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How Can Fiscal Councils Strengthen Fiscal Performance?

by
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There is growing interest in the role of independent fiscal institutions, or fiscal councils, in helping to improve fiscal performance. This article provides some guidance on the scope for improving fiscal performance through fiscal councils based on the available literature and the range of fiscal institutions in the OECD countries. The effectiveness of fiscal councils hinges on several factors, including having full autonomy within the scope of their mandates, active and unfettered dissemination of their analysis, and their credibility. Experience and empirical evidence suggest that delegating macroeconomic forecasting to an independent fiscal council can indeed reduce forecasting bias. There is some empirical evidence that independent fiscal institutions can buttress a government's capacity to comply with a numerical rule. Good fiscal institutions are a necessary condition for achieving disciplined fiscal performance. Experience demonstrates, however, that their existence is not sufficient. Without strong and sustained political commitment to a medium-term fiscal goal and, where relevant, to the mandate of a fiscal council, durable improvements in fiscal performance will remain elusive.

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Keywords: Fiscal policy, fiscal councils, fiscal frameworks

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There is growing interest in the role of independent fiscal institutions, or fiscal councils, in helping to improve fiscal performance. At its most basic level, a fiscal council is a publicly-funded entity staffed by non-elected professionals mandated to provide non-partisan oversight of fiscal performance and/or advice and guidance – from either a positive or normative perspective – on key aspects of fiscal policy. The increased interest is found not only in academic circles and international organisations, but among governments as well. In the past several years alone, new institutions have been established in Canada, Ireland, Portugal, Sweden, and the United Kingdom.[1] As countries begin to grapple with the delicate challenge of consolidating the seriously-deteriorated fiscal positions stemming from the recent crisis, their search for institutional reforms that can deliver fiscal results and provide political cover may well lead to the establishment of yet more fiscal councils.

A fiscal council can contribute to improved fiscal performance in a variety of ways, but it is no "silver bullet" for securing and maintaining fiscal discipline. By depoliticising various aspects of fiscal policy, whether related to formulation or monitoring, fiscal councils can better inform voters on the actual state of fiscal policy and raise the political costs of fiscal indiscipline. There is increasing – albeit still very limited – empirical evidence that the presence of fiscal councils can contribute to better fiscal outcomes. At the same time, there remains some uncertainty over the direction of causation. A fiscally responsible government may wish to create a fiscal council to solidify the credibility it has already gained. Conversely, absent political will, there are no assurances that a new institution such as a fiscal council will help. As von Hagen (2010) has noted: "Fiscal councils may be helpful to strengthen the credibility of medium-term fiscal rules, but only in cases where the government has considerable commitment power to begin with." Thus, a fiscal council could be either superfluous where strong political commitment is present, or ineffective where it is not.

The purpose of this article is to provide some guidance on the scope for improving fiscal performance through fiscal councils. This article synthesises the available literature on independent fiscal institutions. Section 1 provides a short overview of the principal issues at play, both in terms of the reasons for considering the introduction of a fiscal council (or strengthening existing ones) and key institutional considerations. Section 2 provides information on the range of fiscal institutions in the OECD (without pretence of universal coverage) to draw lessons from their experiences. Section 3 considers evidence on the effectiveness of fiscal councils, while Section 4 offers some concluding remarks.

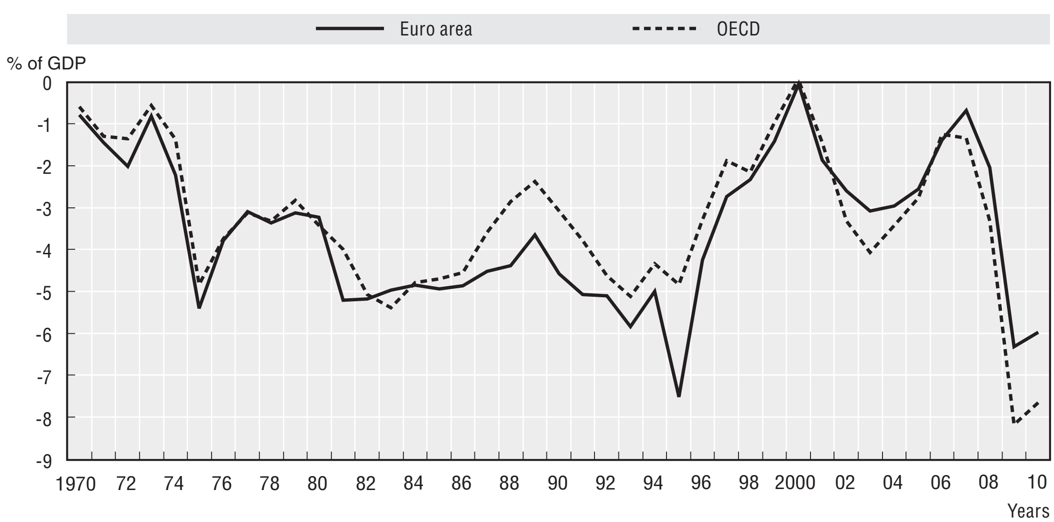
1. The conceptual foundation of fiscal councils

1.1. The persistence of deficits

Budgetary discipline requires that governments maintain fiscal positions that foster macroeconomic stability and sustainable growth. This in turn calls for counter-cyclical fiscal stances to help smooth output fluctuations, calibrated with sufficient vigilance to ensure symmetric budgetary impacts over the cycle to avoid an excessive accumulation of public debt. A prudent stance would also allow for the build-up of fiscal cushions to enable governments to respond to unexpected shocks over the medium term and anticipated pressures over the long term, such as implied by population ageing (Heller, 2003; and Kumar and Ter-Minassian, 2007). The overall record in the OECD over the past several decades, however, largely reflects a much more lacklustre record of sustained high deficits and a widespread tendency to adopt and implement pro-cyclical fiscal positions during cyclical upswings, resulting in high levels of public debt.

