SM/13/219
Supplement 1
Correction 1

July 31, 2013

To: Members of the Executive Board

From: The Secretary

Subject: **Case Studies of Fiscal Councils—Functions and Impact**

The attached corrections to SM/13/219, Sup. 1 (7/17/13) have been provided by the staff:

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

Page 6, paragraph 2, line 1: for "In the mid-2000s, after a number of unfavorable assessments, the Minister of Finance allowed the chairmanship of the PSBR's to lapse without appointing a successor" read "In the mid-2000s, the government was unable to reach a consensus on the composition of the PSBR"

paragraph 2, line 5: "These events resulted in a significant loss of influence for the HCF (Coene and Langenus, 2011)" removed

Page 9, paragraph 2, line 3: for "The reaction was to curtail the influence of the council by leaving the chair of the PSBR group vacant." read " The subsequent two-year vacancies in the PSBR group resulted in no recommendations being given (Debrun et al, 2012)."

Page 20, paragraph 3, line 3: "resulting in a dramatic curtailing of its activities" removed

Page 21, paragraph 1, line 4: "In addition, the council provided a sustainability report looking at finances 50 years ahead." removed

paragraph 3, line 4: "on a non-remunerated part-time basis" removed

paragraph 3, line 6: for "from over 30 to 3" read "to around 3." Nevertheless, both the central bank and the State Audit Office prepare background documents and analysis for the Fiscal Council.

paragraph 4, line 1: new text added "and its execution, developments in government debt"

Page 23, paragraph 2, line 2: for "In its short life the legitimacy it gained, especially internationally, was not sufficient to protect" read "The legitimacy it gained, however, especially internationally, was not sufficient to protect it."

paragraph 2, line 4: for "and much narrower resource base is arguably weakened (Hemming and Joyce, 2013) to the point that many commentators question if it should still be considered as a genuine fiscal council" read " and much narrower resource base, is weakened (Hemming and Joyce, 2013)."

Typographical Errors

Page 5, paragraph 3, line 6: for “12” read “Twelve”

Page 8, footnote 2, line 1: for “Debrun and others 2012” read “Debrun et al. 2012”
footnote 3, line 2: for “(in various languages), such as budget, public debt or fiscal deficit, sourced from Factiva.” read “(in the relevant language), such as budget, public debt or fiscal deficit. Information on the number of media articles has been obtained from the Factiva database.”

Page 10, paragraph 2, line 3: for “listed” read “listened”

Page 11, paragraph 1, line 2: for “promising to the” read “promising to”

Page 15, paragraph 2, line 6: for “there emerged” read “emerged”

Page 19, heading: for “Conclusion” read “Conclusions”

Page 26, paragraph 1, line 3: for “With an expansion in the size of government expenditures increased to 25.8 percent of GDP in 2008, however, this was matched by a similar increase in revenues (Figure 6),” read “An increase in government expenditures to 25.8 percent of GDP by 2008, was matched by a similar increase in revenues (Figure 6),”

Page 32, paragraph 4, line 6: “(in order for costing to be undertaken)” removed

Page 34, paragraph 1, line 1: for “Table 2” read “Figure 9”

Page 43, paragraph 2, line 3: for “The CBO is an agency of the legislative branch, thus it is independent from the President and also since it does not report directly to any Congressional Committee from the Congress (Joyce 2011).” read “The CBO is an agency of the legislative branch. It is independent from the President and does not report directly to any Congressional Committee (Joyce 2011).”

Page 46, paragraph 3, line 6: for “consistently” read “consistently overoptimistic”

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

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

Att: (16)

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BELGIUM – THE HIGH COUNCIL OF FINANCE (HCF)—GAINING AND MAINTAINING CREDIBILITY IS KEY

A. Political and Economic Context

In Belgium, there is more than one independent fiscal body involved in the budget process. The High Council of Finance (HCF) produces normative recommendations and assessments of fiscal policy and the Federal Planning Bureau (FPB), under the umbrella of the National Accounts Institute[1], produces the macro economic forecasts used in the budget.

The HCF is the oldest Fiscal Council and dates back to the 1930s. Since its inception the HCF has been reformed several times and its influence on fiscal policy has fluctuated. An important reform took place in 1989, when the Council's role was redefined in the context of a wider constitutional reform which granted greater fiscal autonomy to sub-national governments. The Council received a new mandate to focus on promoting and coordinating fiscal discipline in the federal system and issuing recommendations on public sector borrowing requirements. At that time, the main fiscal policy challenges facing Belgium was its high budget deficit (7 percent of GDP in 1988) and general public gross debt (125 percent of GDP in 1988) (Bogaert and others, 2006). Belgium's commitment to the Maastricht criteria and joining the Euro provided another opportunity to expand the Council's normative role to include monitoring and issuing recommendations on compliance with the Stability and Growth Pact (SGT).

B. Institutional Set-up

Although formally the HCF is an advisory body to the ministry of finance and is not legally independent, over the past decades it has gained a reputation for quality independent analysis. The HCF consists of a chair (the Minister of Finance), two deputy chairs (appointed by the Minister of Finance), and 24 members appointed for five year renewable terms. The membership is selected based on a specified combination of expertise (economic and taxation) and balance of regional and linguistic diversity. ~~12~~ Twelve members of the council are proposed by Federal ministries and 12 by governments in the regions. In practice, the nominations also reflect a balance of party political affiliations (OECD 2012). Similar to the Swedish Fiscal Council, the members are part time and have other full time employment. The Council is divided into two subsections: the Public Sector Borrowing Requirement (PSBR), and the Taxation and Social Security Contributions. In

[1] The National Account Institute (NAI) was created in 1994 to ensure the independence and quality of economic forecasts and statistics. It is served by Statistic Belgium and the Federal Planning Bureau (FPB) which produces the forecasts on behalf of the NAI. See Bogaert and others 2006 for more details.

addition, there is one study group on ageing. The council is supported by a secretariat of 12 full time staff, who are civil servants in the research department of the Federal Public Service Finance department. The cost of staff, and the HCF's limited other expenses, are covered under the budget of the Federal Public Service Finance department. Thus, the council does not have a separate line in the budget.

The Council's independence has been challenged over time. In the mid-2000s, ~~after a number of unfavorable assessments, the Minister of Finance allowed the chairmanship of the PSBR's to lapse without appointing a successor~~ the government was unable to reach a consensus on the composition of the PSBR with the consequence that the council could not provide fiscal recommendations (OECD, 2012 and Coene and Langenus, 2011). It took two years to reach an agreement on the new membership of the PSBR. ~~These events resulted in a significant loss of influence for the HCF (Coene and Langenus, 2011).~~

C. Functions

The general broad mandate of the HCF is to advise the Minister of Finance and the Minister of Budget on developments in fiscal, financial, and budgetary policy. The HCF produces normative recommendations on the government's fiscal policy (Hagemann, 2010). The remit of the HCF extends explicitly to the regions and is designed to provide whole-of-government oversight and monitoring. As part of the 1989 reform, new tasks were assigned to the HCF including monitoring the fiscal policy of the regional governments, formulating medium-term financial objectives for the federated entities, and assessing the convergence with the Maastricht criteria for joining the Euro. Post-euro entry, the HCF monitors compliance with the stability program. The HCF does not produce macroeconomic forecasts. This is the role of the FPB, nor does it costs policy proposals or election platforms of political parties.

The analytical reports prepared by the Council's secretariat are the central instruments for indirect intervention into the budget process. The PSBR section produces two main reports a year. It assesses ex-ante and ex-post compliance with the Euro stability program and medium-term budgetary targets for the general government and the different subsectors, as well as providing explanations on why some targets were not met. In addition, its annual report evaluates the medium to long-term budget outlook and recommends the budget targets for the general government and its subsectors and individual federal entities. As part of its remit, the HCF provides annual advice and recommendations on the borrowing requirements of the regions. If necessary, the HCF can recommend limiting the borrowing capacity of any of the regions. Based on the HCF advice, regions borrowing can be limited for up to two years by royal decree. In practice, this power has never been used by the HCF, partly because using it would give rise to political tensions with the regions (Coene and Langenus, 2011). The study group on ageing produces long-term projections on the budgetary effects of ageing that covers a 50-year period.

