six countries that were subject to the parallel audit project face challenges in terms of fiscal sustainability in a broad sense, but the nature of these challenges vary across countries. The sustainability risks that the SAIs identified range from examples like projected increases in future age-related public expenditures to the presence of contingent liabilities such as state guarantees, explicit and implicit liabilities in public private partnerships or in the financial sector.

The generally non-binding character of the recommendations makes it difficult to judge whether a government action in line with a recommendation is a result of the recommendation itself or if it would have been carried out anyway. Contributing to this complexity is also the fact that recommendations are formed in interaction with national authorities and stakeholders. Some recommendations may thus have current national policy debate as origin rather than expert opinions by the international organisations' officials. Keeping this in mind, a conclusion from the parallel audit is that national governments tend to follow recommendations to a reasonable extent.

There are also quite a few examples of non-compliance. In some cases, national governments simply apply alternative solutions to the same problem. In other cases, no action is taken and no explanation is given to why a specific recommendation is disregarded. It could therefore be argued that governments should provide their national parliaments with a clarification when they choose not to follow a certain recommendation.

The effectiveness of government measures in response to the various recommendations proved to be a delicate matter to assess. The participating SAIs moreover dealt with this question very differently, as a consequence of diverging national conditions. These differences therefore make it difficult to draw common conclusions in this area.

The various examples and findings from the SAIs that participated in this parallel audit demonstrate that public dissemination and consultation of international advice is an important part of multilateral surveillance. The observations and recommendations of the EU, the IMF and the OECD can be very useful for national governments, since their observations and recommendations are made within a broad international perspective. This gives national governments the opportunity to benchmark their national policy and to learn from the observations and recommendations of these renowned international institutions, which eventually can lead to better policy making.

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1 Introduction

The long-term sustainability of the public finances and the budgetary impact of ageing population is a concern for many EU-countries. Post-crisis progress in restoring public finances have been made, but debt levels, fiscal risks and vulnerabilities remain high. A weakened starting point in terms of the public sector's initial financial position and concerns about demographic and structural challenges ahead, have increased governments' focus on issues of fiscal soundness and sustainability. In this context, SAIs have an important role to play in supporting and auditing a true and fair view of governments' long term fiscal positions.

The European Union (EU), the International Monetary Fund (IMF) and the Organisation for Economic Co-operation and Development (OECD) regularly review the member states' economies in order to identify risks and imbalances that need to be managed to maintain macroeconomic stability, growth and sustainable public finances. In this context, the EU, IMF and OECD¹ issue country-specific recommendations for economic and financial policy. The recommendations are elaborated through processes that involve discussions and consultations with national governments and other stakeholders. This is done in an effort to ensure the governments' ownership of the recommendations. The recommendations are generally not binding, but can be seen as an instrument to encourage responsible economic policies and to meet common goals. Some of the recommendations concern the long-term sustainability of fiscal policy and risks related to long-term sustainability, which is the focus of this parallel audit.

1.1 Aim and common audit approach

The aims of the parallel audit was to 1) draw attention to risks that need to be addressed in order to maintain fiscal sustainability based on recommendations from international organisations; and 2) assess how the governments dealt with the recommendations they received.

The audit work followed a common approach agreed by the participating SAIs, but all SAIs had the discretion to define their own specific approach. The SAIs have mapped the various recommendations to their respective country according to a set of agreed categories to facilitate comparisons. In addition to this categorisation, the SAIs studied the government responses to the recommendations, including procedural issues, guided by a set of commonly agreed

¹ Hereafter referred to as "international organisations".

questions (see below). A number of SAIs have moreover assessed the effectiveness of government measures.

The reviewed Country Specific Recommendations (CSRs)² were issued between the years 2011-2015 in the context of the:

- European semester (EU semester)
- Article IV consultations of the IMF and Financial Sector Assessments
- OECD's Economic Surveys
- Economic and Financial Assistance Programme of the EU, ECB and IMF (Portugal)

Departing from these recommendations, the idea was to identify relevant risks that may have an impact on the long term sustainability of public finances and to audit how national governments have been dealing with those risks.

Each participating SAI was free to decide the scope, specific audit questions and methods for their respective audit work as long as they followed a common approach. This common audit approach was guided by the following broad questions:

Main questions

1. Have national governments addressed the recommendations concerning risks to sustainable public finances from the European Council, the IMF and the OECD?
2. Did national governments' measures contribute to reduce the risks identified?

² In this report "Country Specific Recommendations" refers to recommendations issued by international organisations, even though the term usually refers only to recommendations in the context of the EU semester.

Procedural questions

1. Are the CSRs regularly made available to the public at the national level and/or submitted to the parliament?

If yes:

- Is this procedure mandatory / regulated?
- Which ministry/authority/institution is in charge of publication?
- Does the publication cover all recommendations or a selection of them?

3. Does the competent ministry/authority/institution publish a statement at the national level with an official opinion on the CSRs?

If yes:

- Is the statement mandatory?
- Does the opinion cover all recommendations or a selection of them?

4. Is there an explicit follow-up process for each set of recommendations in relevant ministries/authorities/institutions with an assessment of compliance with recommendations?

If yes:

- Are the follow-up documents regularly made available to the public at the national level and/or submitted to the parliament?
- Does the assessment include explanations in cases of non-compliance?

1.2 Outline

This report contains six country sections with key findings from each of the participating SAIs in the parallel audit. The findings have been structured under the following headlines:

- Overview of CSRs for the period 2011-2015 from the European Council with regard to the European semester, the IMF in its article IV consultations and the OECD in its Economic Surveys
- Identified risks to fiscal sustainability on the basis of CSRs
- Government response to CSRs
- Effectiveness of Government measures
- Public availability of CSRs and follow-up procedures

Each country section also contains a description of SAI specific audit approaches and evidence bases. General observations and common conclusions are presented in section 2.

1.3 Concepts

Multilateral Surveillance

Multilateral surveillance by international organisations such as the EU, IMF and OECD are examples of what is known as "soft law". The Monitoring usually does not lead to sanctions, except for specific provisions under the rules governing the European Semester. Instead, "...any impact on national governments has to result from the (mild) pressure of having to justify one's action in the light of a common evaluation of the compliance of this action with joint goals."³ Multilateral surveillance by these three international institutions thus provides opportunities for national governments to challenge their own national policies.

After the recent economic crisis in Europe, the EU's economic governance developed and strengthened. The introduction of the European Semester (EU semester) in 2010⁴ and subsequent initiatives have resulted in a wide-ranging European framework for economic governance, designed to promote sustainable economic growth, sound public finances and financial stability.

Although not subject to the same level of procedures, the economic policy monitoring by the OECD Economic Surveys and the IMF's Article IV consultations have similar starting points. The IMF surveillance focuses on possible risks to financial stability and provides advice on policy adjustments. The OECD Economic Surveys focus on structural measures that have the potential to improve the economy's long-term performance of the monitored countries.

The processes by which these recommendations are elaborated all include elements of consultations with national governments and multilateral discussions. These aim to increase the national governments' sense of ownership of the recommendations and the possible actions they may result in.

The European Semester

The EU Semester is a policy cycle aiming to achieve ex-ante coordination of the budgetary and financial policies of the EU and its Member States.⁵ It has been described as a "key element of the EU's economic governance framework which aims to detect, monitor, prevent and correct problematic economic trends such as excessive government deficits and public debt levels"⁶.

³ Armin Schafer (2006) A new form of governance? Comparing the open method of co-ordination to multilateral surveillance by the IMF and the OECD, *Journal of European Public Policy*, volume 13, 2006, Issue 1, s. 70-88.

⁴ The first recommendations under the European Semester were issued in 2011.

⁵ A comprehensive description of the EU semester can be found on the EU Council's website: <http://www.consilium.europa.eu/en/policies/european-semester/>

⁶ European Parliament briefing "European Semester revamping and 2016 priorities", 2016. [http://www.europarl.europa.eu/RegData/etudes/BRIE/2016/577976/EPRS_BRI\(2016\)577976_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/BRIE/2016/577976/EPRS_BRI(2016)577976_EN.pdf)

The EU-semester's legal basis are the rules and guidelines governing the Stability and Growth Pact (SGP), the Macroeconomic Imbalances Procedure (MIP), and the Europe 2020 Strategy.⁷

The main aim of the SGP is to prevent excessive public deficits and public debt in EU countries by providing recommendations for sound fiscal policies and public finances. The MIP serves to detect macroeconomic imbalances early on and to issue recommendations so that these can be prevented. The SGP and MIP have preventive and corrective arms. The corrective arms are used for countries that are experiencing excessive deficits or macroeconomic imbalances. The Europe 2020 strategy helps EU countries to track and improve their performance in relation to defined targets for employment, research and development, climate change and energy, education, and poverty and social exclusion.

If countries continue to breach the rules of the SGP and MIP, while under their corrective arms, it may lead to sanctions in the form of fines (for Euro area countries) or withheld EU funding. The Europe 2020 Strategy does not include sanctions.

With regard to the process, the CSRs are proposed by the Commission for approval by the Council. As a rule the Council is expected to follow the Commission's proposal. If the Council disagrees, it should explain its position. The CSRs are formally endorsed by the European Council and adopted by the ECOFIN Council (EU finance ministers). Once adopted, the member states are expected to reflect the CSRs in national policy making, notably in the drafting of the national budgetary plans. That process is referred to as the "national semester" and runs until the next EU semester cycle starts. Euro-countries should also submit their draft budgetary plans for review by the European Commission.

Since the first CSRs were issued in 2011, the EU semester has been subject to continuous changes. For example, a revamp of the EU semester in 2015 aimed to introduce greater focus on EU priorities (limiting the number of CSRs), promote better implementation of recommendations and increased ownership at national level.⁸

The EU semester should actively involve national governments and other stakeholders in the formulation of CSRs. National governments should account for how they have consulted with their parliaments during the semester cycle.

⁷ The main legal basis are relevant articles of the Treaty of the Functioning of the European Union (including articles 121 and 148) as well as the rules governing the SGP and MIP, laid down in the "6-pack" and "2-pack" regulations and the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union. The main guidelines for the Europe 2020 strategy are provided by Council Recommendation (EU) 2015/1184 and Council Decision (EU) 2015/1848.

⁸ European Parliament briefing 2016.

The IMF Article IV consultations

All member countries of the IMF agree to subject themselves to continued surveillance of their financial and economic policies under article IV of the IMF's Articles of Agreement. According to the IMF, this surveillance includes "regular monitoring of economies and associated provision of policy advice [...] to identify weaknesses that are causing or could lead to financial or economic instability"⁹. As a result of a broad consultation process, including the government and central bank of the member country, the IMF issues a report with recommendations. In most cases this is a yearly process and the recommendations focus on monetary, fiscal and financial policies.

OECD Economic Surveys

In a process similar to the IMF's Article IV consultations, the OECD publishes Economic Surveys for all OECD member countries every two years. The OECD's Economic and Development Review Committee (EDRC) plays a central role in issuing the recommendations that feature in the country reports. These recommendations are developed based on a peer-review process within the EDRC. All OECD countries and the European Commission have one representative on this committee. The recommendations reflect their joint conclusions. The examined country is represented by a delegation of high-level officials from several government departments. As with the other two processes described above, the government's participation should serve to anchor the process in the country in question and ensure government ownership of the recommendations.¹⁰

The focus of the OECD Economic Surveys is on policies having a potential to improve the economy's long-run performance, including labour markets, health care spending and pension systems in close connection with the macroeconomics of public finance sustainability and the economy's growth potential.¹¹

Latvia was invited to join the OECD in 2016, prior to which the country undergone in-depth reviews by a number of OECD committees. Due to its status as a member of the European Union, Latvia's legislation and policies were already in conformity with many OECD standards. The accession process nevertheless resulted in a number of recommendations on economic policies, of which several needed to be implemented prior to joining the OECD.

Economic and Financial Assistance Programme

For the period 2011-2014 the majority of recommendations from international organisations to Portuguese authorities were given under an Economic and Financial Assistance Programme (EFAP). The programme was established through a Memorandum of Understanding (MoU)

⁹ IMF 2017 (<https://www.imf.org/external/about/econsurv.htm>)

¹⁰ OECD 2017 (<http://www.oecd.org/eco/surveys/>)

¹¹ <http://www.oecd.org/eco/surveys/abouteconomicsurveysandtheedrc.htm>

signed between the Portuguese Government and the so called Troika institutions - the EC, the ECB and the IMF. More information about EFAP and its consequences can be found in the country section about Portugal.

Fiscal sustainability risks

The parallel audit project has used the concept of fiscal sustainability applied in the European Commission's Fiscal Sustainability report 2015 as a starting point. The report presents the toolkit for fiscal sustainability analysis used in the context of the EU Semester. This toolkit identifies sustainability challenges in three different time dimensions: short, medium and long run - based on three different sustainability indicators. The medium and long run indicators refer to a more traditional view of fiscal sustainability based on the government inter-temporal budget constraint. The short term indicator is instead designed to capture short term risks of fiscal stress stemming from the fiscal and macro-financial sides of the economy.¹² In addition to these indicators, the Commission also analyses other factors in its sustainability assessment, such as risks related to the structure of public debt financing and contingent liabilities.