Deficits have clearly been the norm throughout most of the industrialised world during the past several decades. The overall fiscal balance of OECD economies, as well as in the large majority of its member countries, was in deficit throughout virtually the entire three decades to 2007 (Figure 1). A number of countries, however, have achieved sustained fiscal consolidation, noticeably lowering public indebtedness. Still, in many countries, deficits have been accompanied by sustained high levels of public debt (Figure 2), leaving inadequate fiscal cushions to comfortably respond to the financial crisis. In turn, public debt has now reached post-World War II record levels in many cases. It is widely recognised that sustained high deficits over such long periods can be harmful to long-run economic growth and are incompatible with optimal fiscal strategies, such as tax smoothing. Deficit bias is thus problematic.

Figure 1. **General government net lending**

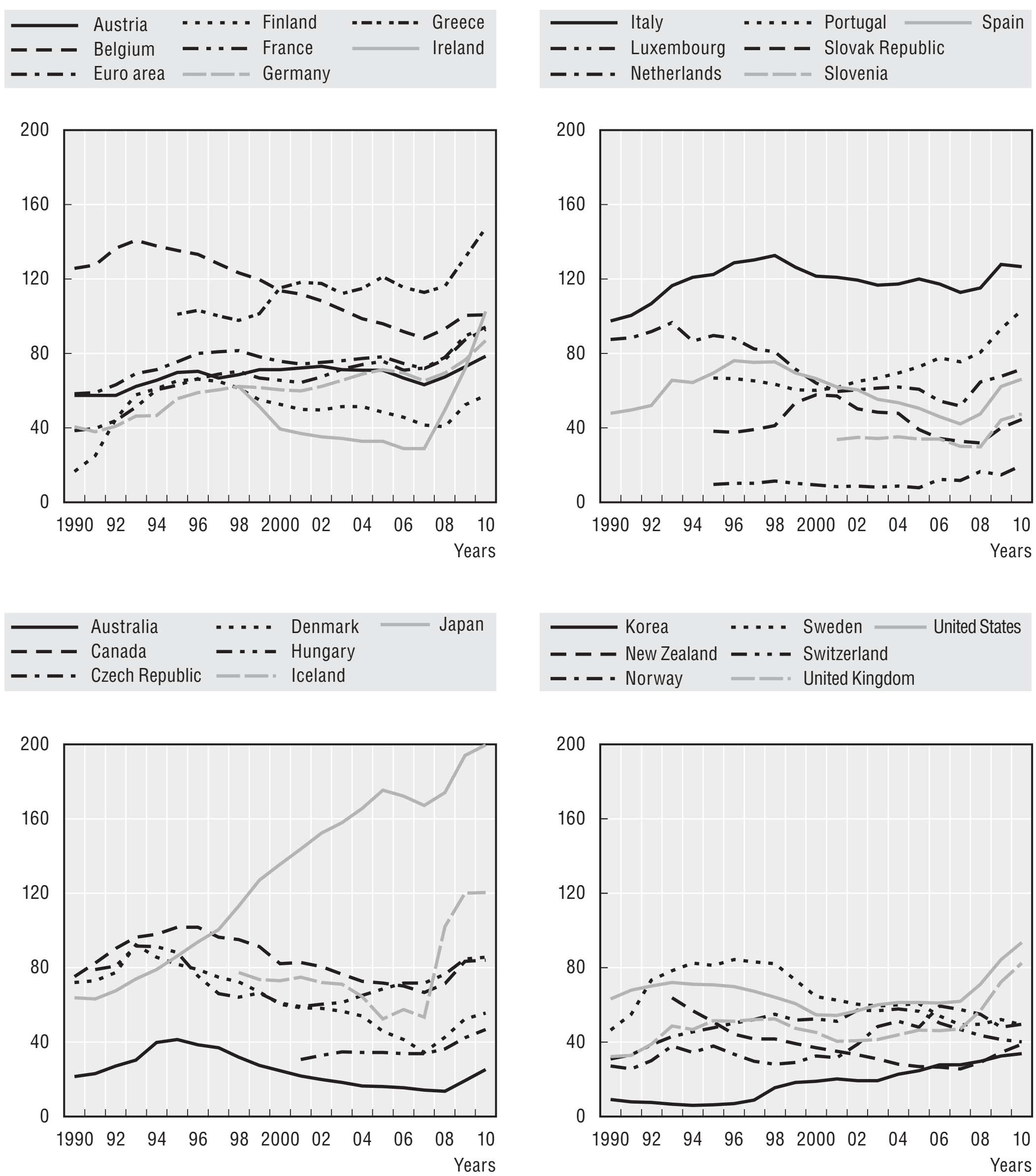


Source: OECD, *OECD Economic Outlook 89 Database*.