D. Analysis and Impact

The performance of the Council can be broken down into two periods: pre and post-euro adoption, with the HCF having greater influence in the pre-euro period and declining influence after Euro adoption (Coene 2010). In the pre-euro adoption period, the Maastricht convergence criteria led to a good alignment of the Council's and policymakers' objectives and the Council's recommendations were largely followed. During that period, the structural primary surplus increased by 5 percent of GDP, public debt started falling and the budget moved towards balance. After euro adoption, the influence of convergence criteria on fiscal policy and discipline declined, and the appeal of the Council's recommendations eroded (Hagemann, 2010). The primary balance deteriorated sharply, as most of the savings on debt interest payments were used to fund tax cuts and expenditure growth (Coene and Langenus, 2011).

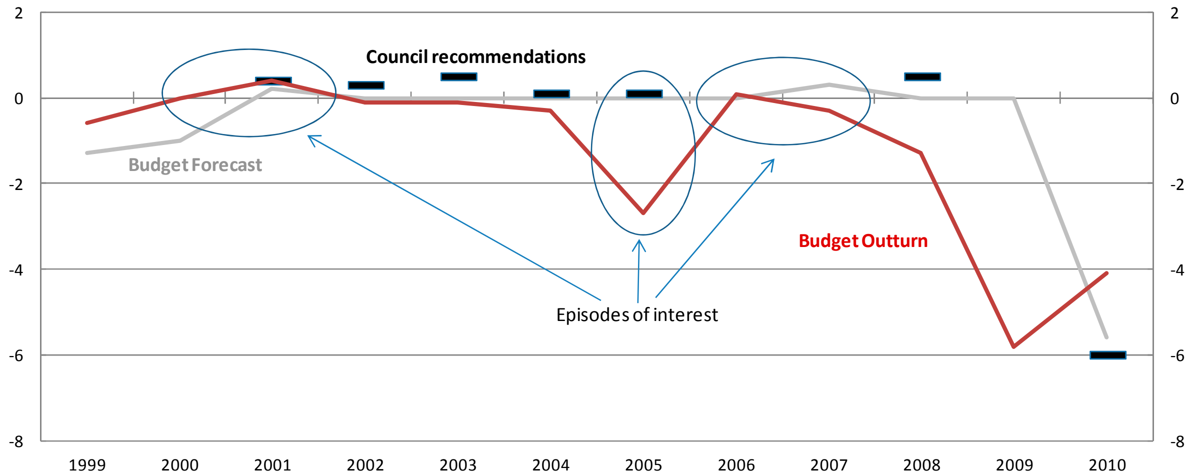
In the period after the adoption of the Euro, when there were deviations from fiscal objectives and targets, the role of the HCF was to raise the alarm. Figure 1 shows the Council's recommendations for the fiscal balance and are displayed in black for each budget year, the budget forecast in gray, and the actual outturn in red. A number of interesting episodes stand out:

- The first is the two years that follow the adoption of the euro in 1999, when outcomes were broadly in line with the Council's recommendations (Hagemann, 2010).
- The second episode is in 2004, when increasing divergences with the council's recommendations led to critical assessments of government policies.
- Finally, in 2005 and 2006, the Council could not produce reports or recommendations as the chair of the PSBR group was left vacant.

During periods when there are deviations from fiscal targets, the expectation is that the HCF would highlight this in their reports and in statements to the media. Since the influence of the HCF and many FCS is indirect, they depend on having a strong media presence to get their message across to the public and put pressure on politicians to act. Section E examines how effectively the HCF conveyed its message during key periods.

Figure 1. HCF Budget Balance Recommendations, Forecasts, and Outturns

(In percentage of GDP)



Sources: High Council of Finance and authors' calculations.

E. Media Coverage[2]

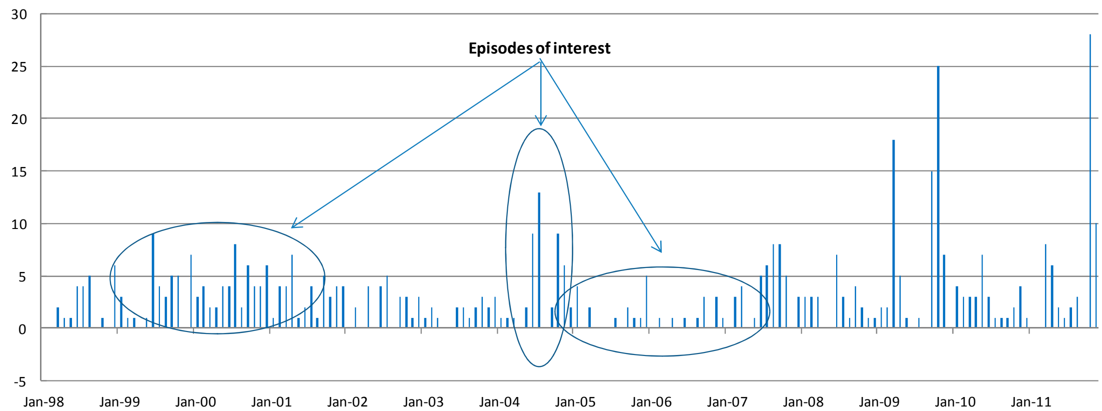
Having a significant media presence[3] at key times is important for the HCF to get its message out. In the initial period leading up to and during the euro adoption, there was strong and sustained press coverage of the Council's recommendations in the Belgian press. This tails off as the 2000s progress and the Council clearly begins losing its influence. In 2004, the Council became openly critical of government's policies,[4] leading to a surge in media reports. Finally, during the period when the Council had no formal chair of the PSBR group and stopped reporting, its media footprint diminished substantially, despite emerging discrepancies between plans and outcomes in 2006. Figure 2 maps these three episodes into a measure of press coverage of the HCF, and gives an insight into how the fiscal council tries to support its recommendations by getting public attention and it also shows the capability of the council to act.

[2] This section is drawn from Debrun ~~and others~~et al. 2012.

[3] Media activity is measured by the number of unique newspaper articles containing a combination of the name of the fiscal council and various key words (in the relevant language~~various languages~~), such as budget, public debt or fiscal deficit. Information on ~~,~~the number of media articles has been obtained from the Factiva database~~sourced from Factiva~~. The same methodology is applied to all case studies.

[4] The large deficit in 2005 was almost entirely due to a one-off debt assumption, related to the restructuring of the national railway company, which was attributed after the event.

Figure 2. Press Coverage of the HCF
(Number of press articles relative to 4-year rolling-average)



Sources: Factiva and authors' calculations

The HCF raised the tone of its statements gradually in response to continuing deficit bias and lower than expected budget outturn. In the early 2000s, when public finances were on track, press articles were relatively benign and the HCF reports noted with a fairly neutral tone minor deviations with respect to recommendations. For instance, the October 1999 reports observes that "The deficit of the central government for 2000 is projected at 1 percent of GDP, which is 0.2 percent higher than recommended by the HCF." The tone of HCF reports changed drastically in 2004. In July of that year, the Council launched a stern warning in these terms: "The High Council considers these fiscal scenarios unrealistic in the medium-term" and "The High Council wants to point out that the deteriorating fiscal position is [not only] due to cyclical factors but also—and mainly—due to discretionary measures such as lowering taxes and a major growth in government spending." Of course, there is no report to quote for the last episode.

In sum, the HCF did raise the alarm but not strongly enough initially. When it did become more openly critical and issued strong normative statements against government policy, the media listened as did the government. ~~The reaction was to curtail the influence of the council by leaving the Chair of the PSBR group vacant~~The subsequent two-year vacancies in the PSBR group resulted in no recommendations being given (Debrun et ~~and others~~al., 2012). This action was possible because of the limited operational independence of the HCF, and it was successful in limiting its operational capacity and diminishing its media presence for two years.