Risks to sustainable public finances can therefore refer to traditional fiscal sustainability analysis with regard to the public sector's solvency over a very long time period. It can also refer to short term macro-financial risks that may influence the public sector's ability to fulfil its commitments over the long term.

¹² European Commission, Fiscal Sustainability report 2015, p. 21 ff.

2 General observations and conclusions from the parallel audit

2.1 The nature of country specific recommendations

The recommendations from international organisations to national authorities examined in this parallel audit encompass a wide range of economic policy issues. The EU semester recommendations address fiscal policy under the Stability and Growth Pact, structural policies related to the Europe 2020 Strategy and macro-financial policy specifications under the Macroeconomic Imbalance Procedure. Many IMF Article IV Consultation recommendations focus on issues relevant to financial stability. OECD Economic Surveys focus on policies having a potential to improve the economy's long-run performance.

A general observation of the parallel audit working group is that despite this wide coverage of policy issues, the CSRs for each country tend to converge and even overlap. This might indicate that the international organisations have pinpointed relevant areas of concern. To a certain extent it might also be a result of recommendations emerging from already existing national policy debates. The overall conclusion is that the multilateral surveillance of economic policy, even when recommendations are not binding, constitutes good opportunities for governments to learn from best practices and to improve their policies.

The broad international perspective gives national governments the opportunity to benchmark their national policy and to learn from the observations and recommendations of these renowned international institutions, what eventually can lead to better policy making. The international organisations have gathered significant expertise and are well capable to make cross country comparisons and to share best practices. One could even argue that these organisations challenge the national policies and provide opportunities to reconsider national policies that are easily taken for granted or considered as the only thing possible.

2.2 Identified risks to fiscal sustainability

Risks to sustainable public finances can refer to the public sector's solvency over a very long time period. It can also refer to short term macro-financial risks that may influence the public sector's ability to fulfil its commitments over the long term. It is nevertheless difficult to draw the line between fiscal sustainability issues and economic policy in general. A general observation from the analysis of CSRs in this respect is that risks to fiscal sustainability are interconnected. Measures aimed at addressing short term challenges may therefore at times conflict with measures aimed at achieving long term fiscal sustainability.

All six countries that were subject to the parallel audit project face challenges in terms of fiscal sustainability in a broad sense, but the nature of these challenges vary across countries. A common observation (e.g. by the NAO of **Finland**) is that sustainability risks are stemming from both current imbalances between public revenue and expenditure as well as projected increases in future age-related expenditures. In combination with slow growth this constitutes a dilemma since consolidation efforts might have unfavorable impact on economic growth.

Pension systems that are not financially sustainable in the long run were clearly identified as a risk by almost all participating SAIs. In addition to obvious concerns about age-related public expenditure, some SAIs identified risks from contingent liabilities such as state guarantees and explicit and implicit liabilities in public private partnership projects or in the financial sector. The **Latvian** SAI and the SAIs of **Portugal** and **Slovakia** also identified a need for improving tax collection and compliance in order to ensure future funding of public expenditure. The SAIs of the **Netherlands** and **Sweden** identified vulnerabilities caused by an unsustainable build-up of housing related household debt, with several similar challenges across the two countries in this respect.

2.3 Government response to country specific recommendations

Economic recommendations by the EU Council, the IMF and the OECD are in most cases not directly binding, with exception of those within a financial assistance mechanisms (the case for **Portugal** from 2011 to 2014). Since most of the time there is a lack of clear follow-up reporting per CSR, it is difficult to judge whether a government action is in line with a CSR as result of the recommendation itself or if it would have been realised anyway. Contributing to this complexity is also the fact that recommendations, particularly those from the EU Semester, are formed in interactions with national authorities and other stakeholders. Some recommendations may also have been originated in, or reflect, the national policy debate. Indeed, some recent reforms of the EU semester have aimed at increasing the policy dialogues at national level (between governments, parliaments and social partners). A conclusion from the parallel audit is that national governments tend to follow recommendations to a reasonable extent.

There are also quite a few examples of non-compliance. In some cases, national governments apply alternative solutions to the same problem. In other cases, no action is taken and no explanation is given as to why a specific recommendation is disregarded. It can be argued that governments should provide their national parliaments with a clarification when they choose not follow a certain recommendation. The rules governing the EU semester process also stipulate that national parliaments have a role to play in the EU semester.

Portugal was the country that followed recommendations to the greatest extent in comparison with the other countries in the parallel audit, partly because this country was particularly affected by the economic crisis and partly because of the strict conditions and comprehensive approach of the Economic and Financial Assistance Programme (EFAP).

2.4 Effectiveness of Government measures

The effectiveness of Government measures in response to the various CSRs is no doubt a delicate matter to assess. The specific question that SAIs tried to answer according to the common audit approach was “Did national Governments’ measures contribute to reduce the risks identified?” The participating SAIs dealt with this question very differently. Hence the answers differ considerably making it difficult to draw common conclusions in this respect:

The SAI of **Finland** selected one newly and one not yet implemented reform as case studies (the 2017 pension reform and the health, social services and regional government reform planned for 2019) and assessed the probability of positive fiscal sustainability impacts of the reforms ex ante. The approach illustrated among other things the importance of transparent impact assessments and sensitivity analyses.

The SAI of **Latvia** did also conduct a case study and concluded that while specific measures to combat shadow economy were not organized systematically and efficiently by the government, there is also an underlying lack of effective tax policy and room for improvement regarding tax collection.

The SAI of the **Netherlands** described the Government’s various instruments to investigate the effectiveness of their policy and concluded that specific measures are not evaluated individually.

The **Portuguese** findings was based on three earlier audit reports which showed that the central government deficit target was achieved despite a lack of a systematic approach by means of structural and permanent measures, that the monitoring framework for budget transparency improved and that there was some progress in the public administration, health and education sectors.

The SAI of **Slovakia** evaluated the progress in risk reduction of government measures by using a set of key national indicators for seven different risk areas. The evaluation demonstrated that the implementation of recommendations helped to mitigate risks. However the Slovakian SAI also stressed that, in many cases, it is difficult to distinguish effects of the measures from effects of external factors.

The Swedish SAI chose not to audit the effectiveness of government measures in relation to CSRs at this stage. Instead it plans to conduct a separate performance audit on the effectiveness of macro-prudential supervision, which was an important field covered by the CSRs.

2.5 Public availability and follow-up procedures

With regard to procedural issues, a general observation by the parallel audit participants is that there is a marked difference between the procedures ascribed to the EU semester CSRs and the recommendations issued by the OECD and IMF. In the EU semester, governments should consult national stakeholders, including parliaments, throughout the process. However, the consultation procedures and the involvement of national parliaments do vary between the audited countries.

Several examples show that national parliaments are only somewhat involved in the process. Governments seem to choose how to respond to recommendations at their own discretion and the ensuing follow-up process where measures are analysed and accounted for is generally not straightforward. But there are also examples of the duly involvement by national parliaments in all stages of the EU semester, including the implementation of CSRs. This situation may reflect the fact that national parliaments play more or less prominent roles in the formulation of national policies, notably in the national budget procedures.

The various examples and findings from the SAIs that participated in this parallel audit demonstrate that public dissemination and consultation of international advice is an important part of multilateral surveillance. By compiling CSRs over a five year period and analysing governments' responses to these recommendations, each participating SAI is part of this process.

2.6 Adaptations of the common audit approach

The participating SAIs have used the common audit approach described in chapter 1.1. While broadly following the common approach, each SAI was free to adapt their audit work according to their mandate and other national circumstances. For example, some SAIs extended the audit period to include more country reviews. Table 1 summarises the main deviations from the common audit approach.

Table 1. Audit approach adaptations

SAI	Audit period	Main deviations from the common audit approach
National Audit Office of Finland	2012-2016	Case studies to assess effectiveness of the preparation of government reforms.
State Audit Office of Latvia	2011-2016	Case study in order to evaluate the effectiveness of measures taken to combat the shadow economy.
The Netherlands Court of Audit	2011-2015	As concerns the effectiveness of government measures, the audit was based on the Government's own policy evaluation instruments.
The Portuguese Court of Accounts	2011-2015	Included findings from previous audits of the implementation of the Portuguese Economic and Financial Assistance Programme (EFAP).
Supreme Audit Office of the Slovak Republic	2011-2015	Used key national indicators in order to assess the risk reduction capacity of government measures.
Swedish National Audit Office	2011-2015	Did not audit the effectiveness of government reforms.

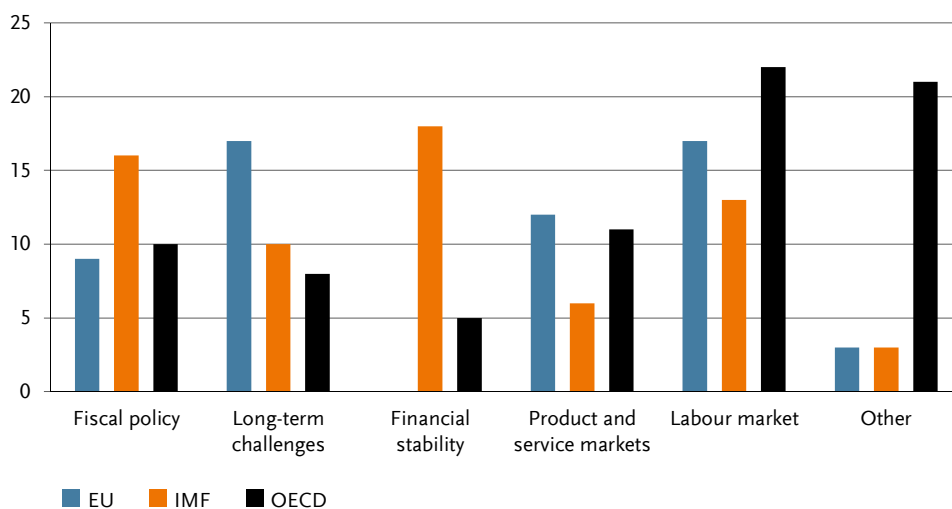
3 Key findings – Finland

3.1 Overview of country specific recommendations

Recommendations to Finnish authorities cover a wide range of topics related to economic policy.¹³ The summary of the recommendations is presented in graph 1.

Recommendations in the fiscal policy stance–category typically concern the need for fiscal consolidation or adjustment. Measures aimed at long-term fiscal challenges typically include recommendations related to structural reforms to contain health care, long term care and pension costs. Labour market recommendations are concentrated on the decentralisation of wage bargaining system and various other issues that are thought to have impact on employment rate (e.g. the level of unemployment benefits, early retirement pathways, active labour market programmes). Economic policy guidance in product and service markets–category focus on the opening of service markets to competition, other deregulation and business subsidies. Recommended financial stability measures concern mostly the strengthening of the macro-prudential framework. Other recommendations include e.g. some energy policy and education policy issues.

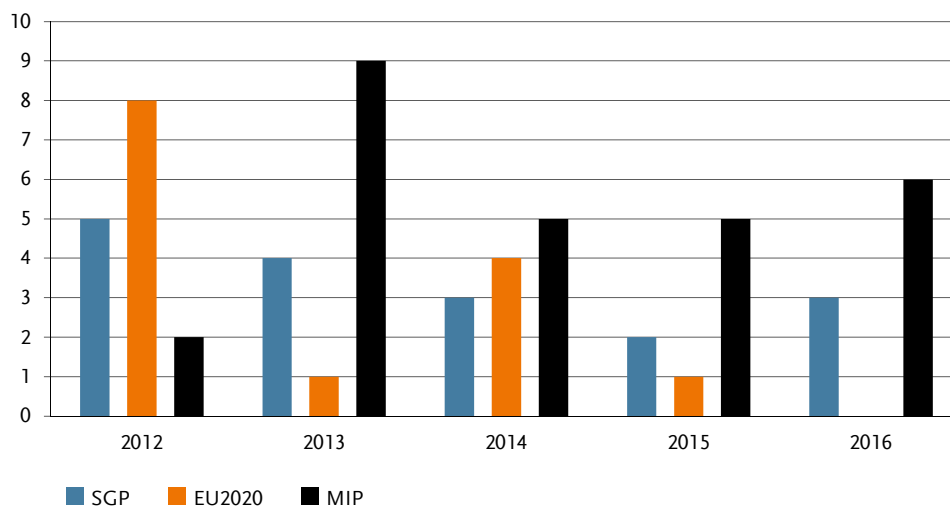
Graph 1. The recommendations of EU, OECD and IMF from 2012 to 2016, categorised according to their principal focus



¹³ The Finnish audit encompass recommendations during 2012-2016, see section 3.6 Audit approach and evidence base.

EU country specific recommendations include as standard parts, if applicable, the recommendations related to Stability and Growth Pact, the recommendations arising from in-depth review related to Macroeconomic Imbalances Procedure (MIP), and the recommendations linked to the objectives of EU 2020 strategy. During 2012 – 2016, the focus in recommendations has varied a lot (see graph 2). In 2012, most recommendations were related to EU 2020, whereas in 2016 all recommendations were given on the basis of Stability and Growth Pact or MIP. It should be noted that the number of individual recommendations identified in the analysis exceeds the number of recommendations in the actual Council Recommendation: each item in the Council document has been usually broken down to several sub-recommendations. It is interesting to note that same recommendation may be given on different legal basis over the years. For example, the recommendation to open up retail sector for more competition was based on EU2020 in 2012, whereas in 2013 and 2014 it was based on MIP. In 2015 the basis was EU2020, and finally in 2016 it was again grounded on MIP.