There is ample evidence that deficit bias is accompanied by pro-cyclicality bias as well. Although there are wide differences across regions and countries in the strength of automatic stabilisers, the cyclical movements of budget balances in general appear to be smaller than would result from the operation of the automatic stabilisers alone, implying a tendency toward offsetting discretionary policies (Balassone and Kumar, 2007). For instance, for industrial countries, on average, a 0.3% of GDP improvement in the overall nominal budget balance accompanies a one-percentage point of GDP increase in actual relative to potential output. Set against a larger actual average budgetary impact of automatic stabilisers of around ½ per cent of GDP (van den Noord, 2000; Bouthevillain *et al.*, 2001; and IMF, 2004), discretionary policies appear to result in a pro-cyclical fiscal stance. Moreover, the tendency toward pro-cyclicality is asymmetric, whereby discretionary policies offset the effects of automatic stabilisers during upturns but not during economic downturns (Balassone and Kumar, 2004).

Figure 2. **Gross public debt in OECD countries**

As a percentage of GDP, 1990-2010



Source: OECD, *OECD Economic Outlook Database*.

1.2. The political economy problem

The persistence of deficits over so long a period in so many countries suggests that factors other than economic conditions are at play. Nordhaus (1975) was among the first to posit a strong relationship between public spending and the political cycle. Researchers have since focused increasingly on the interplay of political motivations on the one hand and accommodating budgetary practices and institutions on the other as a potentially key determinant of deficit bias (Poterba and von Hagen, 1999).

Political economy considerations are now widely recognised as crucial to understanding the deficit and pro-cyclicality biases in fiscal policy. Several explanations are prominent in the literature. First, the deficit bias is related to the short-sightedness and selfishness of policymakers who initiate deficit-augmenting spending or tax-cutting programmes in the interest of re-election (Persson and Svensson, 1989; and Alesina and Tabellini, 1990). Policymakers' myopia is rooted in electoral uncertainty, which weakens their concern about the implications for future tax increases or expenditure cuts of their politically-motivated deficit-increasing favours. In turn, the fiscal behaviour of incumbent legislators will lead to higher deficits than desired by voters (Rogoff, 1990). This behaviour is facilitated by budgetary opacity that masks the fiscal truth, such as when policymakers are vague about economic assumptions underpinning the budget, or when they resort to creative accounting and off-budget financing schemes (von Hagen, 2010). Second, deficit bias can also arise from so-called "common pool" problems. Incumbents enhance their chances of re-election by maximising the marginal benefits of public goods or services (or tax breaks) to their own constituents without internalising to these same constituents the full marginal costs of those commitments. The "common pool" problem is especially problematic to disciplined overall fiscal policy when decentralised fiscal entities can partake in free-rider behaviour, neglecting the impact on the aggregate fiscal position.[2] A third potential cause of deficit and pro-cyclicality bias is the well-known problem of time-inconsistency (Alesina and Tabellini, 1990), whereby stated *ex ante* policy positions that are consistent with the national interest are conveniently considered by policymakers to be less desirable *ex post*, when electoral and regional interests dominate. Problems of time inconsistency can also arise when a government saddles a successor (and possible rival) government with a larger debt burden, leaving it less fiscal "space" than otherwise to sustain existing programmes.

In theory, given sufficient transparency, financial markets ought to provide sanctions that are adequate to discourage fiscal indiscipline due to misguided discretion, through several channels (Debrun *et al.*, 2009). First, prospectively higher deficits would signal an increased risk that these would be monetised, raising inflation expectations and long-term interest rates, reducing policymakers' likely options for politically motivated fiscal initiatives. This effect could be further strengthened if credit spreads on public debt increase due to higher perceived risks of default. Second, policymakers may gradually fear the country's rising public debt is approaching a "tipping point", with politically costly near-term adverse effects on economic growth.[3] The evidence, however, is mixed on the extent to which financial markets effectively discipline fiscal profligacy. As a general rule, they tend to react with some delay.[4]

1.3. Institutional remedies

Institutional reforms are thought to hold the promise of modifying the decision calculus of policymakers to improve the prospect that fiscal policy will remain supportive of macroeconomic stability. A number of different instruments and approaches can improve policymakers' incentives. One option is to require that fiscal commitments be made clear via fiscal targets set out in a medium-term fiscal framework, with implementation buttressed by procedural and transparency requirements spelled out in a fiscal responsibility law (Kumar and Ter-Minassian, 2007). New Zealand and Australia stand out in this context. Both committed, through legislation, to fiscal frameworks requiring that budgets take into account the long-term consequences of policies; when budgets depart from a prudent path, the government is obliged to explain how caution is to be restored to fiscal policy. The idea behind such legislation is to force future governments to actually have to repeal the law, which in turn could be politically costly.

