SM/13/219
Correction 1

July 31, 2013

To: Members of the Executive Board

From: The Secretary

Subject: **The Functions and Impact of Fiscal Councils**

The attached corrections to SM/13/219 (7/17/13) have been provided by the staff:

Factual Errors Not Affecting the Presentation of Staff's Analysis or Views

Page 11, paragraph 20, line 7: for "the United Kingdom (2011)" read "the United Kingdom (2010)"

Page 13, Box 1 (Concluded), line 28: for "United Kingdom, Office of Budget Responsibility 2011" read "United Kingdom, Office of Budget Responsibility 2010"

Page 35, paragraph 53, line 4: for "The Belgium HCF experienced a two year delay in the appointment of key members after its recommendations were at odds with government's objectives." read "The Belgium HCF made recommendations which were at odds with government's objectives and experienced a two year delay in the appointment of key members."

Page 38, paragraph 59, line 10: for "That influence dramatically weakened in the immediate post euro era, culminating in open conflict with the government." read "That influence dramatically weakened in the immediate post euro era, culminating in the council providing strong public critical assessments of the government's fiscal policies."

Questions may be referred to Ms. Curristine (ext. 38349), Mr. Debrun (ext. 38321), and Mr. Kinda (ext. 39538) in FAD.

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

Att: (4)

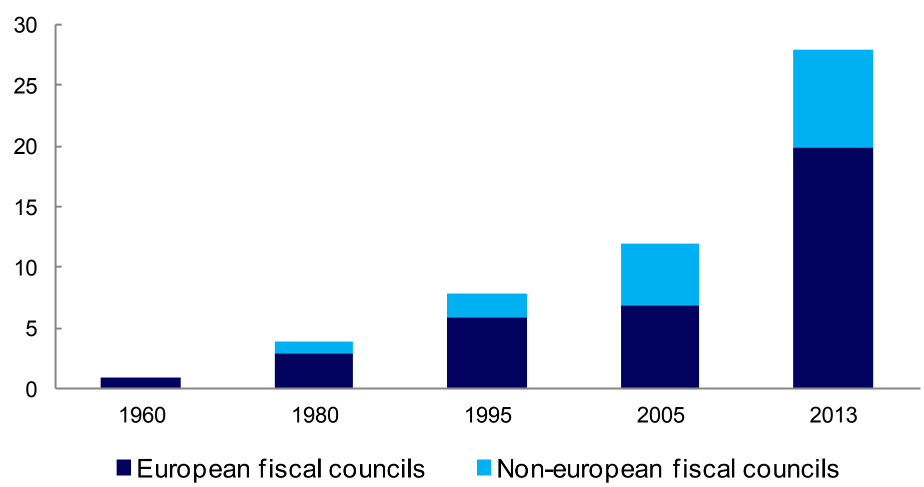
Other Distribution:
Department Heads

MAPPING FISCAL COUNCILS

A. Fiscal Councils in the World: A Growing and Diverse Population

20. The number of fiscal councils has increased rapidly since 2005. In 1960, only one country—The Netherlands—had an active fiscal council and only four additional countries—Denmark, Germany, the United States, and Belgium—adopted such institutions over the next three decades. The number surged after 2005, reaching 29 at end–January 2013 (Figure 1).[9] Newcomers include the Fiscal Policy Council in Sweden (2007), the Parliamentary Budget Officer in Canada (2008), the Fiscal Council in Slovenia (2009) and Romania (2010), the Office for Budget Responsibility in the United Kingdom (~~2011~~2010), the Portuguese Public Finance Council (2011), the Irish Fiscal Advisory Council (2011), parliamentary budget offices in Kenya (2009), Australia (2012), Italy (2012) and South Africa (2013), and the High Council of Public Finance in France (2013). This year, Chile has formally established a fiscal council, while Spain is expected to complete legislative work on a Fiscal Authority for Fiscal Responsibility by year-end. Although most of established fiscal councils are in advanced economies, particularly in Europe, there is growing interest in emerging markets and developing economies.

Figure 1. Number of Fiscal Councils



Source: IMF Fiscal Council Dataset.