Graph 2. The distribution of EU country-specific recommendations according to their legal basis



Many of EU, IMF and OECD recommendations are repeated from year to year. Also, the recommendations available from three organisations share a significant part of their substance. There appears to be no major, clear disagreements in the approaches adopted. In the area of fiscal consolidation, IMF has put more emphasis on the protection of economic growth than EU, but adherence to EU's fiscal rules appear also as an issue in IMF's assessments. In its Economic Outlook in the end of 2016, OECD has identified fiscal space for Finland, but this conclusion was not reflected in the recommendations given for Finland in 2016. Each

organisation has some unique features and they have recommendations that are not put forward by other organisations. These are often linked to smaller issues, and are partly due to the different level of detail provided in the economic policy guidance. The relatively high convergence of different sets of recommendations is not surprising, given the global nature of economic debate.

3.2 Identified risks to fiscal sustainability

The picture emerging from international analysis and recommendations shows several risks to fiscal sustainability. These risks are very much interconnected. The existence of long-term sustainability gap and the prevalence of slow economic growth during the audited period constitute the core challenges. Being broad and general problems, almost all recommendations are directly or indirectly linked to them.

Sustainability gap: The estimated gap is due to current imbalance between revenue and expenditure and also due to projections about the increase of age-related expenditures. The measures to decrease the sustainability gap may therefore include short-term, medium-term and long-term measures, and tackling the other identified risks is normally also contributing to the closing of sustainability gap.

Slow growth: Many recommendations are motivated on the basis of their impact on supporting the revival of economic growth. Slow growth, if prolonged, would prevent the improvement of public finances. Behind slow growth, IOs have identified both external factors and shocks but also national factors that can be tackled by government actions. Slow growth and sustainability gap constitute a dilemma as many fiscal measures are supposed to have detrimental impact on economic growth, both in short and long term.

Low employment rate: Although relatively high in EU or OECD-level consideration, Finnish employment rate is clearly lower than in other Nordic countries. Higher employment rate has been seen as a key to support growth and therefore ease also sustainability challenges. In addition, it would have direct fiscal impacts by way of higher tax revenues and lower unemployment insurance expenditure.

Limited competition and high regulation in service sector: Deregulation of service sector is assumed to have various channels to contribute to sustainability. First is due to its anticipated positive impacts on productivity, and second is due to increasing employment.

All of the mentioned risks have a clear, even if varying, link to fiscal sustainability. In addition, IMF in particular has paid attention to **financial stability risks**, including high household debt, high concentration of banking sector, and also strong regional linkages of financial sector and the challenges for banking supervision in that context. Even though this risk area is not

primarily a fiscal sustainability concern, it can be argued that the realisation of different risk scenarios in the financial sector might also have a significant impact on public finances.

3.3 Government response to country specific recommendations

The relationship between international recommendations and national-level decision making is complex. The implementation of recommendations given by EU, OECD and IMF is generally voluntary. Also, the recommendations are formed in an interaction with the national authorities, social partners and other parties. Often the issues present in the national political debate or policy formulations end up being part of IOs recommendations. In Finland, the central role of Government programmes is a practical issue that limits the practical significance of international advice. The Government programme is defined for the whole Parliamentary term (four years), and introducing new significant measures that are not foreseen in the government programme is challenging if they lack wide support from the government coalition.

Compliance with the recommendations is, in many cases, a matter of degree. Nevertheless, it is possible to make general conclusions about the compliance. Overall, the decisions made in Finland have been relatively well in line with the international recommendations. When considering all recommendations between 2012 - 2015, there are at least some actions taken after the issuance of recommendations in line with the recommendations for majority of recommendations. This observation finds support in the analysis of follow-up sections included in the IOs' documentation, even though the follow-up done by IMF and OECD themselves should be used with some caution. Also, the observation is consistent with an earlier study published by EU commission, which concluded that Finland's implementation record of CSRs from 2012 and 2013 was among the highest in EU member states.

However, there are also important issue areas where decision-makers have not shared the views of external evaluation, or final decisions have not followed the international advice for other reasons. Examples of such issues are summarised in table 1.

Table 2. International recommendations that have not been fully followed by Finland

Recommendation/observation	Note
Research and development expenditure: In 2015, IMF noted that intended cuts in R&D spending could weaken medium-term productivity growth and noted that plans to cut such spending should be reconsidered. In 2016, IMF recommended reallocating resources toward R&D spending.	According to statistics, cuts to government R&D funding in the budget for 2016 amounted, in real terms, to 9,4 %. According to the budget for 2017, smaller cuts were carried out for 2017.
Financing of active labor market programs (ALMPs): In 2015, IMF recommended strengthening of active labor market programs and reconsidering plans to reduce funding for these programs. In 2016, IMF recommended reallocating resources toward well-designed ALMPs. In 2016, EU advised to ensure targeted and sufficient active labour market measures.	Cuts to ALMPs were implemented for 2016, and also for 2017, even though there were reforms to allow more flexibility in the use of unemployment benefit resources for active measures.
Unemployment and disability pipelines to early retirement, part time pensions: EU recommended reducing or eliminating early exit pathways every year from 2012 to 2015. OECD has recommended tightening early retirement routes in 2012, ending part time pensions in 2014, ending unemployment pipeline in 2014 and 2016, and limiting the access to disability pensions to be based on medical reasons in 2014 and 2016. In 2016, OECD also advised to adjust the new pension scheme for those in demanding jobs to life expectancy.	The 2017 pension reform did not extensively restrict the availability of early retirement routes. Several changes were introduced and part-time pension was thoroughly reformed, but important early retirement options still exist.
Wage setting: IMF recommended in 2012, 2014, 2015 and 2016 to increase the flexibility in wage setting or to align wage growth with labor productivity. EU has recommended supporting the alignment of real wage and productivity developments or enhancement of local level bargaining in 2012, 2013, 2015 and 2016.	In the Competitiveness Pact (2016) between the Government and labor market, it was agreed that the progress on the issue will depend on and will be based on collective agreements negotiated between labor market parties, rather than on legislative changes.
Parental leave, home care allowance: According to OECD, work incentives for second-earners in families with small children should be improved (2012), and the combined duration of parental leave and the home-care allowance should be reduced (2016).	Plans to reform home-care allowance comprehensively have not materialised.
Environmentally harmful subsidies: OECD has in 2014 and 2016 recommended phasing out environmentally harmful subsidies.	According to OECD country survey 2016, no actions have been taken.

3.4 Effectiveness of Government measures

The need for structural reforms has been prominently present in the recommendations of IMF, OECD and EU during the period analysed in the audit. For example, many recommendations have dealt with the pension system and the organisation of health and social services. This has been largely due to the recognition of the ageing population and projected increase in age-related expenditures as one of the primary risks to the sustainability of Finland's public

finances. Two measures related to these challenges were selected as case studies: the pension reform which entered into force in 2017, and health, social services, and regional government reform which is currently under preparation. The objective was to illustrate issues that affect the transparency of uncertainty related to structural reforms and the probability of positive fiscal sustainability impacts of the reforms.

Table 3. Features that have an impact on the certainty of impacts and on the transparency of uncertainty of structural reforms

	2017 pension reform	Health, social services and regional government reform
The role of fiscal sustainability goal in the design of the reform	Improving fiscal sustainability was the core objective of the reform, which was not subject to major compromises.	The objective of cost containment was among the two main objectives of the reform. However, the two main objectives are partly contradicting. The reform has expanded and currently it covers additional areas.
Estimated impact on fiscal sustainability	According to estimates, the reform decreases the sustainability gap by ca. 1 %-point.	According to the draft bill, it has been estimated that there is a cost-saving potential of 3.000 million EUR (in 2019 prices) by 2029.
The existence of significant transitional costs	There are no significant transition costs, but there is some potential for short-term expenditure pressures due to benefit changes.	There are major transitional costs involved (e.g. wage harmonisation, ICT). The assessment of the magnitude is still work-in-progress.
The probability of the realisation of the transition costs, compared to chances that positive impacts on sustainability will be realised	Not relevant (see above).	The realisation of transitional costs is more automatic than the realisation of cost savings.
The availability of the assumptions behind impact assessments	Assumptions are available in background documentation, but not in government bill.	The methodology behind the calculation of cost-saving potential is available in background documentation
The availability of sensitivity analysis / alternative scenarios related to fiscal sustainability impact	Comprehensive sensitivity analysis or alternative scenarios were not produced using the calculation approach that was used for impact assessment of government bill.	No sensitivity analysis or alternative scenarios have been made available so far.
The sensitivity of the results to the changes in assumptions	The new sensitivity analyses carried out for the audit do not point to significant sensitivity, but highlight moderate short and long term uncertainties.	Even though difficult to quantify, the results depend greatly on various uncertain factors

The analysis carried out in the audit illustrates the different elements that may influence the certainty of outcomes and the transparency of risk position of each reform. In sum, **the pension reform** appears as a relatively riskless reform, which has clear objectives. In the preparation process, impact assessments were made to ensure that the final structure of the reform is likely to bring about the intended impacts. The transition costs of the reform are low. The availability of different impact assessments supports the confidence in the impacts of the reform. However, the scarce reporting of assumptions behind the baseline scenario in the impact assessment of government bill and the unavailability of sensitivity analysis in that context have decreased the transparency of reform's impacts on fiscal sustainability.

The draft **health, social services, and regional government reform** is a multi-objective reform, which necessarily entails compromises between various goals. New objectives have also been added in the preparation process. From the standpoint of fiscal sustainability, this increases the level of uncertainty related to the impacts. The riskiness of the reform is further increased by significant transition costs, whose realisation is also more automatic than the cost-saving elements. Impact assessment of the reform is very demanding, and the nature of the cost-saving mechanisms does not allow straightforward calculation of alternative scenarios. Overall, the reliability of currently available impact assessments of the reform seems relatively low.

3.5 Public availability and follow-up procedures

As a part of the audit the communication of recommendations to both general public and Parliament was examined, as well as the existence of national-level follow-up documentation. The results are summarised in table 3.

Table 4. Public availability and follow-up procedures

COORDINATOR/PROSESS-OWNER	EUROPEAN SEMESTER: MINISTRY OF FINANCE (MOF) OECD COUNTRY SURVEY: MINISTRY OF FINANCE (MOF) IMF ARTICLE IV: BANK OF FINLAND (BOF)
PUBLICATION OF NEW RECOMMENDATIONS	<p>European Semester: Carried out by MoF in 2015 and 2016, shortly after Commission publication. The publication refers to CSRs and provides links to Commission materials. No publication carried out during 2012-2014. When the Council adopts the recommendations there is no separate publication.</p> <p>OECD Country Survey: Carried out by MoF, in the context of media conference related to the release of the new country survey. The publication refers to the recommendations without complete listing or analysis. Links are provided to OECD materials.</p> <p>IMF Article IV: BoF prepares a press release at the time IMF's Concluding Remarks are published, containing a Finnish and Swedish summary of the Concluding Remarks. In 2016, a press release was also published at the moment IMF published the Country Report.</p>
SUBMISSION OF NEW RECOMMENDATIONS TO THE PARLIAMENT	<p>European Semester: Yes. The form and timing of information has varied somewhat over 2012-2016. There are ministerial hearings in the Grand Committee of Parliament before Council meetings, which gives the Grand committee an opportunity to discuss the matter. In 2012 and 2014, MoF also sent the Commission recommendations as a separate letter to Parliament.</p> <p>OECD Country Survey: No.</p> <p>IMF Article IV: No.</p>
OFFICIAL STATEMENT DELIVERED AT THE TIME NEW RECOMMENDATIONS ARE PUBLISHED	<p>European Semester: No published statement, but Finland's position in the Council is available by request, and the position is also occasionally covered in the communication related to Council meetings.</p> <p>OECD Country Survey: No.</p> <p>IMF Article IV: No. IMF Country Report includes a part containing national authorities' views on IMF's analysis.</p>
NATIONAL-LEVEL FOLLOW-UP DOCUMENTATION	<p>European Semester: Prepared by MoF, included in the standard format of national reform programme (NRP), as defined by the Commission.</p> <p>OECD Country Survey: No national-level follow-up documentation prepared.</p> <p>IMF Article IV: No national-level follow-up documentation prepared.</p>
PUBLICATION OF NATIONAL FOLLOW-UP DOCUMENTATION	<p>European Semester: NRP is published by MoF, but a press release was prepared only in 2012, 2013 and 2015. Press release itself did not analyse how fully CSRs have been addressed, but the link was provided to NRP containing that information.</p>
SUBMISSION OF NATIONAL FOLLOW-UP DOCUMENTS TO THE PARLIAMENT	<p>European Semester: NRP is submitted to the Parliament as a separate issue (a letter to Grand Committee).</p>

There are positive aspects in the communication practices related to international recommendations. Currently all of them are published in one way or other by national authorities. However, there is also room for improvement. The publication of EU and OECD recommendations relies too much on the material on the IOs' own websites. The publication practice for EU recommendations appears not to be fully established. Therefore, in the future, attention should be paid to the establishment of publication procedures and the clear publication of the content of recommendations in national languages. For EU semester, there is a need for a comprehensive communication plan or strategy, covering both the dissemination to the general public and also the information to Parliament.