Where political commitment is lacking or not sufficiently strong, however, numerical fiscal rules may hold promise of constraining the perverse incentives noted earlier.[5] Fiscal rules have gained popularity. In 1990, only seven countries worldwide had a fiscal rule; by early 2009, either national or supranational rules were in place in 21 advanced economies, 33 emerging markets, and 26 low-income countries (IMF, 2009). Such rules can improve fiscal performance when backed by sufficient political commitment and a fully transparent fiscal process. There is evidence of a positive link between the quality of numerical fiscal rules and fiscal discipline (European Commission, 2005 and 2009; Guichard *et al*., 2007; and IMF, 2009). At the same time, numerical fiscal rules suffer from several weaknesses. First, unless carefully constructed, rules can in some circumstances (*e.g.* simple deficit and debt ceilings) result in pro-cyclicality (IMF, 2004). Second, rules can be harmful to the quality of public finances through inadvisable compositional effects when, for instance, pro-growth public investment is cut to respect an expenditure cap (Blanchard and Giavazzi, 2004). Third, where political will is lacking, rules can motivate creative accounting and off-budget operations, undermining transparency and, ultimately, democratic control over the budget (von Hagen and Wolff, 2006).

A third, and potentially complementary, option is the establishment of an independent fiscal body as a practical means of depoliticising fiscal policy. The principal purpose of creating such an entity is to reduce the risks of government failure arising from the problems noted above. At one extreme, one might envisage the complete delegation of authority for setting the fiscal balance and debt target to an independent fiscal authority (IFA), similar to the delegation of monetary policy to an independent central bank. Beyond hypothetical proposals, most of which are surveyed in Debrun *et al.* (2009), no such body exists or is likely to be created. As Kopits (2007) has noted, an IFA "is nonviable because of the difficulty of defining unambiguously a principal-agent relationship at arm's length for the conduct of fiscal policy". There are also several implementation problems. First, whereas a pre-defined range of inflation is the usual objective of monetary policy,[6] the twin objectives of fiscal policy – promoting stable economic growth and ensuring fiscal sustainability – can pose difficult conflicting policy challenges when there are uncertainties over the extent and appropriateness of discretionary counter-cyclical policy. Second, the target for monetary policy is usually a specific level of short-term interest rates or the rate of growth of the money supply, which are relatively straightforwardly measured and impacted with predictable lags. Finally, there tends to be fairly broad agreement on what constitutes an excessive rate of inflation. By contrast, consensus is lacking on what is an unsafe level of the fiscal deficit or the optimal level of public debt. As well, the instruments otherwise available to an independent fiscal agency – taxes and public expenditure – would, for distributional concerns, need to remain under the control of elected officials.[7] Thus, and not surprisingly, no country has yet outsourced the formulation of fiscal policy.

There are several ways in which an independent body, or a fiscal council, with more circumscribed responsibilities can potentially contribute to improved fiscal performance.

Broadly speaking, fiscal councils can help by limiting political influence over technical aspects of fiscal policy formulation (from either a positive or normative perspective) or monitoring. With respect to positive economic analysis, fiscal councils can intervene at any number of points in the policymaking process. They can be tasked with making independent macroeconomic forecasts, or providing assumptions or projections of key variables or parameters on which budget projections can be based. Indeed, as previously noted, an important source of deficit bias in practice is an overly optimistic macroeconomic scenario. Empirical evidence demonstrates that macroeconomic forecasts show no statistically significant bias when prepared by independent agencies, in contrast to forecasts in countries that rely on government agencies (Jonung and Larch, 2006; and Hallerberg *et al.*, 2001).[8] Fiscal councils can also be tasked with making independent revenue and expenditure projections, whether based on current or prospective policies. Revenue projections are particularly prone to politically self-interested upward bias, since these create the *ex ante* fiscal space for planning higher spending than otherwise advisable.[9] Fiscal council assessments of long-run fiscal implications of tax and spending initiatives also can contribute to improving the transparency of budgetary decisions that are highly sensitive to demographic developments. In some instances, fiscal councils can be assigned a key role in monitoring fiscal performance under a politically agreed medium-term fiscal framework. Fiscal councils tasked with a mandate to undertake positive economic analysis play an indirect but potentially effective role in limiting politically-motivated deficit bias by improving transparency and helping to highlight the true cost of fiscal decisions.

Less than full delegation of fiscal policy does not, however, pre-empt assigning a normative role to an independent fiscal council. While final fiscal decisions are left to elected officials, a fiscal council's proposal regarding the appropriate stance of fiscal policy and a cautious budgetary path for securing sustainability can play a disciplining role by raising public pressure on officials. Where the government's credibility is particularly weak following a long period of poor fiscal performance, its commitment to a policy framework formulated on the basis of, or in concert with, the normative position of a fiscal council, can help garner public support. Indeed, broad agreement on the fiscal objective and a willingness of the government to fully integrate the fiscal council into the fiscal policymaking process are necessary pre-conditions for a fiscal council to be effective.

Fiscal councils will vary across countries due to a large number of country-specific factors. These include the underlying causes of the lack of fiscal discipline, the political landscape and the party structure, and the existing institutional budgetary arrangements and procedures. But whatever form the council takes and its delegated responsibility, four institutional features will predominate in all cases. First, the agency's mandate must satisfy several criteria. It should be unambiguous and achievable, and the delegated responsibility should have an economic rationale, such as to reduce deficit bias. Second, the agency needs to be assured full discretion in carrying out the tasks necessary to fulfillment of the mandate. Third, accountability is critical; elected officials must be able, on behalf of voters, to conduct *ex post* evaluations of the council's performance to ensure that the delegated powers are in fact being used in pursuit of the agency's mission. Finally, independence from political influence requires adequate firewalls, both in the staffing of the agency and in the latter's everyday operations. Moreover, independence is not unrelated to the agency's funding. The level of public funding must obviously be commensurate with the scope of the agency's mission, and should be protected from politically-motivated reductions, notwithstanding the difficulties of distinguishing the latter from other apparent reasons.