[9] Note that there are two fiscal councils in Belgium and Slovenia, corresponding to a separation between forecasting and advisory functions. See Bogaert and others (2006) for details on the Belgian case.

Box 1. The IMF Fiscal Council Dataset

The fiscal council dataset assembled for this paper covers existing fiscal councils across the Fund's membership, as well as councils for which the primary legislative texts have been adopted as of end-January 2013, and those that were de facto or de jure eliminated. The dataset used a variety of sources, including fiscal responsibility laws, fiscal councils' websites, IMF country papers, and in some cases, country authorities themselves. The dataset has also benefited from inputs by IMF desk economists. For EU and OECD member states, the dataset draws from the European Commission's Fiscal Institution Database and the background country notes used by the OECD to prepare their draft Principles for independent fiscal institutions. The dataset includes general information such as the name and acronym of the council and its date of creation, the main features of the council's remit, their specific tasks and instruments at their disposal to influence the conduct of fiscal policy, and key institutional characteristics such as the existence of formal guarantees of independence, accountability requirements, and their human and financial resources. The main variables used in the descriptive and empirical analyses (this section and the next) are as follows:

Independence:

- *Legal independence*: The council's independence from political interference is guaranteed by law (Yes: 1, No: 0).

- *Safeguards on budget:* Safeguards on the council's budget are deemed to exist if the budget is (i) set by the central bank, (ii) part of the overall budget of the legislative branch (i.e. protected from executive decisions), (iii) guaranteed by budget appropriations with separate line item in the budget, or (iv) subject to any other guarantee commonly granted to independent institutions, such as regulators.

Fiscal rules monitoring: The council is mandated to monitor compliance with numerical fiscal rules (Yes: 1, No: 0).

High media impact: This variable reflects IMF staff assessment based in the number of publications, media references to these reports, and in the case of EU members, the authorities own assessment reflected in the Fiscal Institutions Database.

Forecasts provision/assessment: The council is mandated to provide or assess macroeconomic forecasts used for budgetary projections (Yes: 1, No: 0).

Costing of measures: The council is mandated to provide costing of measures and reforms affecting public finances (Yes: 1, No: 0).

Box 1 (Concluded)

Table. List of Fiscal Councils in the Dataset

Country	Fiscal Council	Conventional Acronym	Start of activity	Type
Australia	Parliamentary Budget Office	…	2012	Parliamentary Budget Office
Austria	Government Debt Committee	…	2002	Attached to the Central Bank
Belgium	High Council of Finance - Section "Public Sector Borrowing Requirement"	HCF	1989	Attached to the Executive
Belgium	Federal Planning Bureau	FPB	1994	Attached to the Executive
Canada	Parliamentary Budget Office	PBO	2008	Parliamentary Budget Office
Croatia	Fiscal Policy Council	…	2013	Attached to the Executive
Denmark	Danish Economic Council	…	1962	Attached to the Executive
Finland	National Audit Office of Finland	…	2013	Audit Office performs tasks of fiscal council
France	High Council of Public Finance	…	2013	Attached to the Audit Institution
Georgia	Parliamentary Budget Office	…	1997	Parliamentary Budget Office
Germany	German Council of Economic Experts	…	1963	Stand-alone
Hungary	Fiscal Council	…	2009	Stand-alone
Ireland	Irish Fiscal Advisory Council	IFAC	2011	Stand-alone
Italy[1]	Parliamentary Budget Office	…	2014	Parliamentary Budget Office
Japan	Fiscal System Council	…	1950	Attached to the Executive
Kenya	Parliamentary Budget Office	…	2009	Parliamentary Budget Office
Mexico	Center for Public Finance Studies	…	1999	Parliamentary Budget Office
Netherlands	Netherlands Bureau for Economic Policy Analysis	CPB	1945	Attached to the Executive
Portugal	Portuguese Public Finance Council	CFP	2011	Stand-alone
Romania	Fiscal Council	…	2010	Stand-alone
Serbia	Fiscal Council	…	2011	Stand-alone
Slovak Republic	Council for Budget Responsibility	CBR	2011	Stand-alone
Slovenia	Institute of Macroeconomic Analysis and Development	IMAD	1991	Attached to the Executive
Slovenia	Fiscal Council	…	2009	Attached to the Executive
South Africa[1]	Parliamentary Budget Office	…	2014	Parliamentary Budget Office
South Korea	National Assembly Budget Office	NABO	2003	Parliamentary Budget Office
Sweden	Swedish Fiscal Policy Council	FPC	2007	Stand-alone
United Kingdom	Office for Budget Responsibility	OBR	2010	Attached to the Executive
United States	Congressional Budget Office	CBO	1974	Parliamentary Budget Office

[1] The South African and Italian PBOs are being established and expected to be fully operational by the end of 2014. Chile has established a Fiscal Advisory Council in April 2013.