F. Conclusions

Over the last two decades, the HCF's influence on fiscal policy has fluctuated. In theory, a split of responsibilities between independent institutions, in the case of Belgium between the HCF and the FPB, allows for greater technical specialization and helps minimizing political pressure on each of the institutions (Bogaert et al., 2006). Nevertheless, the independence of the HCF has been questioned by some commentators (Kirchgässner, 2011) because it lacks legal and operational independence and has limited autonomy over its resources and staff and is chaired by the Minister of Finance.

In the pre-euro period, limitations on the HCF's legal and operational independence did not impede the council's influence. There was consensus on the objectives of fiscal policy and an alignment of the council's and government's goals. By the early to mid 2000s, post Euro adoption there was no longer a consensus and the goals and interests of the council, and the government, deviated.

After the adoption of the Euro, when a consensus no longer existed, the limitations on the council's independence strongly affected its influence and its capacity to operate. When the council raised the alarm about the government fiscal policies, initially no one listened, until it sharply criticized the government. This was followed by the government's two-year delay in appointing the new chair of the key PSBR group, which resulted in the near suspension of councils operations for two years.

Although the government's receptiveness to, and the public's interest in, the council's message changed throughout pre and post-euro periods the HCF continues to have a good reputation for independent high quality analysis. This reputation combined with the council's long history and established institutional position has contributed to its capacity to reinvigorate itself. In the late 2000s, the council played a key role in setting targets for the government's consolidation plan and it continues to play an important role in the budgetary process by setting budgetary targets.

CANADA – PARLIAMENTARY BUDGET OFFICER (PBO)—THE CRITICAL EARLY YEARS BUILDING CREDIBILITY AND WALKING THE INDEPENDENCE TIGHT ROPE

A. Political and Economic Context

In 2006, the Canadian Conservative party came to power with a broad reform agenda promising to ~~the~~ strengthen government accountability, transparency, and ethics. The creation of a Parliamentary Budget Officer (PBO) was part of this agenda and one of the provisions in the wide ranging 2006 Federal Accountability Act (FAA). The motivation for creating the PBO was twofold: first to provide parliamentarians with technical expertise and independent information to improve their capacity to hold the executive to account, and second to provide an objective assessment of the Department of Finance's fiscal and economic forecasts and to help improve their accuracy. The government's economic, and especially fiscal forecasts, have been criticized for consistency underestimating the deficits in the 1980s and early 1990s and for persistently underestimating surpluses from the mid-1990s to the late 2000s (Ernst & Young, 1994 and O'Neill, 2005). At the time of the creation of the PBO, concerns persisted about the credibility of the government's forecasts.

The establishment of a PBO to provide objective analysis to Members of Parliament and parliamentary committees on the state of the nation's finances received all party support in Parliament. After some delay, the first PBO Kevin Page, a senior civil servant with 30 years of experience, was appointed in March 2008.

B. Institutional Set-up

The PBO began operations in 2008 based on a provision in the Federal Accountability Act (FedAA) and subsequent amendments to the Parliament of Canada Act. The PBO is an officer of the Library of Parliament and holds office for a once renewable 5-year term (Hagemann, 2010). The selection process for the PBO is conducted by the Parliamentary Librarian and the official appointed is made by the Governor in Council based on the advice of the Prime Minister. In practice, this means the PBO is appointed and serves "at the pleasure of" the Prime Minister[5] (OECD, 2012).

[5] Comment of Bruce Campbell, April 29, 2013, http://www.policyalternatives.ca/publications/commentary/fulfilling-promise-parliamentary-budget-office-bill-c-476

The PBO has full responsibility for hiring his/her staff and their employment conditions are similar to those of the Library of Parliament staff. The council has a staff of around 15 full-time equivalents and is divided into two divisions. The Economic and Fiscal Analysis Division is responsible for analysis of economic trends and public finances. The Revenue and Expenditure Analysis Division is responsible for costing proposals and budgetary estimates. In addition, the PBO hires outside consultants. The PBO's budget is part of the Library of Parliament's budget. It does not have a separate line in the budget of Parliament.

From the outset, there has been issues surrounding the basic legal and operational design of the PBO especially concerning its location, budget, and mandate. (OECD, 2012 and Brooke, 2010). During its first five years, lack of clarity on these fundamental design issues has resulted in tensions which the PBO argued threatened his office's operational independence. The decision to locate the office in the Library of Parliament has given rise to a number of issues. As an officer of the Library of Parliament, the PBO has "fewer teeth" than Officers of Parliament, like the Auditor General who is independent from the government of the day and reports directly to Parliament (OECD 2012). Initial issues centered on who the PBO should report to and who had the power to decide its mandate–the Parliamentary Librarian or the speakers of the House (Brooke, 2010). The PBO and the Parliamentary Librarian both sought outside legal opinions. The PBO argued, and in practice operates, such that he is administratively accountable to the Parliamentary Librarian but reports to the speakers of both Houses.

Further tensions arouse over the publication of reports. The Library of Parliament provides confidential services to members of Parliament (MPs). This contrasts with the PBOs approach of publishing all reports and correspondence and actively promoting its analysis through the media. The Parliamentary Librarian criticized the PBO for publishing its first report, *the Fiscal Impacts of the Canadian Mission in Afghanistan* (PBO 2008) during an election campaign[6] (Brooke, 2010). He claimed this brought the library into disrepute. The report's analysis, which showed the cost of the war to be significantly higher than the government's estimated, proved controversial.

Some commentators and the PBO argued that this report, and other criticism of the government, resulted in an early attempt to reduce the budget and operational independence of the office (OECD, 2012 and Brooke 2010). The PBO had been promised a 2009 budget of 2.8 million for its second year of operation. Subsequently, however, the PBO was informed that the second year budget would remain at the start up provision of 1.9 million. After complaints by the PBO, MPs, letters from leading academics and economists, and a report by the Joint Committee on the Parliamentary library, the full budget was resorted to the PBO, although only in 2010.[7]

[6] See http://www.parl.gc.ca/content/hoc/Committee/402/BILI/Reports/RP3993042/bilirp03/bilirp03-e.pdf

[7] See http://www.parl.gc.ca/HousePublications/Publication.aspx?DocId=3993042&Mode=1&Parl=40&Ses=2&File=18&Language=E

In 2012, the PBO in its alternative economic forecasts warned of a slower growth rate 1.9 percent compared to the official projected growth rate of 2.2 percent in 2012.[12] Although the PBO was criticized at the time, the actual 2012 GDP rate was 1.8 percent. In addition, the PBO's fiscal sustainability report highlighted the impact of the ageing population on the workforce and potential GDP growth. In these instances, the PBO highlighted these issues and its concerns via press conferences and appearances before Parliamentary committees, and although action was not immediately taken by the government, it did promote public awareness and discussion in the media on issues like the structural balance, the predicate growth rate, and the impacts of ageing on economic growth.

A key reason for establishing the PBO was to improve the accuracy of the government's forecasts. IMF research confirms that since the mid-1990s, the Canadian government's budget projections for macroeconomic and fiscal aggregates have been more cautious than in any other G7 country (Muhleisen and others, 2005). The Department of Finance had two independent reviews of its forecasting[13] and introduced changes including using economic projections in the budget which are based on consensus of private sector forecasts. From the experiences of the 1990s economic crisis, ~~there emerged a~~ political and public consensus emerged on the need for sound public finances and avoiding deficits. The 2005 O'Neil review attributed the surpluses to the mid 1990s and 2000s to explicit prudency assumptions built into the forecasts to ensure that the government achieved its no-deficit policy. Despite this, the report acknowledged concerns that the underestimation of surpluses for nearly ten years could distort the budgetary decision making processes. The opposition argued that the government used this as a means to avoid discussions on policy priorities and to allocate funds for political purposes.