2. The scope of existing fiscal councils

Although fiscal councils remain more the exception than the rule throughout the world, their number is growing. The impetus to create new independent fiscal councils comes both from generally positive experiences in countries in which they have existed, and from increasing support among international organisations for such agencies. The scope of and for independent fiscal institutions has been of interest in the European Commission for some time (see, for instance, European Commission, 2006), and among the staff of the IMF (see, for example, Annett *et al.*, 2005; and Kumar and Ter-Minassian, 2007). Recommendations to consider such agencies have appeared in a number of recent OECD *Economic Surveys*.

While stocktaking of fiscal councils is complicated by the variety of agencies that fit the generic definition of a fiscal council, most in OECD countries tend to fall into three non-exclusive categories.[10] A first set includes bodies that provide independent forecasts used in the formulation of the budget, or against which the official projections are, or can be, assessed. Also included in this group are entities that assess fiscal policy issues using positive rather than normative analysis such as assessing cyclical impacts on the budget or the fiscal implications of budgetary programmes (*e.g.* the medium- and long-term costs of a health care reform). A second group comprises entities with a mandate to provide normative views on the appropriateness of the overall stance of fiscal policy from, say, a cyclical perspective, or the desirable timeline to restore fiscal sustainability. A third category includes councils that are tasked with providing independent forecasts of macroeconomic and budgetary variables needed for the elaboration of the annual budget. Existing institutions include hybrids of these, however, that combine independent macroeconomic and budgetary projections with a mandate to assess performance relative to prior commitments to a medium-term fiscal framework or a numerical rule. Table 1 lists a number of independent fiscal institutions in the EU members of the OECD, together with an enumeration of their tasks. It should be borne in mind that the existence of an institution within the terms of this exercise does not imply that it has either a wide or *ex ante* mandate, or that it is effective in carrying out this role. From the earlier discussion, a particularly important distinguishing feature of a fiscal council is its *ex ante* role in economic diagnostics and providing input into budget formulation, along with (in some instances) real-time monitoring of compliance with an agreed fiscal rule. By contrast, public audit institutions included in the EU survey typically provide *ex post* assessment of performance. Fiscal councils in several other OECD countries are discussed below.[11]

2.1. Fiscal councils with a normative mandate

Throughout the OECD, especially in the European Union, the mandates of a number of different types of independent fiscal institutions include the possibility or requirement to take normative positions on various aspects of fiscal policy. Such institutions can include advisory bodies, independent research institutions, and some state audit offices. Where such institutions tend to be most effective is when they are formally integrated into the fiscal policy formulation and monitoring process, and when the government is required to

Table 1. **List of independent institutions considered in the EC study**

General information		Tasks to be filled									
		Forecasts and projections of macroeconomic and/or budgetary assumptions					Independent analysis on fiscal policy				
	Institution	Macro forecasts	Forecasts for government expenditure	Forecasts for government revenues	Forecasts for government balance and debt level	Long-term projections of government finances	Analysis of budget	Monitoring of budgetary implementation	Estimates of short and long-term effects of policy measures	Analysis of whether budgetary plans and outcomes are in line with fiscal rules	Not explicitly in charge of any of these tasks, but fulfils some of them
Austria	Institute for advanced studies (HIS)	X			X						
Austria	Institute for economic research (WIFO)	X			X						
Austria	Government debt committee	X					X				
Belgium	National audit institute	X						X			
Belgium	High council on finance (HCF) – Section "Public Sector Borrowing Requirement"									X	X
Denmark	Danish Economic Council	X	X	X	X	X					X
Estonia	State Audit Office										
France	Commission Économique de la Nation and Conférence Économique Annuelle	X			X		X				
France	Cours des Comptes							X			
Germany	Working Party on tax revenue forecasting			X							
Germany	Joint Economic Forecast by 6 leading research institutions (JEF)	X	X	X	X						X
Germany	Council of Economic Experts on Overall Economic Trends	X				X					X
Germany	Advisory Board to the Federal Minister of Finance										X
Greece	Center of Planning and Economic Research (KEPE)	X	X	X							X
Hungary	State Audit Office (ASZ)						X	X		X	
Hungary[1]	Fiscal Council of Hungary	X	X	X	X		X	X		X	
Italy	ISAE	X	X	X	X						X
Luxembourg	Court of Auditors										X
Netherlands	The Netherlands Bureau for Economic Policy Analysis (CPB)	X	X	X	X	X	X	X	X	X	
Portugal	Court of Auditors							X			X
Spain	Court of Auditors						X	X		X	
Spain	National Committee of local administration										
Slovenia	Macroeconomic Analysis	X						X			
Sweden[2]	Fiscal Policy Council	X				X	X		X	X	
Sweden	National Institute of Economic Research	X	X	X	X	X					X
United Kingdom	National Audit Office						X				
United Kingdom[3]	Office of Budget Responsibility (OBR)	X	X	X	X	X			X	X	

1. Author's assessment. The Fiscal Council of Hungary was essentially disbanded by the newly elected government in late 2010.
2. Author's assessment, based on answers to 2008 EC questionnaire. The mandate is to monitor and evaluate the quality of the government's economic forecasts and underlying models.
3. Based on HM Treasury "Draft: Charter for Budget Responsibility" (HM Treasury, 2010).