3.6 Audit Approach and evidence base

The audit was primarily based on the analysis of documentation, notably the reports produced by EU, IMF and OECD, as well as documentation prepared by authorities at national level, particularly national reform programmes related to EU semester. In order to include enough recommendations also from the IMF and the OECD, the audit encompass recommendations to Finnish authorities during 2012-2016 (cf. 2011-2015 in the common audit approach). Between 2012-2016, there have been three OECD Economic surveys (2012, 2014 and 2016) and four IMF Article IV consultations (2012, 2014, 2015, 2016) for Finland, in addition to annual European Semester country-specific recommendations. For the assessment of structural measures, the main sources were impact assessments carried out in different phases of the preparation of the reforms. The impact assessments were complemented by new sensitivity analyses carried out by Finnish Centre for Pensions, commissioned by National Audit Office. For all parts of the audit, interviews with authorities were used as an additional evidence base. The audit questions, evidence base and methodologies are summarised in table 4.

Table 5. Audit approach and evidence base

Audit questions	Sub-questions	Evidence base and methodology
1. What kind of recommendations related to fiscal sustainability have international organisations given to Finland during 2012 – 2016?	<ul style="list-style-type: none"> a. What are the main issues taken up in the recommendations? b. Has there been variation over time in the content of recommendations? c. Have there been differences between international organisations as regards the content of recommendations? 	<p>EU: country-specific recommendations 2012-2016 (Commission recommendations, and final Council recommendations), EU semester legislation</p> <p>IMF: Article IV consultations 2012, 2014, 2015, 2016: Country reports</p> <p>OECD: Country Surveys of Finland, 2012, 2014, 2016</p> <p>Document analysis, interviews</p>
2. Have the measures carried out in Finland been in line with international recommendations?	<ul style="list-style-type: none"> a. Have IOs recommended such actions that have not been realised or prepared in Finland? 	<p>Follow-up documentation of IOs, National Reform Programmes, Government Programmes, Government's Annual Report, state budgets</p> <p>Document analysis, interviews</p>
3. Are the substance of recommendations and follow-up information communicated effectively at national level?	<ul style="list-style-type: none"> a. Has the communication about new recommendations to the public and to Parliament been comprehensive? b. In which ways the possible follow-up information has been communicated at the national level? 	<p>Web sites (MoF, BoF, Ministry of Foreign Affairs, Parliament), EU-commission guidance, guidance of Ministry of Justice, National Reform Programmes</p> <p>Document analysis, interviews</p>
4. How effectively two structural reforms (pension reform of 2017 and health, social services and regional government reform under preparation) address the fiscal sustainability risks?	<ul style="list-style-type: none"> c. What are the major uncertainties related to the reforms? d. Do the impact assessments prepared for the reforms include sensitivity analyses? e. Have any uncertainties communicated transparently? f. Is there more uncertainty involved with positive impacts on sustainability than with negative impacts? g. Are there significant risks that the positive impact of the reform will be essentially smaller than anticipated? h. How central the role of fiscal sustainability has been in the objective setting and in the decision-making of the reform? 	<p>Government bills, drafts, decisions and background materials related to structural reforms</p> <p>New sensitivity analyses carried out by Finnish Centre for Pensions, commissioned by NAOF</p> <p>Document analysis, interviews, sensitivity analysis</p>

4 Key findings – Latvia

4.1 Overview of country specific recommendations

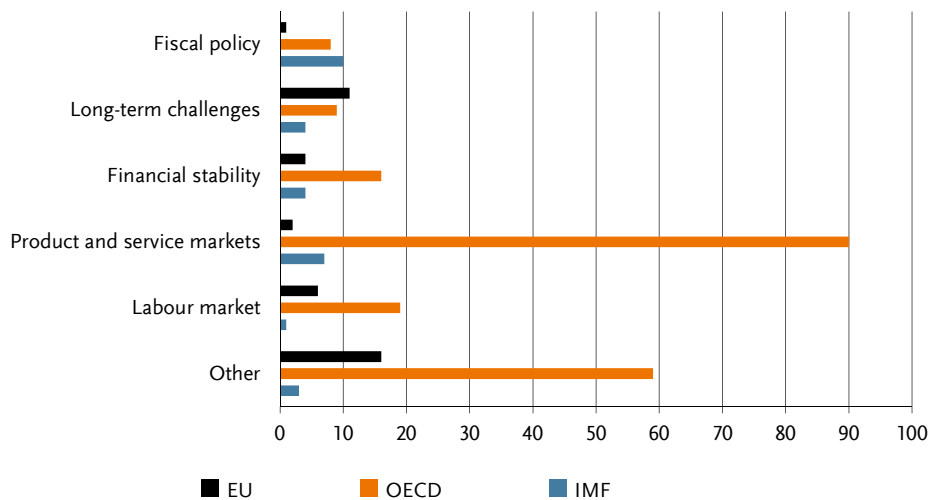
During the audit, SAO of Latvia reviewed 270 recommendations provided by international organisations over the audited period. It should be pointed out that several of the recommendations are given regarding the same issues both by different international organisations and by the same organisation in consecutive years, where the evaluation of the progress has called for an additional recommendation in the same area. Most recommendations are provided in the classification group of product and service markets / business environment, which are mostly OECD best practice recommendations in areas like trade, competition policy and the digital economy.

The number of EC, OECD and the IMF recommendations on the most important Latvian public finances sustainability risks has reached 67 (groups – fiscal policy stance / fiscal framework / fiscal transparency; measures aimed at long-term fiscal challenges; financial stability measures).

Regarding the fiscal policy stance / fiscal framework / fiscal transparency, most recommendations are provided by IMF – 10 recommendations. To facilitate measures aimed at long-term fiscal challenges, most recommendations have been provided by EC (regarding the National Reform Programme of Latvia) – 11 recommendations and financial stability measures recommendations are mostly provided by OECD – total of 16 recommendations.

Classification of recommendations in groups demonstrates that the EC, OECD and IMF have all independently provided recommendations in each of the recommendation classification groups.

Graph 3. Number of recommendations provided by international organisations in each group of recommendations



4.2 Identified risks to fiscal sustainability

Despite the lack of a unified recommendations management process, the responsible institutions assess the risks identified by the international organisations as relevant and adequate to the Latvian fiscal, economic and social problems.

In the Declaration of Fiscal Risks of 2016, the following risks to sustainable public finances have been identified:

- quantifiable fiscal risks – state guarantees; state loans; quantifiable risks in the welfare sphere; an increase of regular payments into the EU budget and international cooperation; the EU policy instruments and other foreign financial assistance programmes; state guarantees for study loan and student loan; capital on demand;
- non-quantifiable fiscal risks – explicit and implicit fiscal government liabilities in public private partnership projects and concession agreements; state-owned enterprises; enforcement of judgements of international courts and the Constitutional Court; finance sector (risk, that for the sustainability of the banking sector, public finances will have to be used).

Government's priorities - strengthening the economy, national security and national identity, improvement of the demographic situation, improvement of the quality of life of families and social security, structural reforms in the education and science sectors, reforms in healthcare – are focused on the development of the state, to reach the goals set out in the Sustainable

Development Strategy of Latvia until 2030 and the National Development plan of Latvia for 2014-2020.

For example, certain actions set out in the Latvian government action plan include direct references to the recommendations provided by the international organisations, including introduction of a Banking Union, linking the allocated finances of the institutions of higher education with the quality of the education and research, as recommended by the EC, as well as the conclusion of negotiations on Latvia's accession to the OECD. Government Action Plan includes actions in such key fiscal sustainability areas as fiscal policy and fiscal discipline, a balanced budget, tax policy, health system, pension system and measures to combat the shadow economy.

4.3 Government response to country specific recommendations

The state does not have a regulated and traceable unified process for initial evaluation, implementation, monitoring, assessing of the progress and reporting regarding the recommendations provided by the international organisations. With no unified recommendations governance process and a lack of basis to ensure traceability of future actions, there is a risk that significant recommendations for fiscal sustainability provided by international organisations will not be taken into consideration. Responsibility for coordination with the international organisations has been delegated to the following institutions – The Central Bank of Latvia, in cooperation with the Ministry of Finance (IMF), the Ministry of Economics (EC) and the Ministry of Foreign Affairs (OECD), however – without a unified or standardised set of actions or guidelines to be followed in order to evaluate the recommendations and carry out the implementation and follow-up procedures of the actions taken by the government.

Recommendations of international organizations are given in a number of areas, which are also the government's priorities, however, references to recommendations are not found in the medium-term planning document National Development Plan of Latvia for 2014- 2020, which determines the country's development objectives, priorities and results to be achieved, as well as the course of future action. Additionally, certain measures aimed at the implementation of the recommendations of international organisations or measures which promote the implementation of the recommendations do not refer to the main policy guidance document – the Declaration of the Cabinet of Ministers. An indirect reference to the recommendations can be found only through the analysis of the action plans set out in the development planning / policy guidance documents and aligning them with the content of the recommendation.

In the absence of a unified or standardised recommendations management process, and without recommendations embedded in the development planning and policy guidance documents,

lacking also the basis to ensure traceability of future activities, there is a risk that the independent evaluation and the recommendations of the international organisations are not taken into account, despite the time and resources invested in the drafting of the recommendations both by the international organisations, as well as the ministries of Latvia and the Central Bank of Latvia in ensuring a successful cooperation with the international organisations.

4.4 Effectiveness of Government measures

Since 2010 international organizations have recommended the Latvian government to address the issue of counteracting the shadow economy, but until 2016 the assessments of international organizations indicate that the measures taken by the government to mitigate the shadow economy and tax evasion are not sufficient and effective, Latvia has showed small progress in improving tax collection and tackling the shadow economy and there is a need to continue the efforts to reduce the scale of the shadow economy.

In order to assess how successful the implementation of the recommendations of international organisations has been, which actions and whether sufficient measures the responsible institutions have taken to implement the recommendations, SAO of Latvia has examined the recommendations provided to combat the shadow economy.

To evaluate the effectiveness of the measures taken to combat the shadow economy, SAO of Latvia for the purpose of this parallel audit has reviewed, as an example, the results of the financial audit of the Annual Accounts of the Ministry of Finance of 2015 (events funded by New Political Initiatives – *Facilitation of combating shadow economy by ensuring competitive and motivational State Revenue Service remuneration and Radical action in combating shadow economy in tax administration and customs affairs*) as well as justification of allocated finances for actions taken in combating shadow economy and combating shadow economy by facilitating an effective tax policy. The SAO of Latvia has concluded that these specific measures taken by the State Revenue Service and combating shadow economy by facilitating the development of an effective tax policy are not organised systematically and efficiently:

- the state does not have a development planning document either in 2014, nor 2015, which would include goals and outputs to be achieved in combating shadow economy;
- State Revenue Service, from the total funding for the specific measures to combat shadow economy, has fully spent the allocated resources for wages, but the absorption of the funding to ensure more efficient operation of the customs controls is delayed;
- allocated funding for the remuneration of the State Revenue Service employees, who carry out the procedures of combating shadow economy, does not comply with the priorities set

in the remuneration policy of the State Revenue Service, thus not facilitating targeted and pre-emptive problem-solving;

- in order to justify the funding for the New Political Initiatives, the State Revenue Service and the Ministry of Finance have indicated as performance indicators the additional tax and non-tax (fines) revenues in the state budget without providing information to support the projected additional revenue. The Ministry of Finance performs an assessment of actions performed by the State Revenue Service without providing a comparison of the planned and the actually achieved results.

Despite the fact that implementation of some certain recommendations provided by the international organizations shows positive progress, nonetheless the prevention of several major risks is delayed, for example, when assessing such an important public finances sustainability issue as shadow economy, the SAO of Latvia has concluded that, even though there is an agreement on an action plan for the implementation of the recommendations for the government institutions, the progress of reforms to combat the shadow economy is still slow.

4.5 Public availability and follow-up procedures

Currently, although the information may be considered publicly available, however, for the communication to reach its primary goal – to promote good public governance and involvement of the civil society in decision making, improvement of the availability of information is necessary.

The society is not provided with comprehensive, detailed information on the recommendations of international organisations and the measures taken by the government to implement the recommendations:

1. the information is not available in one place for all the recommendations;
2. it is not presented in an easily understandable manner and in the Latvian language;
3. it is not sufficient to encourage public feedback and structured and timely discussions.

SAO of Latvia considers that restricted availability of information connected with the implementation of recommendations increases the risk that implementation of important recommendations will remain at a formal level due to the responsible ministries not having to be accountable to the society.