Unlike most fiscal councils, which encourage the government to produce more cautious forecasts, in case of Canada, the FC's role is to reduce a pessimistic bias. Currently, macroeconomic forecasts are obtained from a panel of private sector forecasters. There is, however, little direct involvement of outside agencies in preparing revenue and expenditure forecasts. Fiscal forecasts contain an explicit prudence factor.

The government's estimates in all three areas, revenues, expenditure and balance, have become more accurate and less pessimistic since the creation of the PBO. Table 1 compares the government's forecasting errors from before and after the creation of the PBO in 2008, for revenue, expenditure, and balance, Figure 3 shows the forecasting errors over a ten-year period.

[12] PBO Economic and Fiscal Outlook Ottawa, Canada April 24, 2012

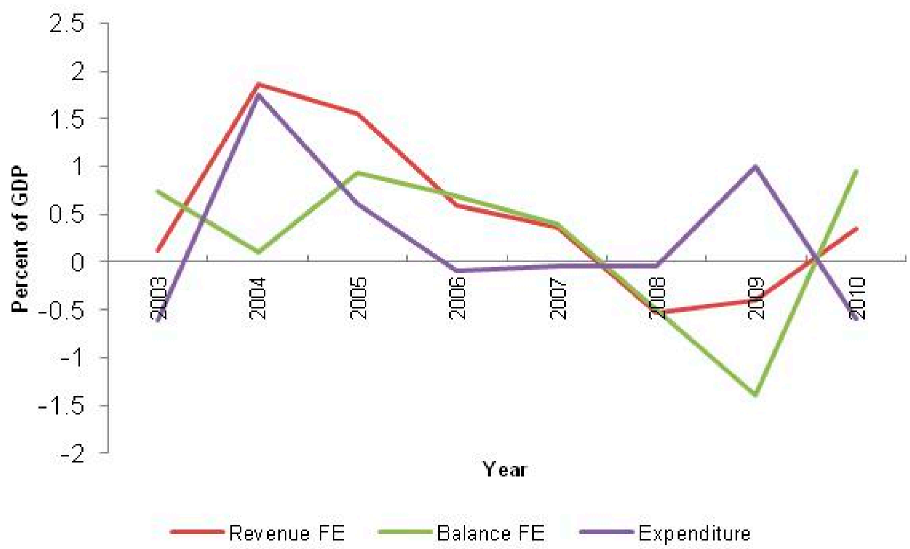
[13] Ernst & Young (1994) Review of the forecasting Accuracy and Methods of the Department of Finance and Tim O'Neill (2005) Review of Canadian Federal Fiscal Processes and Systems.

Table 1. The Government's Average Forecasting Error Before and After PBO

Expenditure	
Average Fiscal Error Before the PBO	0.3
Average Fiscal Error After the PBO	0.2
Revenue	
Average Fiscal Error Before the PBO	0.7
Average Fiscal Error After the PBO	0.0
Balance	
Average Fiscal Error Before the PBO	0.4
Average Fiscal Error After the PBO	-0.2

Sources: Canadian budget, PBO and staff calculations.

Figure 3. Forecast Errors on Government Forecasts 2003–2010



Sources: Canadian budget, PBO and staff calculations.

In general the fiscal forecast of the government and the PBO are close. Table 2 compares the PBOs forecasting errors with that of the government again in expenditure, revenue, and balance. These results need to be interpreted with caution given that the PBO has been in existence for a short period and only three years of data is available which is from the period of the great recession. Given this, it is difficult to reach any firm conclusions about the impact of the PBO on the government's forecasts. However, it can be argued that PBO's generating forecasts has created competition for the government's fiscal forecasts and created incentives to examine methodological approaches.

F. Conclusions

The PBO has earned a reputation for good quality independent analysis for its research, costings, and forecasting work. The strategy of being front and center on the fiscal policy issues of today combined with transparent reporting and an active media approach has proven successful in raising the media profile and the influence of the council. It has, however, also placed the council at the center of many high profile disputes with the governments resulting in the PBO turning to the courts for clarification on issues related to its institutional set up and independence.

Having a Parliamentary Budget Officer as opposed to a council with several members, has the advantage of having a clear head and a single public face for the council. This emphasis on the individual, however, may have the disadvantage that the council can become associated with one person and when that individual leaves the influence of the council is impacted. The first transition period will have a strong influence on how the PBO stands the test of time. The outgoing PBO warned that for the PBO to maintain its independence, changes are needed in the institutional set-up including Parliament appointing the PBO and making it an independent office of Parliament, like the auditor general.[17] The new PBO will face a number of challenges as uncertainties remain about the mandate, the role, and the future of the body.

[17] In June 2013 a Private Member's bill which proposed this change was defeated in Parliament.

HUNGARY – WATCHDOGS NEED TIME TO BECOME ESTABLISHED AND BUILD CREDIBILITY

A. Political and Economic Context

During the 2007 Hungarian elections, improving public finances and fiscal policy were high on the political agenda. The country faced a deteriorating debt situation, sharply declining investor confidence, and a large deficit peaking at 10 percent of GDP in 2006 the highest among EU countries. In November 2008, the then government enacted a Fiscal Responsibility Law, which included a fiscal council as part of a wider reform package establishing a rules-based fiscal policy framework and fiscal transparency standards.

The law established the fiscal council, as a collective body with its own technical staff (Office of the Fiscal Council). At the time, two very different potential models for the council were discussed: the Swedish Fiscal Policy Council model—small with limited resources and functions—and the U.S. CBO model—large with significant resources and remit covering nearly all FCs functions. In the end the Fiscal Council was closer to the CBO model in terms of its remit and functions.

Although the new law contained a number of compromises, it failed to gain the support of the main opposition party. When the opposition came to power the Fiscal Council was not abolished, but its framework and working conditions were significantly revised~~ resulting in a dramatic curtailing of its activities~~.

B. Institutional Set-up and Functions: The Two Periods

Council 2009–2010

The Council's original design established it as a body consisting of three non-partisan members independent from the government and political parties. The three members were nominated by the President of the Republic, the Governor of the National Bank of Hungary, and the President of the State Audit Office. Following hearings in the Budget and Finance Committee, the members had to be elected by a simple majority in Parliament for a 9-year period on a non-renewable basis. The Council had an office of the fiscal council with over 30 economists, mainly public servants headed by the Chair of the council. The council reported to the parliament.

The fiscal council's mandate was to help restore the sustainability of fiscal policy and to promote fiscal transparency. The remit of the council was broad ranging from macro-fiscal baseline scenarios and independent fiscal impact assessment of bills, to providing methodological guidelines and making proposals to enhance sustainability and transparency. As part of this remit it costed all significant tax and expenditure proposals (Hagemann, 2010). The assessment of budget bills and mandatory laws was obligatory, while assessment of other financial acts was optional. Macroeconomic forecasts and projections included the baseline for the annual budget and a 5-year baseline. ~~In addition, the council provided a sustainability report looking at finances 50 years ahead.~~ The fiscal council monitored compliance with Hungary's fiscal rules (including the pay-as-you- go rule and the debt limit requirement). On balance, the council was able to carry out its mandate, although it only existed in this form for a short period (Kopits and Romhanyi, 2010).

Council 2011

The Council had not even been in operation for two years before the newly elected government suggested significant revisions to its legal framework. This followed a period of tension between the government and the council. The council criticized the government's medium-term budgetary plan in the 2011 budget bill and other aspects of government's economic policy including temporary, industry-specific taxes, and the diversion of private-pension contributions to the state. Following these criticisms, several commentators have argued the government sought to curtail the voice and influence of the council (Hemming and Joyce 2013), although the official argument for the proposed changes to the council's legal and institutional framework was budgetary saving.

This process resulted in a reform at the end of 2010 which was part of a broader political reform agenda in Hungary. The council was replaced by a new significantly reduced and much more compliant model (Hemming and Joyce 2013)~~)~~. It is composed of three members: a chairman of the council, appointed by the President of the Republic, who serves for six years ~~on a non-remunerated part-time basis~~, the governor of the central bank, and the head of the state audit office, both of them ex officio. In addition, a major cut in funding took place which reduced the council's staff from ~~over 30 to 3~~ to around 3. Nevertheless, both the central bank and the State Audit Office prepare background documents and analysis for the Fiscal Council.