Source: "National independent institutions", Chapter III, *Public Finances in EMU, 2006*, except where noted.

Table 1. **List of independent institutions considered in the EC study** *(cont.)*

General information		Tasks to be filled						
		Normative reports and/or recommendations on fiscal policy						
	Institution	Normative statements in budgetary plans and respect of the fiscal policy rules	Assessment of the budget/alternative quantification of the measures therein	Proposals for changes in the budgetary plans	Normative statements on implementation of fiscal plans/respect of fiscal rules	Alert function to signal a possible deviation from plans	Recommendation in case a slippage to initial fiscal plans is identified	Others
Austria	Institute for advanced studies (HIS)							
Austria	Institute for economic research (WIFO)							
Austria	Government debt committee			X				
Belgium	National audit institute							
Belgium	High council on finance (HCF) – Section “Public Sector Borrowing Requirement”			X	X	X	X	
Denmark	Danish Economic Council			X (Federated entities)	X	X	X	
Estonia	State Audit Office				X	X	X	
France	Commission Économique de la Nation and Conférence Économique Annuelle							
France	Cours des Comptes				X			
Germany	Working Party on tax revenue forecasting							
Germany	Joint Economic Forecast by 6 leading research institutions (JEF)						X	X
Germany	Council of Economic Experts on Overall Economic Trends						X	
Germany	Advisory Board to the Federal Minister of Finance							X
Greece	Center of Planning and Economic Research (KEPE)							
Hungary	State Audit Office (ASZ)		X		X			
Hungary[1]	Fiscal Council of Hungary		X	X	X	X	X	
Italy	ISAE							
Luxembourg	Court of Auditors		X			X	X	
Netherlands	The Netherlands Bureau for Economic Policy Analysis (CPB)							
Portugal	Court of Auditors	X			X			
Spain	Court of Auditors				X			
Spain	National Committee of local administration		Only local finances					
Slovenia	Macroeconomic Analysis							
Sweden[2]	Fiscal Policy Council					X	X	
Sweden	National Institute of Economic Research	X			X			
United Kingdom	National Audit Office	X						X
United Kingdom[3]	Office of Budget Responsibility (OBR)	X				X		

1. Author’s assessment. The Fiscal Council of Hungary was essentially disbanded by the newly elected government in late 2010.
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Source: “National independent institutions”, Chapter III, *Public Finances in EMU, 2006*, except where noted.

consider the recommendations made by the agency. Several such institutions stand out in the OECD area.

In Austria, the Government Debt Committee (GDC) has a mandate to regularly assess the status of fiscal policy, taking into account macroeconomic circumstances, with a particular focus on the quality of public finances and the outlook for debt sustainability. Its twelve members are public finance experts nominated by the federal government, various national policy institutions, and representative bodies of Austrian communities, cities and states. It receives funding and staffing from the Austrian National Bank. The GDC disseminates to the public its annual report that contains recommendations made to the government via the Minister of Finance. As in Belgium (see below), the GDC has proved effective in helping to control sub-national borrowing in a federal context (von Hagen, 2010).

Belgium's High Council on Finance (HCF) is an advisory body formed initially in 1936 but strengthened in 1989 to help promote budget co-ordination and fiscal discipline in Belgium's federal system, and to contribute to the design and implementation of fiscal policy.[12] While the HCF has several tasks, including making long-run ageing-related expenditure projections and providing regular assessments of various aspects of fiscal policy, its most vital role is normative insofar as it is charged with recommending the budget targets for the general government and its subsectors that are consistent with the borrowing requirement implied by the Stability Programme. Several assessments (Debrun *et al.*, 2009; Lebrun, 2006; and Coene, 2010) point to the HCF as having been highly effective in achieving disciplined fiscal policy during the 1990s, driven in part by the desire to be positioned to adopt the euro in 1999, and by social consensus and strong political will to stabilise and consolidate fiscal policy. Interestingly, the same research points to the lesser influence of the HCF during the post-euro adoption period than before.

In Denmark, the Economic Council is an advisory body that not only provides macroeconomic forecasts but also undertakes analyses of a variety of fiscal policy issues related to the functioning of the public sector, the tax system, fiscal sustainability and the fiscal stance, on the basis of which it issues policy recommendations. The council is also charged with monitoring compliance with current fiscal rules, issuing recommendations as needed to ensure compliance.

In 2007, Sweden created the Fiscal Policy Council with a mandate to assess the extent to which the government achieves its policy objectives of long-run sustainability, a surplus target, a ceiling on central government spending, and a fiscal stance consistent with the cycle), and to monitor and evaluate the transparency of the budget and the quality of the government's economic forecasts. The Fiscal Policy Council's first major challenge arose in relation to one of Sweden's fiscal policy objectives: ensuring an appropriate cyclical stance of policy. Despite strong resistance from the government, the council eventually prevailed in promoting the larger fiscal impulse it deemed warranted following the onset of the recent worldwide financial crisis. This characterisation of effectiveness has to be seen, however, from the perspective of the Fiscal Policy Council's mandate, which includes advising on the appropriate *stance* of fiscal policy.