The summary on the availability of information provided bellow:

Table 6. Public availability and follow-up procedures

No.	Question	EC recommendations	IMF Article IV Consultations	OECD Recommendations
1.	Are the country specific recommendations regularly made available to the public at the national level?	Available in Latvian on the EC website, coordinating institution – Ministry of Economics	No, but information is available on the IMF website, coordinating institution – The Central Bank of Latvia in cooperation with the Ministry of Finance	No, link to OECD website provided in the coordinating institution website, coordinating institution – Ministry of Foreign Affairs
2.	Are country-specific recommendations submitted to the Parliament?	Yes, the European Affairs Committee of the Parliament	No, but there are discussions at the ministerial level	Yes, recommendations for accession process are provided to the Parliament
3.	Does the competent institution publish a statement at the national level with an official opinion on the country specific recommendations?	Yes, opinion included in the budget plan, published on the website of the Ministry of Finance	No, opinion is not published	No, information is provided to the government, it is not published in an easily accessible way
4.	Is there an explicit follow-up process for each set of recommendations in relevant institutions with an assessment of compliance with recommendations?	Yes, additionally progress reports on procedures carried out in implementing the recommendations provided to the Parliament	No	Since the accession to OECD, regular follow-up reviews are carried out – Corporate Governance Committee, Health Committee

Recommendations provided by EC and reports of their implementation are freely and publicly available to the society. Information regarding recommendations provided by OECD is only partly available, and there are deficiencies in the availability of information to the society on the IMF Article IV consultations and implementation of the recommendations.

4.6 Audit Approach and evidence base

The audit covered a period from 2011 to 2016.

The scope of the audit does not include recommendations provided by IMF under the Loan programme and post-programme monitoring reports till 2012. The EU balance of payments assistance programme to Latvia expired on 19 January 2012 and from 20 January 2012 to

16 January 2015 Latvia was subject to post-programme surveillance, which expired as Latvia has repaid 75% of the EU loan¹⁴.

Assessment criteria

During the course of the audit, assessment criteria were set according to the four issues to be reviewed.

Table 7. Assessment criteria

Audit issue		Assessment criteria
Audit issues and criteria related to the assessment, implementation and monitoring of recommendations		
1.	Have responsible institutions developed systematic and transparent implementation and monitoring process of recommendations provided by international organisations?	A Traceable process of implementation and monitoring of recommendations has been developed.
2.	Have responsible ministries assessed compliance of recommendations with the actual situation and planned reforms in the state?	The process has been developed: when receiving a recommendation, its compliance with the actual situation and the planned reforms in the state are assessed and a conceptual decision is made whether the recommendation will be implemented and what measures will be taken for implementation of the recommendation.
3.	Do responsible institutions take into consideration recommendations provided by international organisations when planning the policy?	Responsible institutions take into consideration recommendations provided by international organisations when planning the policy.
Audit issue and criteria related to the access to information		
4.	Is information on provided recommendations and the progress of their implementation available to the society?	Information on recommendations and their implementation progress is publicly available.

Sources of information include, but not limited to:

1. interviews with the responsible institutions;
2. laws, regulations and annotations;
3. OECD, IMF, EC reports, interim reports and consultations;
4. Declaration of Fiscal Risks;

¹⁴ https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-financial-assistance/which-eu-countries-have-received-assistance/financial-assistance-latvia_en

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5. National Reform Programme of Latvia;
6. Convergence Programme of Latvia;
7. Stability Programme of Latvia;
8. formal and informal communication of the Ministry of Finance with the OECD, IMF
EC;
9. expert interviews.

5 Key findings – Netherlands

5.1 Overview of country specific recommendations

The OECD, the EU-semester and the IMF periodically publish reports with country specific recommendations for The Netherlands. Although the purpose of the reports vary, all three international organisations use the instrument of country reviews to analyse a member state's economy and public finances and to provide recommendations. In the 2011-2015 timeframe the Dutch government received 198 CSR's.

Table 8. Overview of country specific recommendations 2011–2015

	2011	2012	2013	2014	2015	2016*	Totals
Financial stability measures	12	0	4	20	0	1	37
Fiscal policy stance/framework and transparency	1	1	0	13	4	1	20
Labour market	3	14	4	17	1	9	48
Long term fiscal challenges	13	3	10	12	2	1	41
Other like education, health care, social/environmental/energy policies etc.	1	10	0	0	0	7	18
Product and service markets/Business environment	2	9	1	10	1	11	34
Totals	32	37	19	72	8	30	198

*The OECD report of March 2016 is also part of the audit

EU-semester

The European Commission presented 20 CSR's for The Netherlands in the period 2011-2015. Compared to IMF and OECD the European Commission is thrifty with country specific recommendations; it issued just 20 CSRs in the period 2011-2015. The figures below show that the CSR of the European Commission focus mostly on the long term fiscal challenges and the Dutch labour market.

Table 9. EU-semester CSRs 2011–2015

	2011	2012	2013	2014	2015	Totals
Financial stability measures						
Fiscal policy stance/framework and transparency						
Labour market	1	1	2	2	1	7
Long term fiscal challenges	2	3	2	2	1	10
Other like education, health care, social/environmental/energy policies etc.						
Product and service markets/Business environment	1	1			1	3
Totals	4	5	4	4	3	20

IMF

IMF presented 89 CSR's for The Netherlands in the period 2011-2015. The amount of recommendations vary over the years. In 2014, the IMF made many recommendations in comparison to the years 2013 and 2015. Also in 2011 many recommendations have been made but this is because the Financial Sector assessment and the article IV report were published in the same year. Most recommendations of the IMF focus on long term fiscal challenges.

Table 10. IMF CSRs 2011-2015

	2011	2013	2014	2015	Totals
Financial stability measures	12	4	7	0	23
Fiscal policy stance/framework and transparency	1	0	13	4	18
Labour market	2	2	9	0	13
Long term fiscal challenges	11	8	8	1	28
Other like education, health care, social/environmental/energy policies etc.	1	0	0	0	1
Product and service markets/Business environment	1	1	4	0	6
Totals	28	15	41	5	89

OECD

The OECD presented 89 CSR's for The Netherlands in the period 2011-2016. As the table below illustrates, the total number of CSRs per year is roughly stable and fluctuate around 30. The CSRs mostly focus on the labour market and the product & service markets including the business environment. Further but to a lesser extent, OECD also has drawn attention to financial stability measures and other policy areas.

Table 11. OECD CSRs 2012–2016

	2012	2014	2016	Totals
Financial stability measures		13	1	14
Fiscal policy stance/framework and transparency	1		1	2
Labour market	13	6	9	28
Long term fiscal challenges		2	1	3
Other like education, health care, social/environmental/energy policies etc.	10		7	17
Product and service markets/Business environment	8	6	11	25
Totals	32	27	30	89

5.2 Identified risks to fiscal sustainability

Based on the CSRs from the OECD, the European Commission and the IMF, the Netherlands Court of Audit has identified three important risk categories that are related to fiscal sustainability: Fiscal policy stance, Long term fiscal challenges and Financial stability.

Fiscal policy stance

Most recommendations on this area focus on the tax system. All three institutions recommend to increase tax efficiency because the tax system is not as efficient as it could be. More specifically, the institutions recommend to reduce the debt bias and distortions in the VAT exemptions. Related to VAT, the institutions also recommended to unifying VAT rates. According to the institutions, changes are needed regarding to labour income tax, housing related debt and in the way pension wealth is treated within the tax system.

Long term fiscal challenges

Housing market

According to the institutions, more should be done to reduce the debt bias in the housing sector. Many recommendations of the institutions focus on reforming the housing market. Several issues are addressed. Key in the recommendations is phasing out the mortgage interest

deductibility (MID) policy which has significant budgetary implications. Further tightening of loan to value (LTV) ratios and minimum principal repayments and setting greater risk weights on high LTV mortgages are recommended.

The National Mortgage Guarantee (NHG) scheme insures lenders against default and sets flat, below market premiums, independent of borrower risk, with payments almost fully backed by the government. To avoid further contingent liabilities, it is recommended that the government should not expand fiscal risks beyond its packaging of NHG-backed bonds.

Also other issues related to the housing market are addressed. Broader regulatory reform to lessen distortions in the private rental market and in social housing is important. Deregulating the private rental market would ease pressures on home ownership. New risk-sharing instruments could be introduced to protect homeowners. A more market-oriented pricing mechanism in the rental market is recommended.

Long term sustainability

During the 2011-2014 period The Netherlands suffered from an excessive deficit and was subject to the Excessive Deficit Procedure. In those years, the European Commission recommended every year to implement the budgetary strategy to limit the budget deficit and the high public debt ratio within the SGP limits and to ensure reaching the national medium term objectives.

Although in the most recent years, the IMF argues that unexpected serious setbacks to the economic recovery that cause the headline deficit to rise substantially above targeted levels should not trigger further discretionary retrenchment directly. Flexibility in the implementation of the planned fiscal adjustment is desirable should economic outcomes be significantly worse than anticipated. This might be contradictory with the recommendations from the European Commission.

Financial stability

Supervision

The institutions argue that DNB (de Nederlandsche Bank: the Dutch Central Bank) and the AFM (Autoriteit Financiële Markten: The Dutch Authority for the Financial Markets) should be provided with broad supervisory discretion over macro-prudential instruments. Rulemaking authority is limited and should be enhanced. It presently constrains the ability of supervisors to react swiftly to emerging risks. The insurance sector warrants careful monitoring too, given its tarnished reputation, and the financial pressures under which it is operating.

Financial regulation

With relatively high leverage ratios and tighter capital standards to be phased in under Basel III, proactive measures are desirable to prevent emergence of any capital or liquidity shortcomings. Such steps will also smooth the phasing out of government equity from intervened banks and bank restructuring. Proactive actions to fill any residual gaps are desirable. This will also be helpful to unwind the government's substantial ownership interests in some important financial institutions. Policy actions should be executed in a predictable manner to minimize policy uncertainty and support confidence, with a focus on the unwinding of accumulated distortions and balance sheet imbalances as well as on protecting the economy's growth potential.

5.3 Government response to country specific recommendations

In general we found that the Dutch government responded to a reasonable extent to the CSR's that were given during the 2015-2016 period by implementing policy changes to address the identified problem. In the table below we assessed the extent of follow up in a qualitative way.

Table 12. Government response to CSRs

	Subject of recommendation	Addressed by	Extent of follow up
Fiscal policy stance	Tax reforms	IMF, OECD	Limited
Long term fiscal challenges	Housing market	EC, IMF, OECD	To a great extent
	Long term sustainability and deficit	EC, IMF	Full
Financial stability	Financial Regulation	IMF, OECD	Full
Products and service markets / business environment	Supervision	IMF, OECD	Full
	Improving R&D policies	IMF, OECD	To a great extent
	Improving R&D funding	EC, IMF, OECD	Not at all
Labour market	Participation	EC, IMF, OECD	To a great extent
Other like education, health care, social and environmental policies etc.	Employee protection	EC, IMF, OECD	To a great extent
	Health care	OECD	To a great extent
	Education	OECD	Limited

However, the question is to which extent the government intervention was a direct result of the country specific recommendations. Quite a lot of CSRs reflect what was already debated in the Dutch society for a longer period. Further, the Rutte governments made considerable policy

changes in this period in order to restore the (sustainability of) public finances and economic growth. Considering the poor state of the Dutch economy and public finances in the period 2011-2014 and the long standing Dutch tradition of public finance discipline, in those years it was simply politically possible to gain sufficient political and societal support for long debated far-reaching reforms.¹⁵ Although it was also addressed with CSRs by EC, IMF and OECD, the CSRs do not seem to have been crucial in this respect.

5.4 Effectiveness of Government measures

The government in the Netherlands has several instruments to evaluate their policy. Since 2006, ministers are obliged to evaluate all their policy at least every 7 years. The result of this policy evaluation research should show if the policy reached its goals and if the money has been spent wisely. These evaluations are meta-evaluations, focussed on broad themes, and based on more specific policy evaluations. This broad type of evaluation research is not meant to evaluate if specific measures have been effective. Besides this policy evaluation research, the government has several other instruments to investigate the effectiveness of their policy.

If a policy in a specific field has been changed, there is no automatism that this specific change of the policy will be evaluated in the future. It will be part of the above mentioned broader policy evaluation research. However, Parliament can always decide to request the minister to perform such a specific evaluation.

Next to the required policy evaluations on a budget article level, there is a wide array of ad hoc policy evaluations. These could be done on request of Parliament, but also on ministry's own initiative. If it is the ministry's own initiative, the evaluation could be for internal purposes only or could be sent to Parliament as well. In practice, this means that the effectiveness of the follow up of specific recommendations have not been evaluated.

Besides the fact that specific measures are not evaluated individually, it is unclear whether a measure has been implemented because the IMF, the OECD or the EU-semester recommended to do so or if the government was going to implement a similar kind of policy anyway. Their recommendations focus on themes in which the government is always looking for new and better policy. Of course it is possible that the recommendations of these three institutions influence the policy process in the Netherlands, but it is unclear to which extent.

The OECD, the EU and the IMF do monitor if the government has followed up the recommendations they suggested. However, they do not evaluate whether the country specific recommendations they have suggested that are really implemented, are effective.

¹⁵ A good example is the raise of the statutory retirement age. Debated for more than a decade, it was possible to raise the retirement age in order to reduce public spending and to restore the balance in public finances. Another example is the reduction of the mortgage interest deductibility.

5.5 Public availability and follow-up procedures

The European Semester has a more binding character than the country reviews of IMF and OECD. This is reflected in the follow up procedures which differ among the three processes as we will see below.