Remit and Tasks of Fiscal Councils

21. While the common impetus for the creation of fiscal councils has been to encourage sound fiscal policies through independent oversight, there is considerable diversity among them. Beyond the common motivation, the design of individual institutions reflects the legal, political and institutional environments of each country, as well as the specific causes and manifestations of the bias affecting discretionary policies. Fiscal councils can nevertheless be categorized following economically relevant characteristics, including their remit or functions, the tasks performed to accomplish these functions, and basic institutional features, including their governance. The analysis will also make a distinction between "veterans" (established prior to 2005) and the "new generation" (established in 2005 or later). The rationale for that distinction is that the design of new institutions may have been influenced by the intensifying academic debate on their potential role in improving the conduct of fiscal policy[10] , and by the accumulating experience with politically independent agencies in other policy areas

[10] See for instance von Hagen and Harden (1995), Eichengreen, Hausmann and von Hagen (1999), Calmfors (2003), Fatàs and others (2003), Wren-Lewis (2003), Castellani and Debrun (2005), Wyplosz, (2005), and Leith and Wren-Lewis (2006).

such as central banking or the regulation and supervision of specific sectors (banking, energy, media).

22. In line with the definition proposed above, the functions of fiscal councils generally belong to one of the following broad categories (Figure 2):

a. ***Independent analysis, review, and monitoring of government's fiscal policies, plans, and performance.*** This includes reviews of governments' annual or medium term budget proposals generally with respect to compliance with official objectives—such as those enshrined in fiscal policy rules—and/or the long-term sustainability of public finances and the related risks. Typically, fiscal councils focus on a macroeconomic analysis anchored in their ultimate objective to promote sound fiscal policies by informing the public debate. Fiscal councils also provide ex-post assessments of macroeconomic and fiscal performance against official aggregate objectives and targets. More broadly, councils also carry out research with clear relevance for the health of public finances and the conduct of fiscal policy, such as labor market performance, the impact of aging population, or the extent of tax expenditures.

b. ***Developing or reviewing macroeconomic and/or budgetary projections.*** Assessments of macroeconomic and/or budgetary forecasts can be associated with a right to publicly denounce eventual biases or an obligation—de jure or de facto—from the government to "comply or explain" in case of significant differences between the forecasts underlying budget plans and those of the council. The council could also be mandated to prepare the macroeconomic forecasts used for budget preparation or to set key assumptions and parameters, such as a prudent price level for certain commodities with a large budgetary impact (either because the country is a large commodity producer or because of extensive subsidy schemes).

c. ***Costing of budget and policy proposals, including possibly, election platforms.*** Beyond macroeconomic and revenue forecasts, a fiscal council could also be tasked to produce unbiased estimates related to specific spending programs or policy measures.

d. ***Advising policymakers on policy options.*** This function can be general—a right to comment and issue recommendations on any policy issue of its choosing—or specific—limited to a particularly contentious issue that must be solved by consensus. A general function is better suited to countries with an already rich public debate and a relatively consensual approach to policy-making. A specific function can be useful in issues such as the sharing of certain revenues across unequal regions, where a consensus must be found but interests among decision makers diverge strongly. In resource-rich economies, issues related to the regional and intergenerational distribution of revenues from non-renewable commodities is also an area where non-partisan inputs could avoid undesirable biases.