Finally, Hungary established a fiscal council in 2009 to strengthen historically-weak fiscal policy formulation and implementation. The council was effectively disbanded in late 2010, however, following elections that swept into office a new government strongly opposed to the independent body's legal authorities (Box 1).

Box 1. **The brief life of the Fiscal Council of Hungary**

The brief life of the Fiscal Council of Hungary is instructive regarding the importance of political and policy commitment by the government to the creation of a new independent budgetary institution.

The Fiscal Council of Hungary was established in 2009 on legislation enacted in 2008 (the Law on Fiscal Responsibility). The legislation and creation of the Fiscal Council were part of an adopted rules-based fiscal policy framework. Its special mandate was to help restore sustainability of fiscal policy and to promote fiscal transparency. Its tasks included making macroeconomic forecasts and projections for key budgetary variables to serve as the baseline for the annual budget. In addition to biannual medium-term baseline (current legislation) projections, it was to prepare macro-fiscal projections that incorporated the effects of each budget bill in time for legislative action. The Council also made methodological suggestions for fiscal policy planning, and commented on the budget bill and other legislation with fiscal impacts, "costing" all significant tax and expenditure proposals. Importantly, the Fiscal Council monitored compliance with Hungary's fiscal rules (including the pay-go rule and the debt limit requirement), but relied on dissuasive methods – through pressure from the public and financial markets – rather than coercion. Following an early start, and despite a shortage of staff in the initial stage, the Council issued its first baseline projection in anticipation of the 2010 budget, and maintained a high level of activity during 2009 and 2010.

Events in 2010 set the stage for a very considerable weakening, if not the effective demise, of the Council. Following general elections in May, the new government, elected by a two-thirds majority, viewed with considerable suspicion all policies and institutional changes implemented by the previous government. Unhappy with the Council's critical assessment of the new government's medium-term budget strategy spelled out in its 2011 budget proposal, the Government set in motion legislative and other steps to weaken the Council by disbanding the Office of the Council (*i.e.* the technical staff of the Council), changing the composition of the Council, and narrowing considerably the Council's remit. In turn, the Council has effectively been reduced to a part-time body with no specific responsibilities in applying fiscal transparency and sustainability (Kopits, 2011).

2.2. Fiscal councils providing independent analysis of fiscal issues

Fiscal councils that provide independent analyses of fiscal issues play an important role in informing the government and the public about the budgetary implications of select policy issues. The next paragraphs elaborate the mandates and set-ups of several.

The Canadian Parliament enacted in 2006 the Federal Accountability Act (FAA). Among other things, the FAA established the Parliamentary Budget Officer (PBO), modelled on the US Congressional Budget Office. The mandate of the PBO is to provide the legislature objective analysis of the nation's finances, the government's estimates, and trends in the economy and, upon request by a committee or parliamentarian, estimates of the cost of any proposal for matters over which the Parliament has jurisdiction. As a Governor-in-Council appointment, the PBO serves "at pleasure". In turn, the PBO can be dismissed without cause by the Prime Minister, which potentially weakens the agency's political independence. The FAA provides for free and timely access to government data and information needed to fulfill the PBO's mandate. The PBO promotes value by relying on assistance from experts, accountability through dissemination of its products and through public debate, and non-partisanship by operating in an open and transparent manner. Experience during its first years of operation highlights the importance of having a clear mandate and a secure budget (Box 2).

Box 2. **Canada's Parliamentary Budget Officer**

Following parliamentarians' frustrations over persistent Department of Finance under-projection of budget deficits during the 1980s and of surpluses during the 1990s, and recognising the Parliament's lack of technical expertise in accurately estimating the costs of large-scale federal projects, the Canadian Parliament enacted in 2006 the Federal Accountability Act (FAA). The FAA is aimed at addressing issues of conflict of interest, restrictions on election financing, improving administrative transparency, oversight and accountability. Among other offices also created by the FAA, the legislation established the Parliamentary Budget Officer (PBO), modeled on the US Congressional Budget Office. The PBO began operations in 2008. The PBO is an officer of the Library of Parliament, and holds office for a renewable period of not more than five years. The mandate of the PBO is to provide the legislature objective analysis of the nation's finances, the government's estimates and trends in the economy, and, upon request by a committee or parliamentarian, to estimate the cost of any proposal for matters over which the Parliament has jurisdiction. As a Governor-in-Council appointment, the PBO serves "at pleasure". In turn, the PBO can be dismissed without cause by the Prime Minister, which weakens the agency's political independence. The FAA provides for free and timely access to government data and information needed to fulfill the PBO's mandate.

The PBO uses an open and transparent operating model that promotes value by relying on assistance from experts, accountability through dissemination of its products and through public debate, and non-partisanship by operating in an open and transparent manner. There are two divisions. The Economic and Fiscal Analysis Division is responsible for analysis of economic trends and public finances. The Division is staffed with professional economists experienced with the working environment and models at the Department of Finance, the Bank of Canada and the Canadian Revenue Agency. The Revenue and Expenditure Analysis Division is responsible for costing proposals and budgetary estimates.