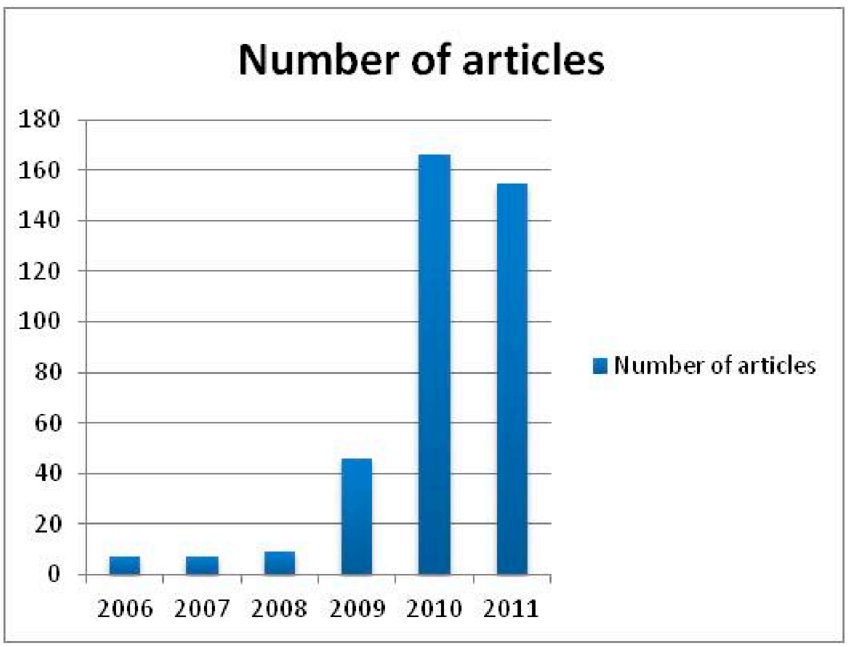
Its mandate was restricted to assessing the state budget and its execution, developments in government debt, and supporting Parliament's legislative activities. It excludes all other legislative proposals, macro-fiscal forecasting, costing of legislative proposals or commenting on fiscal transparency and sustainability. On the other hand, the council was given the right to make a recommendation to Parliament on whether to pass or reject the budget bill, thus giving it the power to veto budget laws. This opens the possibility that the President could dissolve Parliament if it fails to pass a budget by the end of March, if two out of three members consistently reject the budget bill (Kopits, 2011). This power is very extensive although it cannot be properly exercised with a staff of only three people. It has not been used and most commentators think this nuclear option will never be used (Kopits, 2011).

C. Media Coverage

In its mission statement, the council in the period 2009-2010 underlines its emphasis on informing the public: *"The Fiscal Council, created by an act of parliament, is an independent state institution that endeavors to ensure the responsible management of public resources. To this effect, it prepares assessments of the budgetary consequences of government and parliamentary decisions. These assessments and supporting information are made widely available to the public on a timely basis."*

The council sought to make active use of the media to get its message across. Given its short period of existence, it is not possible to conduct an in-depth analysis of its impact. Nevertheless, Figure 5 shows the number of newspaper articles which mentioned the council and its work from 2006–2011. There is some media interest in the establishment phase which increases when the council is operational in 2009 and 2010. In late 2010 and 2011, a major part of the media reports related to the reform of the council itself.

Figure 5. Press Coverage of the Fiscal Council



Source: Factiva

Despite widespread protests in the international and domestic press and in professional and academic circles, as well as adverse reaction in the financial markets, the reform and budget cuts to the council went ahead. The reform of the council's framework and the incidents leading to the reform also gained attention in the international press. The Wall Street Journal [22nd November 2010], for example, reported: *"The bill foresees the dissolution of the Fiscal Council, Hungary's main instrument for the control of public finances, which means that not only its three members but also all 40 members of staff would be dismissed. In its place, a new committee compromising the heads of the*

*National Audit Office and the Central Bank as well as an economist appointed by the president is to be created."(*http://blogs.wsj.com/emergingeurope/2010/11/22/hungary-to-disband-fiscal-council*)*.

D. Conclusions

When the council was established in 2009, it had a broad remit and was well equipped and resourced to undertake its tasks. T~~In its short life t~~he legitimacy it gained~~,~~ however, especially internationally, was not sufficient to protect it. The replacement council with its much more restricted remit and much narrower resource base is ~~arguably~~ weakened (Hemming and Joyce, 2013). ~~to the point that many commentators question if it should still be considered as a genuine fiscal council.~~

Hungary's experience points to a fiscal council that failed to "launch", as its independence and effectiveness was significantly curtailed before it had an opportunity to impact policies. This episode highlights the tightrope that new councils must walk between performing their watchdog function, which often entails criticizing the government, and protecting itself from the challenges this criticism can generate to its independence.

Maintaining independence is more difficult in highly polarized political landscapes where the council's messages can more easily be cast as partisan by one side. It is crucial for councils to build up institutional credibility and trust. This is a long-term process and it "cannot be taken for granted that the role and attributes of the new institution will be readily understood, its non-partisanship trusted, or its beneficial effects recognized without proof." (Kopits, 2011).

KOREA – NATIONAL ASSEMBLY BUDGET OFFICE (NABO)—AN IMPORTANT PLAYER IN THE DEMOCRATIC SYSTEM

A. Political and Economic Context

In 2003, the Korean National Assembly Budget Office (NABO) was formally established as an independent office to provide fiscal policy advice to Parliament. The creation of the NABO was driven by political rather than economic or fiscal factors and part of a broader democratic reform agenda. The NABO was established during the first period of divided government in Korea, when the President did not have a majority in legislature. The NABO was created to provide the legislature with independent information and expertise on fiscal and budgetary issues to match that of the executive and to have the capacity to scrutinize the President's draft budgets. This initiative gained broad cross-party consensus. When the NABO was established, Korea already had stable public finances for sometime, general gross debt was 13.8 percent of GDP in 1990 and only increased to 18.56 percent in 2002.

B. Institutional Set-up

The duties and organizational arrangements for NABO are laid out in the National Assembly Budget Office Act. The NABO is exclusively an organ for the National Assembly. Its Director is appointed by the Speaker of the National Assembly based on recommendations of the Recommendation Committee "that is composed of persons who have expertise concerning NABO's duties, maintain political neutrality and make fair recommendations (NABO Act). The Director is not appointed for a fixed term and serves at the discretion of the Speaker (the impact of this rule is further discussed in the conclusions). The Director can be dismissed by the speaker with approval of the House Steering Committee. A panel of outside advisors comprised of a chairperson and fourteen members who are experts in public finance and economics from universities, research institutes, government offices or the media, advise the Director of NABO on its duties or functions (OECD 2012).

The council is well equipped with resources, and had 125 members of staff in 2011. The budget of NABO is part of the overall budget of the National Assembly, however, it has a separate line in that budget. The council is committed to the four principles: independence, non-partisanship, expertise, and credibility. Its stated goal is "to work towards becoming the global-standard and the No.1 organization in budget analysis and policy evaluation."[18] NABO is audited annually by the Board of Audit and Inspection (OECD 2012).

C. Functions

The United States Congressional Budget Office (CBO) served as the model for the NABO, thus it has a broad remit for providing support to the national assembly. Its mission is "to support legislative activities through analysis and evaluation of national finances and policies." It performs all the main functions of a FC including monitoring and reviewing the government's fiscal policy, developing alternative forecasts, and also costing of proposals and programs. The NABO provides objective, nonpartisan analysis of the annual budget drafts and evaluates general fiscal policies and national programs. The NABO's remit also covers economic and revenue forecasts and general research. Due to the requirement for the government to develop medium and long-term financial plans, the council extended its baseline fiscal projections, and also now conducts analyses of long-term structural issues including pensions and has begun to develop long term projections (Hemming/Joyce, 2013). The council sends its reports to parliamentary committees and its members (Hagemann, 2010).