23. While all fiscal councils identified for this study routinely perform broad oversight functions, there is much more variation as regards the other functions described above. For

This has been done by cutting the council's resources, controlling its work program, delaying appointments of members, or changing its size and mandate altogether.[22] The most egregious example is the Hungarian fiscal council, which in its second year of existence, had its mandate restricted and staff virtually eliminated. ~~The Belgium HCF experienced a two year delay in the appointment of key members after its recommendations were at odds with government's objectives.~~ The Belgium HCF made recommendations which were at odds with government's objectives and experienced a two year delay in the appointment of key members. Canada and Sweden also faced threats to their budget after being critical of government policies.

Resources and Remit

54. Resources commensurate to the remit and tasks of the fiscal councils are essential for its effectiveness. The various tasks of a fiscal council have very different resourcing requirements. In Sweden, fiscal policy assessments have been performed by a staff of 5 at the overall cost of about USD 1 million (including the outsourcing of some background studies). At the other end of the spectrum, policy costing is the most resource intensive and time consuming activity requiring a larger and highly specialized staff. In the US, the CBO has a staff of 240, and a budget of USD 45 million to prepare costing of legislative proposals in addition to fiscal policy analysis, forecasts and long-term sustainability assessments.

55. Although it is difficult to formulate specific guidance on the optimal size of a fiscal council, some broad principles can be outlined. The quantitative ranges given below are for professional staff experienced enough to garner the respect of other experts and commentators of fiscal issues within the relevant country (Figure 14). These ranges are purely based on experience with existing fiscal councils and could vary substantially with the size and complexity of the government system and the institutional coverage of the council's activities.

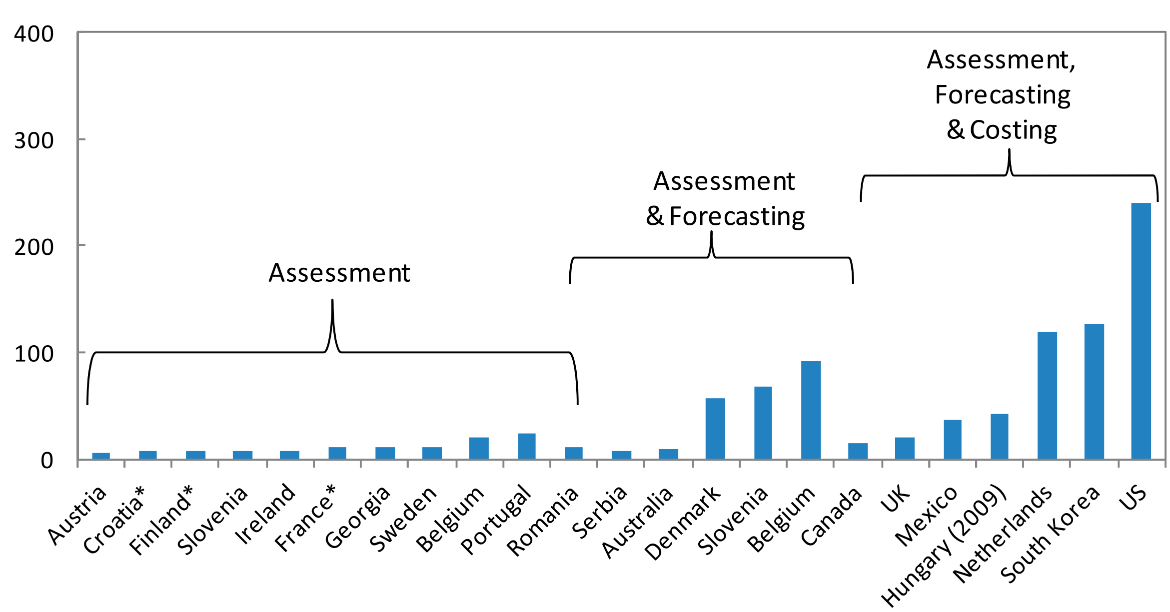
- Undertaking an assessment of fiscal policy, including compliance with fiscal rules, demands relatively few resources, say 2 to 10 full-time professionals.
- Similarly, assessing economic and fiscal forecasts can be done with a relatively small resource base by comparing the government's forecasts to those of other high quality institutions. Moreover, simple forecasting tools are sufficient to raise alarms when the government's budgetary forecasts seem out of line without obvious reasons.
- As the remit is extended to producing independent economic and fiscal forecasts, the resourcing requirements increase significantly, as more sophisticated models and specific expertise—e.g. on certain tax issues—are needed. Although much depends on the extent to

[22] In Belgium, the Netherlands and Sweden the budget is part of the Ministries of Finance budget. In Korea, Canada and the United States, the council's budget is part of the legislature's budget.

which the council can rely on outside expertise (central bank or ministry), experience suggest that fiscal councils involved in forecasting operate at the minimum over 20 professional staff.