EU-semester

The Minister of Finance is in charge of coordinating the European Semester process at a national level (and the Minister of Economic Affairs coordinates the National Reform Programme). It is standard procedure that the minister of Finance sends a letter about the country specific recommendations to Parliament around May. In the letter the Minister of Finance mentions all the recommendations by the European Commission and outlines the government's position on every separate country specific recommendation.

Since 2011, the country specific recommendations are inserted in the draft budget plans for the relevant ministries which are sent to Parliament every September. This enables Parliament (and the public) to monitor the follow up of the country specific recommendations. Our audit shows that the draft budget plans do comply, however there is quite some variance among the different budget plans in the amount of explanation and clearly formulated follow up (and where the government will not be compliant).

Further, the Dutch government reports in the next National Reform Programme on the measures taken on each recommendation. The National Reform Programme is first sent to Dutch Parliament and together with the Stability Programme plenary discussed with the Ministers of Finance and Economic Affairs.

IMF

The Minister of Finance is responsible for the response and the follow up on the relevant IMF reports. After the IMF has published an Article IV report of the Netherlands, the Minister of Finance sends the IMF-report and related documents to parliament. In a letter of the minister, he explains when the mission of the IMF took place and how the IMF presented their findings. In his letter, the minister does not make any statement regarding the content or the recommendations of the report of the IMF leaving unanswered if he will or will not comply. However, it is not always clear whether the IMF recommends, suggests or concludes something.

In the final article VI report the executive director and the advisor to the executive director for Kingdom of the Netherlands at the IMF make a statement. In this statement the executive director gives the authorities view on the conclusions and recommendations of the report. They explain whether they agree with the conclusions and recommendations or not, what kind of

developments they see for the future and if policy changes are desirable and visible. However, the statement does not give a clear overview of the view of the authorities and their follow up actions per recommendation.

The parliament in the Netherlands does not receive an overview of the recommendations of the article IV reports over time besides the progress of the recommendations in the article IV reports itself.

OECD

The Minister of Economic Affairs is responsible for the response and the follow-up on the OECD Economic Surveys. The OECD Economic Surveys have not been send to parliament. During the last publication of the OECD Economic survey 2016, the OECD handed the report to the Minister of Economic Affairs at a public event. During this event the minister gave a speech about the content of the report.

There is no formal procedure in place that makes a reaction of the minister mandatory. Besides the press conference, the minister does not express his opinion on the report in any other formal way. He does not send his opinion to the parliament. In the report itself there is no statement of the authorities of the Netherlands. In the OECD Economic survey 2016, 2014 and 2012 the progress of the main structural reforms is presented.

5.6 Audit Approach and evidence base

In this audit we have mapped the country specific recommendations for The Netherlands in the period 2011-2015. We have used the following reports:

Table 13. Audit approach and evidence base

	Number of reports	Report names
European Semester	5	Macroeconomic imbalances report 2011, 2012, 2013, 2014 and 2015
OECD	3	Economic Surveys 2012, 2014 and 2016
IMF	5	Financial Sector Assessment 2011, Article IV Consultation 2011, 2013, 2014 and 2015.

We have included the 2016 OECD report to balance the number of sources per organisation. Also, the report was published in March 2016 and thus reflects the situation in 2015.

We have studied all the reports and collected all the recommendations in an excel sheet. The European Semester and OECD reports contain clearly defined recommendations. However, the

IMF reports contain many suggestions instead of explicit recommendations. We have selected all the suggestions which are more strongly worded. In total we have collected 198 CSRs: 20 from the European Semester and 89 from OECD and IMF each. We have included more detailed tables and graphs in our report.

Consequently we have categorised all the recommendations in one of the following six categories:

1. Fiscal policy stance / fiscal framework and fiscal transparency
2. Long term fiscal challenges
3. Financial stability
4. Products and service markets / business environment
5. Labour market
6. Other like education, health care, social and environmental policies etc.

Recommendations frequently cover more than one category. We safeguarded consistency by defining which subjects were covered per category and applied this to all CSR. Further we have peer reviewed the categorisation.

Next to this mapping and categorisation of CSRs, we have studied the follow-up procedures and measures taken by the Dutch government. We have done additional desk research, interviews with representatives of the Ministry of Finance and asked our Ministry of Economic Affairs questions by e-mail.

6 Key findings – Portugal

6.1 Overview of country specific recommendations

For the period 2011-2014 the majority of recommendations from international organisations to Portuguese authorities were driven under the Economic and Financial Assistance Programme (EFAP), through a Memorandum of Understanding (MoU) signed 17th May 2011 between the Portuguese Government, the EC, the ECB and the IMF (Troika institutions).

The Programme included a comprehensive set of recommendations. The majority of them focused on **fiscal policy**, mainly on the reduction of the Government deficit by means of high-quality permanent measures, bringing the debt-to-GDP ratio on a downward path and maintaining fiscal consolidation over the medium term up to a balanced budgetary position, notably by containing expenditure growth. Recommendations encouraged also the Government to strengthen public financial management framework, streamline the budgetary process, including adaptations on the local and regional financial legal frameworks, and improve the efficiency of the public administration.

In addition, with respect to **long-term challenges** they reinforced the need of structural reforms aimed at improving efficiency and effectiveness in the health care system, inducing a more rational use of services and control of expenditures, and improving the medium-term sustainability of the pension system. With respect to **financial stability**, recommendations pointed to the need of preserving financial sector stability, maintaining liquidity and supporting deleveraging in the banking sector, as well as strengthening banking regulation and supervision and reinforcing the corporate and household insolvency frameworks.

The EFAP recommendations covered also structural policy measures not directly related to fiscal sustainability. With respect to **product and services markets/business environment**, recommendations focused on tackling the high entry barriers in services sector, including telecommunications and postal services, the regulatory burdens on companies, the dysfunctional rental market, the inefficient judicial system and competition rules. **Labour market policies** recommendations included issues on unemployment insurance system to reduce the long-term unemployment, on employment protection system to foster job creation, on wage setting system to enhance competitiveness, and on active labour market policies to improve the employability of the young. Recommendations on **other policies** areas involved education, energy and transports policies, mainly related to increase efficiency in the education sector and facilitate labour market matching, to ensure consistency of the overall energy policy, and to adopt a strategic plan to rationalise the transport system.

Country Specific Recommendations issued by the EU Council to Portugal in July 2014 (two months after Portugal left EFAP) and in July 2015, in the context of the European Semester followed the same lines of the EFAP recommendations. The IMF in its Article IV Consultation (2012 and 2015) and the OECD in the country surveys (2012 and 2014) have also delivered recommendations to Portugal.

Recommendations during the period 2011-2015 shared a significant part of their substance, showing a high degree of agreement about the main problems facing the Portuguese economy. All international organisations addressed fiscal policy and financial stability. The major difference between them relates to long-term challenges that were essential in EFAP and in the European Semester but not so much in IMF and OECD guidance. Product and services market as well as education, energy and transport policies were not presented in all the EU Council and IMF recommendations. IMF has not covered labour market issues.

6.2 Identified risks to fiscal sustainability

The majority of recommendations during 2011-2015 directly approach fiscal sustainability issues. There is a consensus among them that fiscal consolidation must be underpinned by increased efficiency and quality of public expenditure at all levels of public administration and further reforms of the system for managing public finances, in particular, to ensure expenditure control and strengthening accountability.

In fact, the EFAP was based on the diagnosis made by Troika in 2011 of the following risks about the Portuguese Public Finances:

- Unsustainable levels of total expenditures and unproductive spending;
- Limited fiscal transparency and weak monitoring and reporting mechanisms due to increases in spending across the general government in recent years (arrears, PPP and SOE and local and regional governments);
- Confused coverage of the general government's activities;
- Costs in the social benefits, health and education sectors as key drivers in primary current expenditure increase;
- Complex and distortive tax system due to a myriad of benefits across all types of taxes;
- Weak tax compliance.

By the end of the Programme, the overall assessment made by the EC/ECB (in October 2014) pointed that much has been achieved under the EFAP to reduce the budget deficit on a structural way and thereby put the public debt on a sustainable path. However, it was also recommended to maintain strict budgetary discipline and a speedy completion of the

outstanding budgetary commitments and structural reforms to ensure the durability of the adjustment.

The IMF assessment (in September 2016) is in line with the EC opinion that the Programme succeeded well as a response to fiscal imbalances, notwithstanding, the need for further structural reforms given the high public debt and that important fiscal measures had begun to be reversed.

6.3 Government response to country specific recommendations

Measures taken by Government during 2011-2014 followed the objectives and targets defined in the EFAP, which involved a package of 223 measures in 9 key areas, focusing on: (i) fiscal policy; (ii) financial sector regulation and supervision; (iii) fiscal structural measures; (iv) labour market and education; (v) goods and services markets; (vi) housing market; and (vii) framework conditions for other sectors such as the judicial system, competition, public procurement and business environment.

Fiscal policy measures with impact on the reduction of the deficit in 2011-2014 covered salary cuts (civil servants and pensioners) and the suspension of Holiday and Christmas allowances; the transfer of pension funds, the reprivatizations and concessions, the exceptional tax and social security debt recovery scheme, the pension surcharges, the contributions to the banking and solidarity sectors and changes in direct taxation and VAT system, on the revenue side.

Measures to improve reporting and monitoring of information on budget execution and on public employment covered (i) the publication of a budgetary strategy for public administrations, including in medium-term economic and budgetary forecasts; (ii) the integration into the State Budget of a chapter on fiscal risks, including those arising from PPP, SOE and guarantees provided to banks; (iii) the revision of the Budgetary Framework Law, bringing the budgetary perimeter closer to national accounts; (iv) improvements in the procedures for monitoring the implementation of the budget and the collection of data on public employment; and (v) settling of a commitments control system to prevent the accumulation of arrears by public entities.

Main measures to improve the efficiency of public administration included limits to the admission of employees and the restructuring of central government services.

Regarding efficiency and effectiveness of the healthcare sector, a wide set of measures have been implemented, such as compulsory e-prescription and INN prescription, changes in pharmacies mark-ups, changes in the international reference price system and in the pricing of generics, and removal of administrative and legal hurdles to entry of generics. Legislation has been approved to reduce the categories exempted from moderating fees, introduce automatic indexation to inflation and raise the overall fees. The ongoing reforms have produced savings in

the National Health Service in areas such as pharmaceuticals, operational costs from hospitals, complementary diagnostic tests and therapy, and patient transport.

Measures in the education sector focused both on reducing costs and on improving quality. At the level of costs, major measures included the rationalisation of the school network by creating school clusters, lowering staff needs and centralisation of procurement procedures; and the reduction and rationalization of transfers to private schools in association agreements. In terms of structural reforms, measures included better information system, improvement of quality of secondary education and vocational education and training, reducing early school leaving and adaptation of curricula to the labour market needs.

6.4 Effectiveness of Government measures

The effectiveness of Government measures is based on the conclusions driven from the three audit reports published by the Portuguese Court of Accounts in 2013, 2014 and 2015 on the EFAP. The majority of the measures examined in the audits focused directly on short term risks and, in this sense, they were effective. From the audit findings, we conclude that:

a) The deficit target has been achieved, but there is no systematic approach by means of structural and permanently fiscal policy measures. The composition of consolidation was less supportive of growth than planned, with efforts shifting to the revenue side. It was also less front-loaded than designed, with adjustment postponed in the face of policy slippages. The Programme softened fiscal targets as the growth downturn exceeded expectations. Fiscal slippages and new replacement measures were a recurrent feature of the EFAP from the start, and the fiscal targets were met by temporary revenue measures (transfer of pension funds, reprivatization and concessions, and exceptional debt recovery scheme. Reversibility was also an important aspect of the major measures with influence on fiscal consolidation path (salary cuts, suspension of Holiday and Christmas allowances, surcharges on PIT, and changes in direct taxation and VAT system).

b) The monitoring framework for budget transparency has improved. The inclusion of a fiscal risks chapter in the 2013 State Budget was one of the measures implemented under the EFAP. It included information on: (i) State guarantees to the banking sector and to non-financial SOE; (ii) debt and financing needs of SOE included in the budget perimeter; (iii) financial instruments held by SOE; (iv) future net charges with PPP, including information about renegotiation or resolution of ongoing litigation; and (v) risk analysis on public debt. The implementation of the revised Budgetary Framework Law improved the budgetary process by including in its scope entities belonging to the general government sector in terms of national accounts. In addition, there were improvements in reporting and monitoring of information in areas such as budget execution - particularly with regard to the scope of the entities and the

quality of the information disclosed, commitments and payments in arrears and disclosure of information about public employment. Since 2012, the State Budget report includes most major consolidation measures, despite the lack of detailed information on their impact.

c) Some progress in the public administration, health and education sectors but further reforms are needed. Public administration: 10.4% reduction in the number of employees during 2011/2014, fulfilling the target (2.0% per year); reduction in the number of structures and management positions of the central administration (15% and 14.2%, respectively) below the targets set out in MoU (40% and 27%); however, inexistence of a strategic plan explaining the reform. Health sector: legislation has been approved to raise moderating fees; however, these revenues and revenues from fees charged to cross-border/foreign patients increased less than expected. The ongoing reforms have already produced savings in the National Health Service – pharmaceuticals (€-668 M), operational costs from hospitals, complementary diagnostic tests and therapy (€-125 M), and patient transport; even though, savings on pharmaceuticals and in complementary diagnostic tests and therapy have been lower than estimated. Education sector: costs savings of € 69 M during 2012/2014 driven by a 30% reduction of the number of establishments and basic units; between the school years 2010/11 and 2014/15 the decrease of teaching staff reached 21.1%, particularly due to the fall in more than half the number of staff with a fixed term contract agreement (56.6%); this decrease in teaching staff originated a financial impact estimated in € 328 M in the period of 2012/2014.