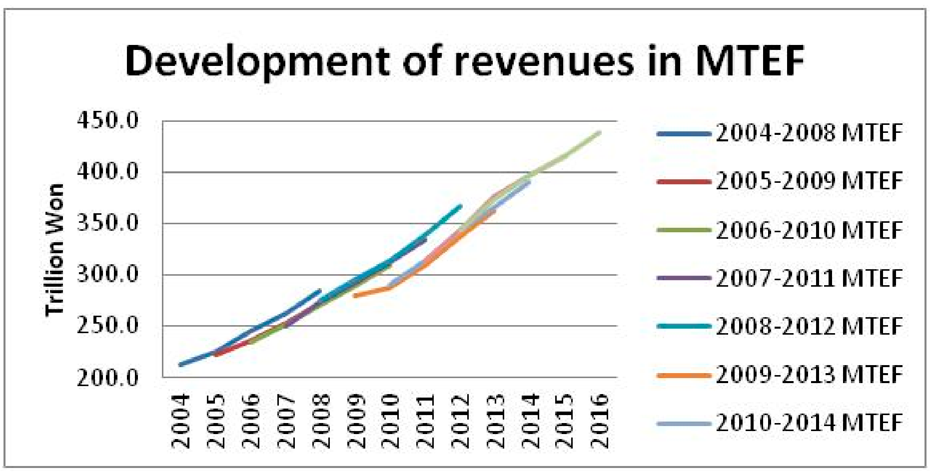
A unique mandate of the Korean council is evaluation. The NABO evaluates and reviews a diverse range of projects, programs and policy initiatives. These include infrastructure projects government services, extra-budgetary funds, and the work of autonomous public institutions. These evaluations often contain recommendations for improving operational efficiency and effectiveness. In Korea, there is also an independent state audit institution, known as Board of Audit and Inspection (BAI) under the executive which focuses on financial audits of government programs. Since the NABO focuses on performance and efficiency issues and the BAI concentrates on financial audits, there is a clear division of labor between them and they do not typically co-operate on their work (OECD, 2012).

[18] http://korea.nabo.go.kr/eng/01_about/mission.page

D. Analysis and Impact

Korea's public finances were sound when the fiscal council was created and continued to be so during its first years of operation. In 2004, Public debt was 26.2 percent of, the budget showed a small surplus, and expenditure amounted to 24 percent of GDP. ~~With a~~An increase in ~~expansion in the size of~~ government expenditures ~~increased~~ to 25.8 percent of GDP ~~in~~ by 2008, however, this was matched by a similar increase in revenues (Figure 6), resulting in a balanced budget for most of the period. In 2009, the Korean government reacted to the crisis with a large fiscal stimulus, which resulted in a sharp increase in expenditure, to 28.4 percent of GPD and a fiscal deficit. In light of the weakening fiscal position and to keep the expenditure growth at a sustainable level, the government aims to reduce discretionary spending from 13.7 percent of GDP in 2011 to 12 percent of GDP by 2015.

Figure 6. Development of Revenues in the MTEF



Source: Korean Ministry of Finance

Over this period of changing economic and fiscal performance, there are three areas of interest particularly in relation to increases in expenditure which a fiscal council could be expected to highlight as part of its watchdog role to legislature and the public (incidents discussed in more detail below):

- In 2006, the Medium Term Expenditure Framework had to be revised upwards for all years when an increase of expenditure as percentage of GDP was evident.
- In 2009, expenditure to GDP climbed to 28.4 percent and increased by more than 2.5 percent over a short time period.

THE NETHERLANDS – BUREAU FOR ECONOMIC POLICY ANALYSIS (CPB)—AN ESTABLISHED INTEGRATED INSTITUTION WITH A STRONG REPUTATION

A. Political and Economic Context

The Netherlands Bureau for Economic Policy Analysis (CPB) is a veteran among fiscal councils. It was established in 1945 just after the World War II as a new planning agency to provide the government with economic plans and analysis. Jan Tinbergen, a renowned economist and winner of the Nobel Prize in 1969, was appointed the first director of the council. He strongly influenced the council's evolution and helped establish its reputation for high quality independent analysis. The CPB has been preparing economic forecasts since the 1950s, publishing reports on the state of Dutch public finances since the 1960s, undertaking election platform costing since the 1980s, and preparing long-term scenario analyses since the 1990s. The CPB also has a number of other roles, including costing of ministries programs and policy proposals, cost-benefit analysis, and a broad research agenda.

B. Institutional Set-up

The CPB is formally a branch of the civil service within the Ministry of Economic Affairs (MEA) and funded from the MEA's budget. Although the CPB is mainly government funded, up to twenty percent of its annual budget may come from external assignments, this gives a small degree of financial independence. Its director is appointed for a period of seven years by the Minister, in consultation with other members of the government. There is an informal agreement between the main political parties that the director will be a well-respected economist and non-partisan. Despite its general financial dependency on the MEA and its lack of independent legal status, the CPB has established itself as fully independent in its operations and in its analysis and research. It establishes its own work agenda. Several elements contribute to the independence of the CPB (Hagemann 2010), including a supervisory committee, whose members are appointed by the cabinet for a 5 year term. In addition, there are 5 yearly independent evaluations of the CPB (usually by academics, many of whom are not Dutch nationals).

C. Functions

The CPB has a broad mandate covering the main functions of fiscal councils. It prepares the forecasts used in the budget, undertakes costing of programs and electoral proposals of political parties, and conducts various analyses and reviews of fiscal policy.

In its reviews, the CPB comments on whether expenditure ceilings and revenue targets set in the coalition agreement are being met and informs the government and the parliament. Like most FCs with a "watchdog" role, the "CPB cannot bite" (Debrun et al., 2012): it has no explicit mandate or instrument to directly influence fiscal policy. Also, it does not provide strictly normative assessments, not even against the government's own commitments and objectives.

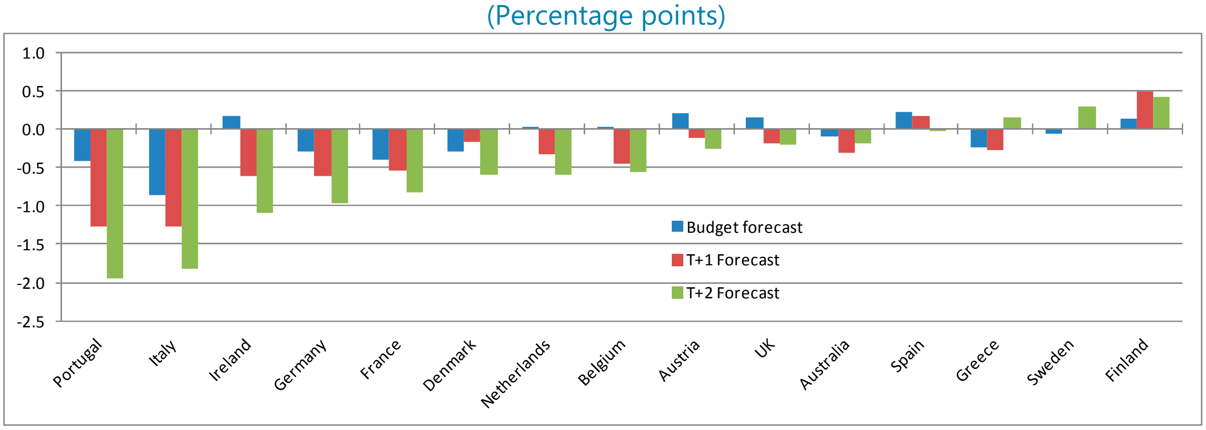
In fulfilling its specific functions, the CPB is fully integrated into the budget process according to a specific schedule. It provides the macroeconomic forecasts used for the budget. Those forecasts are produced behind closed doors, and discussed with the government (initially with the Ministry of Finance, and later with the cabinet) prior to being released. While this means that the budget relies on independent forecasts, private discussions with the cabinet give an opportunity to the latter to put pressure on the CPB (Bos and Teulings, 2011). The CPB provides public information regarding the evolution of the fiscal outlook during the year. The updates in March and September are more extensive than those provided in June and December.