- Finally, policy costing is the most resource intensive and time consuming remit requiring a larger staff base, with an expertise in revenue and expenditure policies, combined with access to data and models that have often taken decades to develop within ministries of finance. To the extent that strong guarantees of independence exist, these resourcing needs can be reduced through data and model sharing agreements with the government agencies which traditionally perform these roles for the government (Australia).

Figure 14. Number of FTE Staff and Functions



Sources: IMF Fiscal Council Dataset.

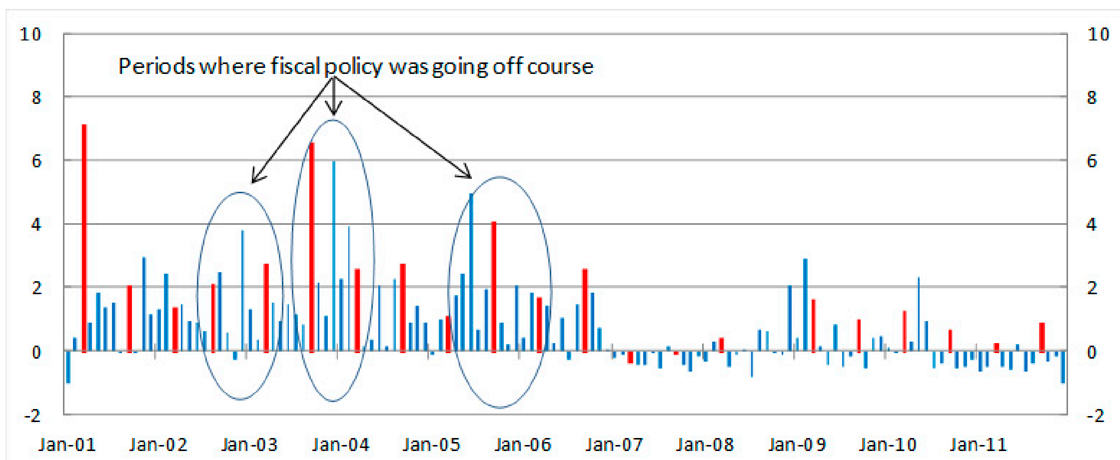
Operational Lessons

56. To remain effective across political cycles, fiscal councils need to actively develop their non-partisan credentials. Political support across party lines for the creation of the council clearly reduces the risk of subsequent partisan threats. In Hungary, the reform of the council in 2010 could be related in part to the lack of strong bi-partisan support for the 2008 fiscal responsibility law, which established the council. Similarly the creation of the Swedish council was not supported by the opposition parties, who feared it would be a mouth piece of the government. However, the Council quickly established its independence through normative analysis critical of the government. The Dutch CPB and the United States' CBO have instead sought to avoid normative analysis. In the case of the CBO, this neutral position helped build a reputation of non-partisanship, which has been critical to its survival and impact.

Assessment of Fiscal Policy

57. For fiscal councils to influence the policy debate it is important to have a strong media presence to communicate their assessment of government's fiscal policy to the public. This is particularly important when fiscal councils need to raise the alarm as when proposed budgets are not in line with stated objectives, when forecasts are over-optimistic and unlikely to be realized, when unsustainable spending or tax policies are being debated, or when the fiscal outturns are coming out significantly worse than projected. By identifying such episodes, and mapping them against the volume of media reporting of the findings of the council, it is possible to get a sense of the effectiveness of the council's communication with the public. The Dutch experience through the 2000s provides a good example of effective communication, with the council increasing its public activity, as evidenced by spikes in media reports, at the specific points of time where fiscal policy was going off course (Figure 15).