6.5 Public availability and follow-up procedures

During the EFAP period, recommendations given by Troika and measures taken by Government followed a comprehensive set of procedures, including a periodic follow-up process and a close interaction between international organisations teams and national teams.

Troika assessed compliance with the measures and objectives defined in the EFAP on a quarterly basis, and additional disbursements depended on the positive conclusion of these review assessments. The majority of EFAP conditions were assessed by Troika as broadly fulfilled.

The EFAP assessment introduced formalized procedures at the national level in order to be possible to examine to what extent their conditions have been met. The main documents of EFAP, namely the MoU, established the measures planned by national authorities to accomplish the targets, its estimated financial impact and timetable. The national authorities had to provide information to Troika in accordance with a fixed timetable and during periodic external reviews. The main documents, the regular monitoring by Troika and the report reviews were expressly made available to the public (Government webpage, Bank of Portugal

webpage) encouraging an adequate ownership by national authorities in order to implement the measures and achieve the targets.

Within the Parliament, a special Commission was created to follow-up the process, which included time for questions to the Governor of the Bank of Portugal with reference to the financial system, the Minister of Finance on the fulfillment of the budgetary targets and other ministries on measures to support economic recovery. The Portuguese Court of Accounts was also called to present the audit findings of the 2013 audit report.

By the end of the Programme, in June 2014, Portugal became fully subject to the model of economic governance of the European Semester.

In this context, the 2015 Draft Budgetary Plan included as an annex, a list with the measures implemented and planned within the context of the Country Specific Recommendations (CSR). The 2015 National Reform Programme included also information on the compliance with CSR, updating the information delivered in the State Budget, and given more detailed information in terms of measures, main objectives, budgetary implications, estimated qualitative impacts and contribution to the national goals of Europe 2020 Strategy. The Portuguese Stability Programme reports with more detail with respect to fiscal policy.

The Ministry of Finance is responsible for preparing and disseminating information in the context of the European Semester, namely in the Draft Budgetary Plan and in the Stability Programme. The Budget General Directorate is the department within the Ministry of Finance responsible for the publication of the State Budget in its website; at the same time, this information is made available in the Parliament website. Both the Stability Programme and the National Reform Programme are published in the Government website.

Currently, the European Semester assessment at national level follows the EU reporting requirements, mainly the inclusion and the follow-up of the CSR within the State Budget and the National Reform Programme. The CSR are made available to the public at the national level with the publication of these two documents (in October, with the Draft Budgetary Plan, and in April, with the National Reform Programme), after Parliament discussions. In terms of procedures, the follow-up process of EU CSR at national level is less supportive for assuring an effective implementation compared to the previously implemented EFAP procedures.

When it comes to IMF and OECD recommendations, there are no formal procedures neither an explicit follow-up process. Notwithstanding, a statement of the IMF executive director for Portugal is annexed to the IMF report.

6.6 Audit Approach and evidence base

The Portuguese country paper is based on the conclusions driven from the three audits reports published by the Portuguese Court of Accounts in 2013, 2014 and 2015 on EFAP under which Portugal agreed to implement comprehensive measures to improve public finances, restore competitiveness, and put the economy back on a path of sustainable growth and job creation. These measures were set at three levels: (i) fiscal consolidation strategy, (ii) structural reforms, and (iii) financial sector strategy based on recapitalisation and deleveraging of the banking sector. This last level of measures was not covered by the audits.

The audit reports covered the following areas:

- Fiscal policy
- Reporting and monitoring of information on budget execution and public employment
- Public Administration
- State-Owned Enterprises
- Healthcare sector
- Education sector

The audits examined whether the national authorities have implemented the measures set out in the EFAP and their effectiveness in terms of fiscal consolidation and services provided by public bodies. This was addressed by the following sub-questions:

- Did the national authorities implement the measures on time and in accordance with EFAP?
- What was the impact of the measures' implementation on the annual budget execution?
- Did the structural measures meet their main objectives?

The methodology consisted in five steps, described below:

- MoU analysis's, including updates and external reviews;
- Review of documentation and data disclosed by entities involved in the EFAP;
- Interviews with the staff of public bodies responsible for implementing and monitoring the measures;
- Identification of the procedures established for the implementation and monitoring of the measures;
- Assessment of the implementation of the measures and their budgetary impact.

7 Key findings – Slovakia

7.1 Overview of country specific recommendations and identified risks to fiscal sustainability

The audit group from SAO SR identified, based on the analysis of recommendations, a total of seven risk areas for medium and long-term sustainability of public finances. Separate part is fiscal consolidation, which falls under the Stability and Growth Pact. Other risks are related to structural policies, two are linked to aging (pensions and health care), two to human capital (education and labour market) and two to the Slovak specifics (tax discipline and Roma inclusion).

The recommendations from international organisations regarding the **fiscal consolidation** were focused on (1) lowering the deficit below 3 % of GDP in 2013, during the excessive deficit procedure, (2) achieving the medium-term objective by structural reforms on reference level 0,5 % of GDP, after exiting from excessive deficit procedure, (3) creating an independent fiscal institution, (4) ensuring binding and enforceable multiannual expenditure ceilings and (5) creating enough room over time to allow automatic stabilizers to work.

The recommendations from EC and other relevant institutions regarding **pensions** were related to (1) strengthening of long-term sustainability of public finances by changes in the pay-as-you-go (PAYG) pillar, mainly by changing the indexation mechanism, directly linking the statutory retirement age to life expectancy and introducing a sustainability factor in the pension calculation formula, which will reflect the demographic changes; (2) ensuring the stability and viability of the capitalization pillar; and (3) improving long-term sustainability of public finances by reducing the financing gap in the public pension system, while ensuring adequate pensions.

Slovakia has received the recommendations from the EC, IMF, OECD and other relevant institutions to improve the long-term sustainability of public finances in the **health sector** by increasing the cost-effectiveness of the health care sector, particularly the rationalization of hospital care and management, as well as strengthening primary care. Among the underlying risks in the Health care system with regard to the sustainability of public finances are (1) cost effectiveness of health care system, especially hospitals, primary and long-term care, (2) availability and quality of health care for all groups of population, (3) indebtedness of health care system.

Recommendations from international organizations to Slovakia, were in the **administration and collection of taxes** focused to (1) increase tax compliance and collection, in particular by improving the efficiency of VAT collection, (2) improve the efficiency of tax administration,

including the strengthening of analytical and audit capacity, (3) link taxation of real estate with their market value, (4) increase revenues from environmental taxes.

International organizations have recommended Slovakia to focus mainly on two critical areas for long-term sustainability of public finances related to **education** in the form of (1) the quality of education and (2) linking education and the labour market. Recommendations on the quality of education were linked to all levels of education, from pre-primary to university. This part also includes a focus on future teachers and the attractiveness of teaching as a profession, including raising teachers' salaries and the corresponding structural reforms. Linking education and the labour market is recommended in two levels, (a) the creation of professionally oriented study programs and (b) the provision of practical training in companies directly.

Slovakia has received the recommendations from international organizations in the field of **labour market** aimed primarily at the employment services, particularly to the area of active labour market policies / measures (ALMP) and counselling. Measures in the area of ALMP should focus on the long-term unemployed, youth and labour mobility. Public employment services should be reorganized and go towards guidance and support for targeting of ALMP. An additional repetitive recommendation is the support for returning to work after parental leave, by improving the availability of childcare facilities for kids in pre-school age.

One of the underlying and partially hidden risks to the sustainability of public finances in Slovakia represents members of the Roma minority and their inclusion. The Roma minority is the biggest minority in the EU. The inclusion of Roma communities is a challenge for all countries with this minority. The Roma minority represents more than 9% of the Slovak population, estimated at 440 000 inhabitants.¹⁶ Slovakia received in the area of **Roma inclusion** recommendations in all relevant areas regarding education, employment, health, housing, financial inclusion and non-discrimination including approaches towards the majority (inclusion through communication).

7.2 Government response to country specific recommendations and the effectiveness of Government measures

The overview of the identified risk areas, the respective risks and corresponding key indicators are provided in table 13. The last two columns indicate the semaphore evaluation of the individual risks by EC and SAO SR.

The risk area of **fiscal consolidation**, during the audited period from 2011 to 2015, managed Slovakia through measures and favourable economic developments eliminate the most. Slovakia carried out in individual year's consolidation effort above average and managed to stand out

¹⁶ http://ec.europa.eu/justice/discrimination/files/roma_country_factsheets_2014/slovakia_en.pdf

from the excessive deficit procedure. It also managed to adopt a constitutional law on fiscal responsibility and establish the Council for Budget Responsibility (CBR). But it failed to meet recommendations concerning the implementation of expenditure ceilings.

Pensions and adjusting the pension system were, taking into account the expected demographic development in Slovakia, about the most fundamental long-term risks to public finance sustainability. Through the reform of the pension system during the audited period, it managed to reduce that risk to an acceptable level. Adequate pensions remain an ongoing risk.

Health care is another risk area interoperating with aging of population. Slovak healthcare system showed significant reserves particularly in terms of cost effectiveness and continuous indebtedness. These risks are managed to eliminate only minimally. The result indicators of the availability and quality of health care also did not experience significant improvement.

Tax collection and tax compliance achieved during the audited period its bottom. The VAT gap was almost 40%. The Action plan to combat tax fraud and other measures managed to improve tax compliance and tax collection. The recommendations were directed also to the taxation of real estate according to their market price. These recommendations were not fulfilled.

Education is an essential area for the development of human capital. The main risks in Slovakia are, the age structure of teachers which, during the audited period shifted in favour of older teachers, learning outcomes and the structure of graduates, in which changes were invested great effort, but the results, because of an effects delay, cannot be clearly assessed.

Table 14. Identified risk areas and corresponding key indicators

Area	Risk	Indicator	EC evaluation ¹⁷	SAO SR evaluation ¹⁸
Fiscal consolidation	Excessive deficit	General government balance		
	Consolidation effort	Consolidation effort		
	Budgetary responsibility	General gov. gross debt		
	Expenditure ceilings	x		
	Automatic stabilisers	x		Not rated
Pensions	Pensions and aging	Pension system balance		
	Adequate pensions	x		
Health care	Cost effectiveness	Expenditures		
	Availability and quality	Healthy life years		
		Avoidable mortality		
	Indebtedness	Hospital's debt		
Taxes	Tax discipline	Effective tax rate for respective taxes		
	Effectiveness of VAT coll.	VAT gap		
	Real estate taxation linked to its market value	x		
Education	Age structure of teachers	Average age		
	Student outcomes	PISA testing		
	Structure of absolvants	x		
Labour market	ALMP targeting	Chance of being engaged		
	Effectiveness of Labour Offices	Clients per employee		
		Efficiency of job mediation		
	Return from parental leave	x		
Roma inclusion	Education	x		
	Employment	x		
	Health	x		
	Housing	x		
	Non discrimination	x		

¹⁷ Colour (traffic light) EC evaluation is based on Country reports for respective years

¹⁸ Colour (traffic light) SAO SR evaluation is based on analysis described in the Country paper, where:

Green: Measures were taken, which have significant impact or the impact can be considered positive for long-term sustainability of public finances

Yellow: Measures were taken, which do not have significant impact, or the impact is not significantly positive for long-term sustainability of public finances

Red: No measures were taken or the measures have little or insignificant effect on the sustainability of public finances

The **labour market** is a place where the inhabitants of the country use their human capital. Active labour market policies and the efficiency of the Labour offices which mediate it should help them in that. ALMP's accuracy and transparency has improved, but their contribution to employment prospects for disadvantaged groups (low qualified, long-term unemployed) are low and in eliminating this risk, there are still reserves. Effectiveness of labour offices, according to the reported indicators has improved. The labour market in Slovakia has a high sensitivity to the external environment and therefore it is difficult to distinguish when assessing the impact of measures to eliminate the risk and impact of other factors.

Partially hidden risk (positive and negative) for the sustainability of public finances is the **inclusion of the Roma population**. If successful, elimination of identified risks and changes in demographic behaviour of the national minority represents another source of potential growth of the Slovak economy. During the audited period, Slovakia managed to reduce the risks, especially in the education of Roma.

7.3 Public availability and follow-up procedures

Slovakia under the EU 2020 strategy as a continuation of the Lisbon Strategy builds on the process of publishing of the National Reform Programme (NRP) as an implementation report responsive to the recommendations of the Council / Commission. The European Semester is a procedure whereby Member States are given Country-specific recommendations (CSR). In addition to these recommendations the country receives recommendations of other international organizations (WB, IMF, and OECD) on the basis of membership or on request.

