

**Fiscal Policy Councils: Why do we need them and what makes them effective?**

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*Comments on “The Role of Fiscal Policy Councils in Theory” by Xavier Debrun*

# Debrun's paper (slides)

- There is a lively academic and policy debate on Fiscal Councils, there are several recent developments at the national level (e.g. UK, SW, HU), but we do not have a fully fledged theory  $\Rightarrow$  **XD aims at developing a theoretical model concerning the potential role of FCs**
- The model combines opportunistic policymakers, electoral uncertainty, information asymmetry (budgetary opacity)
- **XD models a FC that has the mandate to inform the public about fiscal developments**
- The FC can therefore affect the interaction between voters and politicians: it can reduce the gains from opportunistic behavior and increase the re-election chances of disciplined policymakers

# The policy indications

The indications of the paper are cautious and reasonable (they are also based on XD's previous work; Debrun & Kumar, 2008; Debrun, Hauner & Kumar, 2009)

- Fiscal policy is fundamentally different from monetary policy. Parallel with independent central banks is simplistic and misleading ⇒ **FCs cannot run fiscal policy**, they can only try to affect the decisions taken by governments
- In designing national FCs, it is essential to understand the multiple and interconnected roots of fiscal bias, which are highly country-specific ⇒ **there is no single recipe**
- Fiscal institutions must work at the core of the democratic process and be fully owned: they must affect the way voters and policymakers interact ⇒ **FCs cannot stay outside the political arena**

# Some issues may need further work: status and rules

- **Why is the FC created in this model? It is probably created by a virtuous government (which expects the FC to tell the public that it is really virtuous). An un-virtuous government would just commit suicide**
- **Once created, how long can the FC cope with the first un-virtuous government?** XD notes that “independent fiscal agency is a priori much less likely to carry credibility gains than an independent central bank.”
- **Can the FC survive without a constitutional status? What (country-specific) protection does it need?**
- **Can the FC operate without a fiscal rule?** FCs are usually a component of a broader fiscal framework. Moreover, a fiscal rule can provide a benchmark for its assessments: the FC evaluates whether the government is consistent with its medium-term objectives

# Some issues may need further work: tasks

- XD's FC is not assigned two tasks frequently assigned to FCs: **it does not provide macro & fiscal forecasts, nor it provides policy recommendations.** This is a good choice, but can the theoretical framework be extended to these tasks?
- We know that macroeconomic forecasts are not biased when prepared by independent agencies, while this is not always the case for government agencies (Jonung and Larch, 2006). But **should forecasting and monitoring be combined together? Not necessarily:** they are different jobs (J. Kay, *A fiscal watchdog has no need of a crystal ball*, FT, 22 Sept. 2010).
- In some countries FCs also help **promoting budget coordination across different levels of government.** This is again another job.

# The policy debate supports the creation of FCs

- At the **national level**, the **legacy of the crisis** is putting additional pressure for the introduction of medium-term planning and domestic fiscal rules  
⇒ **there is a need for institutions monitoring compliance with the targets & reassuring financial markets** (by increasing transparency and predictability of public finances)
- At the **EU level**, the SGP needs support.  
“The Council agrees that national budgetary rules should be supportive of the Member States’ commitments under the SGP. ... **National institutions should play a more prominent role in budgetary surveillance to strengthen national ownership**, enhance enforcement through national public opinion and complement the economic and policy analysis at EU level.”

*“Improving the implementation of the Stability and Growth Pact”, European Council - March 2005*

# A new development: FCs enter the EU domain

“Over and above these minimum requirements, a set of non-binding additional standards should be agreed upon, covering notably the use of top down budgetary processes, fiscal rules and **the role of public bodies (e.g. fiscal councils) tasked with providing independent analysis, assessments and forecasts** related to domestic fiscal policy matters.”

(Van Rompuy Task Force, *Final Report of the Task Force to the European Council*, October 2010)

“numerical fiscal rules shall contain specifications on the following elements:

- a) ....
- b) effective and timely monitoring of compliance with the rules, such as by **independent national budget offices or institutions** acting in the field of budgetary policy”

(European Commission, *Proposal for a Council Directive on requirements for budgetary frameworks of the Member States*, September 2010)

⇒ Two main tasks: **a) providing forecasts, b) checking compliance with fiscal rules**  
(national & EU)

# But Germany took a different approach

- The new German fiscal rule implicitly defines a **clear mandate for a possible German independent FC**: to provide the economic analysis on which the constitutional court can deliver its judgments. The complexity of the technical issues (CA, the control account) may also suggest that an independent body is necessary to avoid opportunistic interpretations.
- In 2009 with the new fiscal rule Germany created a **Stability Council** (Federal Ministers of Finance & Economy + finance ministers of the Länder), which replaces the Financial Planning Council and is charged with monitoring budgetary developments.
- Whenever the Council considers that a federal or state government risks falling into financial distress, that government has to propose corrective measures. The Council is expected to monitor the implementation of the consolidation plan. Evidently, it is **not an independent FC**. But peer pressure can also be effective.
- Germany has **several councils** in the fiscal domain, mainly with forecasting & advising purposes. von Hagen (2010): they lack visibility, do not have a mandate for maintaining sustainable public finances and do not have enforcement powers. **But the framework works relatively well.**

# And reality can be harsh

*“Hungary’s council has executed its remit in an independent way which has earned it international respect. But **its existence is now threatened**. After having pointed out that the government’s current budget bill is too optimistic, a budget cut for the council that would in effect imply its abolition has been proposed in parliament. The ruling Fidesz party seems determined to replace the council with a more toothless alternative.”*

*“Developments in Hungary are also of a more general interest for the viability of independent fiscal monitoring. It is easy for a government to be in favour of this in principle. **It is more difficult to stand criticism when it is actually delivered.**”*

*“There are examples also from other countries. President Hugo Chávez abolished the fiscal council in Venezuela. In Sweden, the Fiscal Policy Council has been threatened with budget cuts by the minister for finance after criticising policies.”*

Lars Calmfors, Chair of the Fiscal Policy Council in Sweden

Robert Chote, Chairman of the Office for Budget Responsibility in the UK

Coen Teulings, Director of the Central Planning Bureau in the Netherlands

Financial Times, 6 December 2010

# What conclusions can we draw?

- As XD indicates, solutions should be country-tailored. **EU indications should be carefully adapted to the national context.**
- FCs can work only if they are part of a **broader fiscal framework.**
- In some countries a fully-fledged FC with broad tasks may be unnecessary (since forecasting & monitoring tasks are already carried out adequately by existing institutions).
- It may be useful to **separate forecasting and monitoring tasks.**
- **Alternative solutions can also help, e.g.:**
  - increasing the disclosure requirements of fiscal authorities (about forecasts, fiscal risks, non financial liabilities, etc.)
  - increasing the role of CBs
  - reviewing the roles of Audit Courts and Parliamentary technical services
- Practical problems should not be under-estimated: **FCs need good technical staff and need access to all relevant info.**

# Democracy at work

- **XB concludes that:** *“Fiscal institutions must work at the core of the democratic process and be fully owned: they must affect the way voters and policymakers interact.”*
- **Indeed:** *“good finance cannot be attained without intelligent care on the part of the citizens. The rules of budgetary legislation are serviceable ... but equilibrium will only be found where responsibility is enforced by the public opinion of an active and enlightened community”*  
*(C.F. Bastable, 1927, Public Finance, Macmillan, London)*
- **There is no technocratic magic wand.**