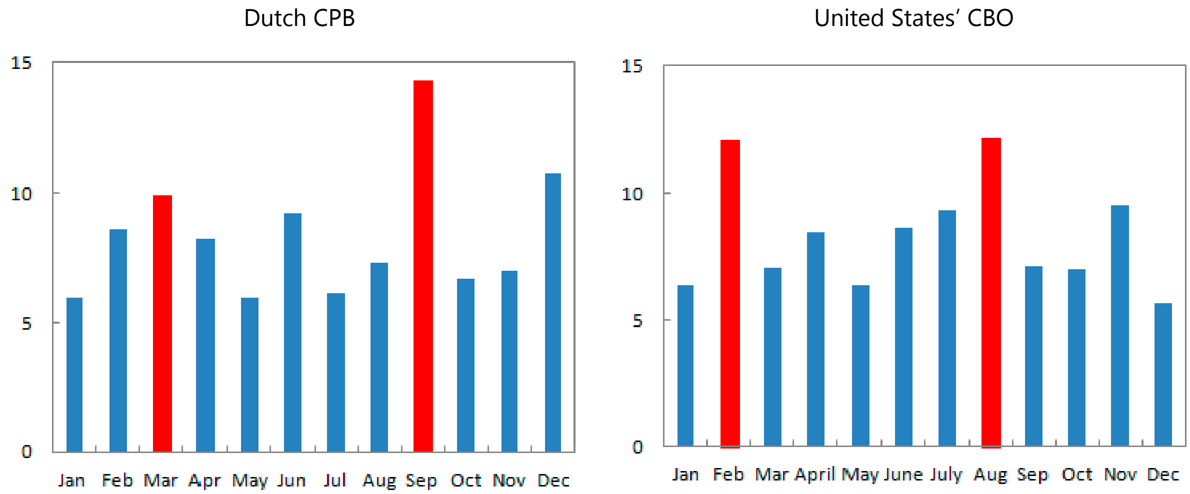
Figure 15. Media Reports of the Dutch CPB
(Number of media articles relative to 4-year rolling average)



Sources: Factiva and IMF staff calculations.

58. While fiscal councils should have a steady media presence, it is important to ensure that key messages on fiscal policy are focused and provided when they matter most during the budget process. If media interventions focus on topics outside of the council's immediate remit and become too numerous, this can reduce the power of their messages when fiscal policy is actually veering away from stated goals. The Dutch CPB is an example of an effective approach. Its interventions systematically take place around the release of its most extensive reports, in March and September—key points in the framing and passage of the budget (Figure 16). Similarly, the CBO's interventions are focused around press briefings twice a year in February and August, when the budget and economic outlook updates are released. The director and staff of the CBO are also easily accessible for journalists, providing background briefings to ensure that they understand the work.

Figure 16. Average Seasonal Pattern of Media Reports



Sources: Factiva and IMF staff calculations.

59. Councils tend to have a stronger impact when combined with a political and public consensus on sound public finances. In Sweden and Canada, there is a public consensus on the need for sound public finances, a legacy from their experiences of economic crises in the 1990s. Politicians are aware of the electoral risks of running deficits and emphasize balancing the budget. A similar consensus exists in the Netherlands. This has the advantage that when the councils raise the alarm, the media are more likely to pay attention. In contrast, when fiscal discipline is not well-anchored in electoral preferences, the task of the council is more difficult. In Belgium, the recommendations of the High Council of Finance had a major influence over fiscal policy when politicians focused on the fiscal convergence criteria to enter the euro area in 1999. ~~That influence dramatically weakened in the immediate post euro era, culminating in open conflict with the government.~~ That influence dramatically weakened in the immediate post euro era, culminating in the council providing strong public critical assessments of the government's fiscal policies.

60. Clear benchmarks that fiscal performance can be judged against increase the traction of the council. These benchmarks often emanate from a fiscal rule, such as the Swedish expenditure ceilings or the SGP deficit ceilings, or other public commitments such as the deficit ceilings that are part of Dutch coalition agreements. Rules reduce the risk for the council of being perceived as partisan. Without such benchmarks, the council may find it difficult to leverage its positive analysis. In the United States, the absence of medium-term political commitments on fiscal outcomes along with other factors has limited the CBO's capacity to influence politicians to constrain deficits (Hemming and Joyce 2013).