EC recommendations are regularly published on the websites, as the Slovak Government so the Commission. The recommendations of the OECD and the IMF publish relevant organizations on their websites and unlike CSR they are not translated into Slovak. Publication process is not regulated, whereas the recommendations are published by the Government Office or MoF. The recommendations are published in full.

The National Reform Programme is the Government's response to the individual CSR, and it also includes an Action Plan, outlining further activities, including responsibilities linked to specific recommendations. NRP responds to all the recommendations of EC and selected OECD recommendations are part of analytical parts of the NRP. NRP including an action plan is approved every year by the Government.

The follow up of implementation of recommendations is up to the relevant ministries. The evaluation of NRP is performed as the fulfilment of tasks in the Action Plan in the year following the sending of relevant recommendations. The evaluations are part of NRP and with it were also made public. In the event of inconsistency, this usually does not comment directly, but there's comment like space for more detailed analysis or future focus on further measures.

7.4 Audit Approach and evidence base

The common approach to the audit assumes the identification of underlying risks for sustainability of public finances by analysing the recommendations from international institutions and the assessment of government measures in identified risk areas. The approach is described by common audit questions:

- Have the recommendations from the European Council, the IMF, the OECD (and other relevant institutions) been followed, regarding underlying risks to sustainable public finances?
- Did these measures contribute to reduce the risks identified?

The Supreme Audit Office of the Slovak Republic extends the common approach by the use of key national indicators for the evaluation of the progress in elimination of identified risks. These indicators are linked to appropriate measures and change in them indicates the development in identified risk area. The use of indicators allows a better assessment of progress in risk reduction. The methodology for using indicators in public policy evaluation is based on outcomes of INTOSAI Working Group on Key National Indicators.

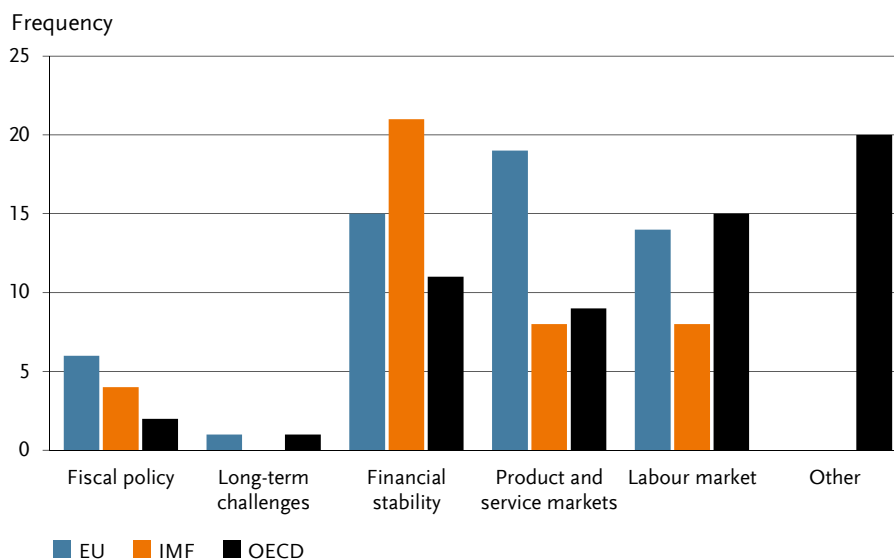
The audit group from SAO SR uses for the analysis and evaluation of government measures, as well as for selecting appropriate measurable indicators the (1) government materials, evaluations, analyses, reports, action plans, etc. (2) budgets, closing accounts, program budgeting, (3) conclusions from previous audits, (4) other available documents (ECA, ECB, CBR, etc.) and (5) interviews at MoF, CBR, Ministry of Education and the Statistical Office. The evaluation whether the declared progress is identical with the real progress and the differentiation of external influences and the measures at risk elimination is beyond the audit scope and the capacity of audit group.

8 Key findings – Sweden

8.1 Overview of country specific recommendations

A limited number of the recommendations from international organisations to Swedish authorities during the period 2011-2015 relate directly to issues of fiscal policy and long-term fiscal challenges. The recommendations in this field were also relatively moderate in nature. The majority of recommendations are instead aimed at perceived financial stability challenges or structural problems in product and factor markets.

Graph 4. Recommendations to Swedish authorities 2011-2015



Source: Swedish NAO's compilation of official documents. Note that OECD Economic Surveys for Sweden usually are published every two years (Jan 2011, Dec 2012 and March 2015).

The main EU semester recommendation regarding fiscal policy has been to keep fiscal policy on a path that ensures continued compliance with the Swedish medium-term objective (MTO). Within the EU semester, age related expenditure pressure was mentioned only once (2014), when it was recommended that the MTO should be adhered to also with a view to the challenges posed on the long-term sustainability of public finances by an ageing population.

The OECD has also issued recommendations in the fiscal policy category. In 2012 it recommended to let the automatic stabilisers work in full if the economic outlook would turn out to be weaker than projected. In 2015 the recommendation was to maintain prudent fiscal policy and to (de facto) let the automatic stabilisers work. As for Long-term challenges, the

OECD advised Sweden in 2011 to more formally link various retirement age parameters to life expectancy.

The IMF has given 4 recommendations on fiscal issues in 2011–2013 and none in 2014–2015. Two of the recommendations encourage the Government to ensure that the Swedish Fiscal Policy Council remains adequately resourced. In 2012 the IMF recommended Sweden to improve targeted tax and expenditure measures in order to make the planned medium term fiscal adjustment more growth friendly. In 2013, IMF directors also saw merit in improving the existing fiscal framework further by introducing an explicit longer-term anchor for fiscal policy, including a target national public debt range well below the Maastricht criterion.

Financial stability is the main area addressed by international organisations. About half of the recommendations within this area are intended to tackle an unsustainable build-up of household debt and house prices. The various proposals for action include reductions of tax incentives such as deductible interest payments on mortgages and reviewing property taxes as well as measures to increase the pace of mortgage amortisation. Yet other recommendations include measures to strengthen the capital requirements of banks as well as bank resolution and crisis management arrangements. Another frequent recommendation is to clarify the roles and responsibilities of different authorities with regard to macro-prudential supervision.

8.2 Identified risks to fiscal sustainability

The international organisations' recommendations to Sweden during 2011-2015 reflect their assessments of the Swedish economy. They all clearly point to high household debt, rising house prices and a large and highly concentrated financial sector as the main areas of concern. The Swedish National Audit Office concludes that these dynamics constitute examples of short term macro-financial risks that may influence the public sector's ability to fulfil its long-term commitments. Meanwhile, the international organisations consider public finances to be healthy and fiscal sustainability does not seem to be a matter of concern in and by itself. Other challenges, such as structural problems in the Swedish labour market are less relevant vis-à-vis the long term sustainability of public finances.

More recent data show that risks on the macro-financial side remain, although housing price increases have slowed somewhat. Housing price inflation declined to about 9 percent in 2016, from 14 percent in 2015. At the same time, household debt continues to rise relative to disposable income, suggesting that vulnerabilities and risks remain. This is again underlined in the 2016 IMF Article IV consultation, the 2017 OECD Economic Survey as well as in the European Commission's Country Report Sweden 2017. These recent reports did however fall outside the parallel audit time period.

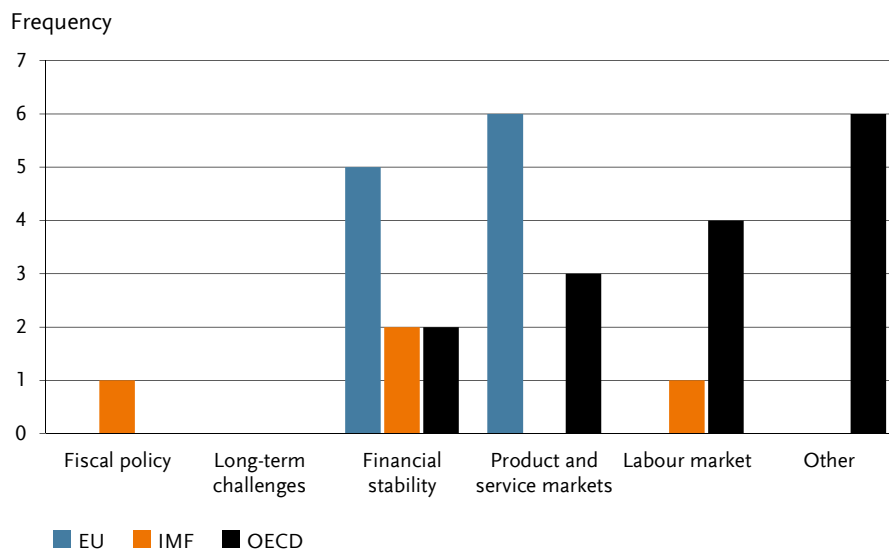
8.3 Government response to country specific recommendations

The Swedish Government has mostly addressed the recommendations given. A notable exception concerns recommendations intended to reduce tax incentives causing debt bias in housing investments. Swedish authorities are well aware of the perils of rising household debt and the issue is frequently debated and reported in the media. Recommendations to manage these risks through reduced tax incentives have however not been followed. The Government has not formally communicated the reasons for not following these recommendations.

Another area in which the Government has not addressed the recommendations concerns deregulation of the rental housing market. This is considered a key reform by international organisations in order to rebalance housing demand and supply.

Table 16 depicts instances within recommendation categories where Swedish authorities neither have complied with nor communicated why they have chosen not to comply with a certain recommendation, according to the NAO's compilation. This is true for 30 recommendations or 20 per cent of the 150 recommendations to Sweden in total.¹⁹

Graph 5. Instances of non-regarded recommendations



Swedish governments regardless of political affiliation have made few efforts to tackle the issue of tax incentives contributing to the unsustainable build-up of household debt and subsequent rises in house prices. Other actions have nevertheless been taken in relation to recommendations given. The Financial Supervisory Authority was for example given the main responsibility for macro-prudential tools in 2014. Macro-prudential measures have been taken,

¹⁹ A full list of country specific recommendations for Sweden including an analysis of Government response in relation to the recommendations, is available from the Swedish National Audit Office at request.

including raising minimum capital requirements for banks, introducing a loan-to-value cap in 2010 and an amortisation requirement on new mortgages in 2016.

8.4 Effectiveness of Government measures

The effectiveness of government action resulting from the recommendations to Swedish authorities has not been audited. The Swedish National Audit Office conducts a separate performance audit in one of the fields covered by the country specific recommendations, namely the effectiveness of macro-prudential supervision.

8.5 Public availability and follow-up procedures

In the Swedish case it is evident that the EU-semester assessments are circumscribed by formalised practices at the national level. In contrast, there are no formal procedures when it comes to OECD and IMF assessments. Only EU semester CSRs are expressly made available to the public, submitted to the Parliament and commented on in a statement at the national level. The Government's reporting on EU semester CSRs to the Parliament covers all the latest CSRs, but all recommendations are not necessarily commented on in detail. Apart from a yearly statement about the latest EU semester CSRs, there is no explicit follow-up process with regard to the recommendations issued by other international organisations.

Table 17. Public availability and follow-up of CSRs to Sweden at national level

	EU-semester	OECD Economic Surveys	IMF Article IV Consultations
Are CSRs regularly made available to the public and/or submitted to the parliament?	Yes / Yes	No / No	Yes / No
If yes: Is this procedure regulated?	Yes, indirectly	--	No
Which ministry/authority/institution is in charge of publication?	Ministry of Finance / Prime Minister's Office	--	The Central Bank publishes a weblink to the IMF report
Does the publication cover all CSRs or a selection?	All CSRs are covered	--	Only the weblink is provided
Does the competent ministry/authority/institution publish a statement at the national level with an official opinion on the country specific CSRs?	Yes, in the National reform program (sent to COM and published in Sweden) as well as in the budget bills.	No	They are briefly mentioned in a communication on the activities of the IMF, World Bank & other institutions
If yes: Is the statement mandatory?	Not at the national level	--	No
Does the opinion cover all CSRs or a selection of them?	Yes, at the overall level but detailed recommendations may stay uncommented.	--	Brief comment
Is there an explicit follow-up process for each set of recommendations in relevant ministries/authorities/institutions with an assessment of compliance with recommendations?	No	No	No
If yes: Are the follow-up documents regularly made available to the public at the national level and/or submitted to the parliament?	--	--	--
Does the assessment include explanations in cases of non-compliance?	--	--	--

Source: Official documents and Interview at Ministry of Finance 2016-10-25. "--" means not applicable.

8.6 Audit Approach and evidence base

The work of the Swedish National Audit Office included a systematic review of all country specific recommendations to Sweden for the period 2011-2015 from the European Council within the framework of the European semester, the IMF in its article IV consultations and the OECD in its Economic Surveys for Sweden. It also identified which sustainability risks these CSRs refer to and how the risks have developed over the years. The work moreover comprised analyses of Swedish authorities' measures in relation to CSRs with the aim of identifying areas where sustainability risks have been neglected. The effectiveness of Government action resulting from the CSRs was not audited.

Apart from the reviewed multilateral surveillance reports, the Swedish contribution to the parallel audit project was also based on the Swedish Governments' financial bills and communications on these issues during the corresponding period. Document studies were supplemented by interviews with officials in the Swedish Ministry of Finance.