In addition, the CPB has an extensive costing role. It receives requests from government ministries to estimate the cost and/or the economic impact of new policy initiatives. It also provides cost-benefit analysis of major infrastructure projects. Through its costing of electoral platforms during elections and coalition agreements after the election, CPB has arguably improved the quality of public information and influenced the debate around elections. Its costing work is encouraging parties to tighten up their commitments in advance ~~(in order for costing to be undertaken)~~ and to avoid making commitments to unaffordable policies (see Bos and Teulings, 2011).

D. Analysis and Impact[25]

Overall, the Council's institutional attributes combined with a long history of producing well regarded analysis and forecasting have given it a considerable degree of public credibility. While the CPB's specific contribution is difficult to isolate, the Netherlands' fiscal performance over the past 15 years has been relatively sound. In particular, there has been no apparent bias in macroeconomic forecasts and ex-post compliance with ex-ante targets has been largely satisfactory. The average forecast errors for the budget year have been, if anything, pessimistic and while they appear slightly optimistic over the out-years, they remain well within the standard deviation of GDP growth in the sample shown below in Figure 8. This is consistent with earlier results from Jonung and Larch (2006) showing that independent forecasting helps to prevent an optimistic bias in GDP forecasts.

Figure 8. Real GDP Forecast Errors (Actual minus Forecast): 2000–2008
(Percentage points)



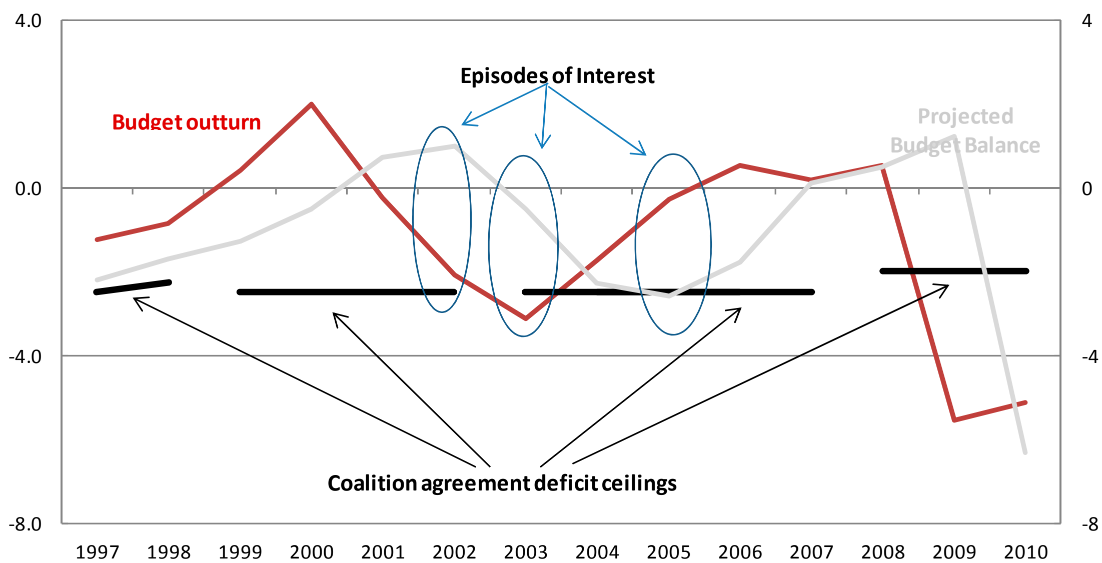
Sources: European Commission (SCPs) and authors' calculations.

Coalition agreements reached at the beginning of each parliamentary term include ex-ante fiscal targets which are set for the political cycle. These agreements specify, among other things, a deficit ceiling for the remainder of the term. The expectation is that the CPB will raise the alarm and inform the Parliament and the public if these targets are in danger of being missed.

[25]Section D and E based on Debrun et al. 2012.

~~Table 2~~Figure 9 **highlights three episodes of interest when it would be expected that the CPB would raise the alarm.** These episodes are characterized as follows: (1) either the budget forecast or fiscal outturn is exceeding the deficit ceiling, or (2) the fiscal outturn is significantly worse than the budget forecast. The government's deficit ceiling is highlighted in the bold black lines in Figure 9. This Figure also displays yearly forecasts for the budget balance (light grey lines), and the final budget outcome (red line).

Figure 9. The Netherlands: Fiscal Targets, Forecasts and Outcomes



Sources: CPB and authors' calculations.

The first episode was in 2002, when the fiscal outturn came out significantly worse than the budget forecast, and was in fact approaching the deficit ceiling set in the coalition agreement. The second episode occurred in 2003, when the outturn was again significantly worse than forecasted, but this time actually breached the deficit ceiling. The third and final episode was in 2005, when the budget forecast exceeded the ceiling, even though the outturn ended up comfortably inside the ceiling. The events related to the financial crisis are excluded, because they represented a more significant exogenous shock with less control available to policy makers.

Using the number of articles which appeared in the printed press which mention the CPB on a monthly basis, Figure 10 examines whether the CPB successfully raised the alarm in this three instances. It shows the events in relation to the media presence of the CPB calculated as the number of newspaper articles containing a reference to the CPB. The columns highlighted in red refers to the months were the CPB releases its public forecasts and fiscal assessments. Some of the spikes observed in the series refer to election periods, when the CPB features heavily in the news.

UNITED STATES – CONGRESSIONAL BUDGET OFFICE (CBO)—THE ROLE MODEL FOR NOVICE COUNCILS

A. Political and Economic Context

The Congressional Budget Office was created in 1974 during a period of heightened political tensions between Congress and President Richard Nixon over the budget. This dispute led to the enactment of the 1974 Congressional Budget and Impoundment Control Act. This act reasserted the Congress' role and authority in the budget process, which had previously been dominated by the Presidency. It instituted a formal process through which the Congress could develop, coordinate, and enforce its own budgetary priorities independently of the President. The House and Senate Budget Committees were established to oversee the execution of the budget process, and the Congressional Budget Office (CBO) was created to provide the budget committees and the Congress with objective and impartial information about budgetary and economic issues. The agency began operations in February 1975.

B. Institutional Set-up

The CBO is the largest fiscal council with a staff of around 250 in 2012. Its size enables it to fulfill its broad mandate professionally and to provide additional services to congressional members and committees beyond its legal requirements. The CBO is an agency of the legislative branch~~,~~. ~~thus~~ ~~I~~It is independent from the President and ~~also since it~~ does not report directly to any Congressional Committee ~~from the Congress~~ (Joyce 2011). CBO's funding is part of the budget of the legislative branch. The Director is appointed by the Speaker of the House of Representatives and the President pro-tempore of the Senate after considering recommendations from the House and the Senate Budget Committees. The Director is appointed for a four year fixed-term which is renewable. Although in theory, the Director should have no political affiliation, in practice, in the past some had a political affiliation prior to appointment however once in office they fulfilled their mandate in a nonpartisan manner (Joyce, 2011). All CBO employees are appointed on the basis of professional competency, without regard to political affiliation, and serve at the pleasure of the Director. The agency has a large number of staff with PhDs in economics.

The agency operates in a strictly nonpartisan manner and has built a strong reputation for producing good quality objective and impartial analysis. This is evident from its reports and the hundreds of cost estimates that its economists and policy analysts produce each year. CBO does not make normative statements or policy recommendations (Hagemann, 2010). Each report and cost estimate discloses the agency's assumptions and methodologies in order to emphasize its independence and non-partisan status.

C. Functions

The CBO has a broad remit that covers nearly all FCs functions. It produces alternative forecasts and reviews the government's forecasts; it conducts independent analysis, review, and monitoring of government's fiscal policies; and produces costings of the President's and Congresses legislative proposals. The CBO prepares baseline budget projections and economic forecasts (for a 10-year period) that are published in its economic and budget outlook. One of CBO's core functions is to present an alternative fiscal outlook to that given in the President's annual budget proposal. CBO's budget baselines help Congress develop its own budget resolution. In addition, the CBO prepares fiscal sustainability reports with projections that span from 25 up to 75 years into the future and estimates the economic impact of alternative long-term budget policies.

The CBO also prepares an analytical report examining different options for reducing budget deficits including reductions in spending and/or increasing revenues. Its reports are analytical and descriptive rather than normative. It provides information on the pros and cons of different approaches without providing recommendations. To help follow budget execution, the CBO also issues a monthly analysis of federal spending and revenue totals for the previous month, the current month, and the fiscal year to date. In addition, CBO prepares analytical reports that examine specific federal programs, aspects of the tax code, and budgetary and economic challenges covering policy fields like health care, education, taxes, energy, the environment, national security, infrastructure, and more. These reports evaluate options for changes without making recommendations.

The CBO has an extensive costing role. It provides costing for all appropriation bills before Congress, bills from congressional committees, and the short and medium costs of government programs and Presidential proposals. It also examines the projected cost of proposed legislative federal mandates on state and local governments and on the private sector. In addition, the CBO has a scorekeeping function; that is it scores the cost of individual and cumulative legislation considered by Congress against the budget baseline and when they existed against established fiscal rules. This function was especially important when the U.S. had a pay-as-go rule in place (Joyce 2011). Beside their formal, written estimates, the CBO "costs" a considerable number of preliminary, informal estimates when asked by congressional members or committees. All of CBO's products, apart from informal cost estimates developed privately for Members of Congress or their staffs, are available to the Congress and the public on the CBO's website.[27] Furthermore, the CBO is involved in research projects and technical working papers and tries to enhance transparency by presenting data and other technical information on its webpage.

[27] For more details on the tasks and products of the CBO: http://www.cbo.gov/about/our-products.

D. Analysis and Impact

There are a range of approaches taken in this case study to assess the effectiveness and impact of the CBO across its set of functions. The first is to examine if having alternative forecasts produced by CBO has helped to improve the executive's forecasts. This is done by looking for bias in the forecasts prepared by the President's Office of Management and Budget (OMB), both before and after the establishment of the CBO, and then comparing the CBOs forecasts against the OMB's in the period following its establishment. Second, is to examine how the CBO has fulfill its role as watchdog and if it has raised the alarmed when it should on proposed policies or actual results are significantly off track.

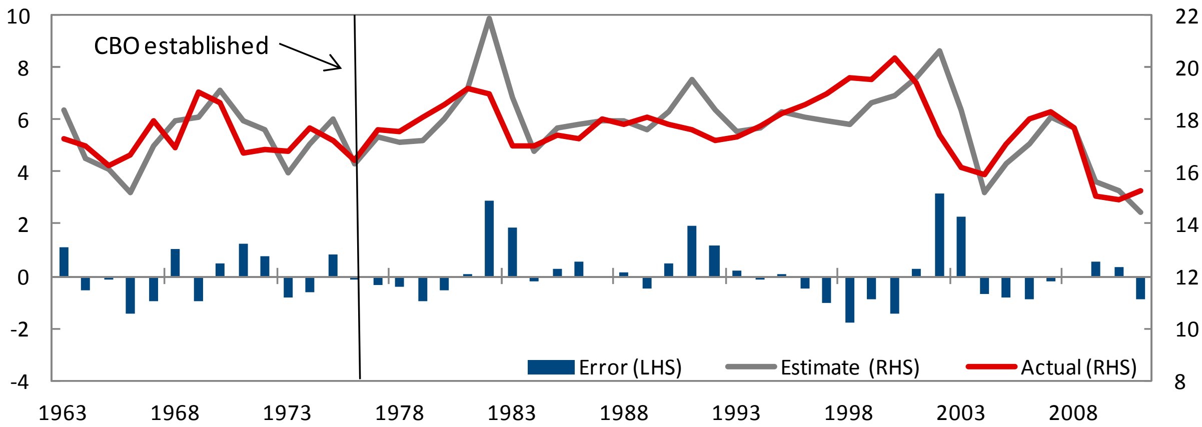
Forecast Accuracy

Fiscal Councils are expected to have a positive effect—in the medium-run—in improving governmental forecasts and avoiding biases in their estimates. While councils whose forecasts are the basis for governmental budgets can influence the bias directly, the CBO can only review and compare with its own forecast with those of OMB and therefore indirectly affect the accuracy of the administration's forecasts. There is a considerable literature looking into evidence of bias in the U.S. fiscal and macroeconomic forecasts with mixed findings such as Auerbach (1999) and McNab, Rider and Wall (2005). The findings depend on what measure is being assessed, over which period, and by what criterion. The administration's forecasts of tax revenue prior to the establishment of the CBO appear to be unbiased. Comparing the administration's tax revenue forecasts to actual outcomes shows that while there were considerable errors from year to year (averaging 0.8 percent of GDP), these errors cancelled each other out, resulting in an unbiased (e.g. zero average error) revenue estimates for the year ahead.

Following the establishment of the CBO, the administrations' forecasting record remained relatively good. While the average forecast error increased from 0 to positive 0.1 percent of GDP, indicating an optimistic bias, this is relatively low, both to that recorded in other economies, and to the standard deviation of revenues of 1.3 percent of GDP. Thus, there remains no evidence of bias in the administration's revenue forecasts over the period to 2003. Similarly, there was no change in the accuracy of the year-ahead forecasts, with the average absolute error remaining at 0.8 percent of GDP, although the post-CBO period was characterized by an increase in revenue volatility, which means that maintaining the same degree of forecast accuracy could be considered an improvement.

Overall, it does not appear that the introduction of the CBO had any noticeable impact on the bias or accuracy of the administration's revenue forecasts (see Figure 12). However, given that there was no bias in the first place, this is not particularly surprising. It is possible that the existence of the CBO's alternative forecasts prevented the continued use of deliberately over-optimistic revenue forecasts by the administration, such as the widely documented rosy-scenario forecasts of the early 1980s, which can be seen by the unusually optimistic revenue forecasts, both relative to history and actual outturns in 1981 and 1982. In this sense, by acting as a preventative agent, rather than a cure for a non-existent problem, the CBO can be considered to have had some success.

Figure 12. The U.S. Federal Receipts Forecast versus Actual
(Percent of GDP)



Sources: CBO

While the fiscal forecasts of CBO and OMB are undertaken on a different basis, with differing policy assumptions underlying them, meaning they are not directly comparable, the macroeconomic forecasts can be directly compared. The CBO regularly publishes an assessment of its forecasts compared to both the OMB and private sector (blue chip consensus forecasts). The latest assessment was published in January 2013, with the key findings presented in Table 4.

Table 4. Average Real GDP Forecast Error 1982–2010
Percent of GDP (positive indicate optimistic forecasts)

	Average		Absolute Error	
	2-year	5-year	2-year	5-year
CBO	-0.1	0.1	1.1	0.9
OMB	0.1	0.3	1.2	1
Blue Chip Consensus	-0.1	0	1.1	0.9

Sources: CBO Economic Forecasting Record 2013.

Over a two-year ahead forecasting horizon for real GDP, the CBO has a slightly pessimistic bias, compared to a slightly optimistic bias for the administration, with the CBO's forecasts proving marginally more accurate, and in line with the private sector forecasts. However, the degree of optimism in the administration's forecasts are relatively small compared to other advanced economies, and are largely limited to a period in the 1980s, when the forecasts were consistently overoptimistic (Figure 13). Over a longer-term forecasting horizon, the administration's bias is more pronounced, but this is also evident, albeit to a lesser extent, in the CBO's numbers.