During its first years of operation, the PBO encountered a number of parliamentary and government challenges to its interpretation of its mandate following the release of its first two reports. The first was the PBO's analysis of the fiscal impact of Canada's Afghanistan involvement, whose dissemination, albeit expected from the outset, was challenged by the parliamentarians who considered, despite *ex ante* agreement to its release, that the report should have been submitted first to Parliament on a confidential basis. The second release was of the PBO's first economic and fiscal outlook highlighting a projected recession in 2009 and the first deficit in a decade. Political displeasure with both releases resulted in a withholding of increased budgetary resources for the PBO, only to be reversed in the 2010-2011 Budget.

Experience during the early years of the PBO points to the need for several reforms going forward. These include: *i)* making the PBO a fully independent authority appointed by the Parliament and serving during good performance rather than at pleasure; *ii)* transparency is best assured if its principle and the release of analysis are enshrined in legislation; and *iii)* resources need to be commensurate with the mandate (Page, 2010).

In the United States, the Congressional Budget Office (CBO) was established in 1974 to provide Congress with independent analyses of the costs and long-term effects of budget proposals. Its mission is to provide objective, non-partisan, and timely analyses to aid in economic and budgetary decisions on the wide array of programmes covered by the federal budget, and the information and estimates required for the Congressional budget process. The CBO produces a considerable number of reports each year, and regularly testifies before Congress. Its work is non-partisan, and the Director is appointed without regard to political affiliation and solely on the basis of his/her fitness to perform the duties for a four-year term (even when the balance of power in Congress switches). The CBO's reputation for credible and impartial analysis has helped it become a central player in the annual budgeting process and in budget monitoring (Blöndal *et al.*, 2003). Among the CBO's most important contributions to the annual budget process is the preparation of its baseline against which are assessed budget proposals, including the President's. The CBO's baseline, however, is constrained by the legal requirement that it be based on current law rather than the most likely policy scenario. While its analyses can focus on the impacts of any fiscal proposal, the CBO conducts only positive analysis; the agency does not engage in policy prescription.

The Netherlands' Central Planning Bureau (CPB) is a major source of objective and independent analysis and forecasting. Since its inception in 1945, it has gained considerable respect for its independence and expertise. The agency's independence is attributable to a number of factors. First, its funding from public sources is both adequate and secure enough to provide the agency sufficient freedom to set its own research agenda. Second, its independence is maintained through a *quid pro quo*; its independence from political interference requires that the agency itself not interfere in the political debate (Bos and Teulings, 2010). The CPB's main responsibilities are to provide independent macroeconomic and budgetary forecasts, but its remit also includes analysis of a wide range of topics, including the welfare state, the labour market, regulation and international economics, among others. It also undertakes cost-benefit analysis of large-scale public projects, as well as long-run studies, such as on welfare, the environment, and the impact of population ageing on Dutch public finances. While making no normative prescriptions, its forecast is co-ordinated with submission of the government's budget, and incorporates the estimated economic and budgetary impacts of proposed fiscal policy measures. Significantly, the CPB's activities and contributions to the preparation of the budget are not mandated, but have become routine practice. In fact, the CPB plays a special role tailored to Dutch coalition politics insofar as all political parties submit their economic programmes to the CPB for assessment, which facilitates comparisons. Moreover, employers' and employees' organisations also rely on CPB forecasts for wage negotiations. The CPB stands out as an institution that has over the decades become fully integrated into the policymaking process while retaining a solid reputation for professionalism and impartiality in its analysis. This aspect of the CPB is considered "best practice" by the IMF (IMF, 2006).

In Portugal, the government has recently established the independent Fiscal Policy Council to help contribute to fiscal consolidation and the restoration of fiscal sustainability.[13] Once operational, the Council's remit calls for the body to assess the Government's macroeconomic scenarios and the consistency of the budget with those scenarios as well as with the Government's fiscal rule, analyse the sustainability of public debt, taking into account existing commitments (with special emphasis on pensions and health), assess the fiscal state of regions and local governments and public enterprises, monitor budgetary outturns, and provide the Council's opinion on any issue it considers likely to significantly impact the public finances.

In the United Kingdom, the new coalition government established the Office of Budget Responsibility (OBR) during 2010 to help bolster the credibility of the Government's commitment to a balanced structural budget during its term.[14] The OBR consists of a three-member Committee for Budget Responsibility elected by Parliament, and a technical support staff. The overarching remit of the OBR is to monitor progress toward fulfillment of the Government's mandate through preparation of the macroeconomic forecast that underpins the budget, and real-time assessments of fiscal-related legislation. The OBR also undertakes debt sustainability analysis.

Finally, the Government of Ireland has created the Fiscal Advisory Council as part of a broader reform of the country's public financial management architecture. The independent Council's remit, spelled out in a new Fiscal Responsibility Bill, is centered on assessing the appropriateness and soundness of the Government's macroeconomic projections and the fiscal stance. The Council will also assess the extent to which the Government's budget and its execution are consistent with the agreed fiscal rules, also established in the Fiscal Responsibility Bill.[15]

3. Assessing the effectiveness of fiscal councils

Empirical evidence of the effectiveness of fiscal councils is of three sorts. First, country-specific experiences have been investigated for a few countries. These perforce attempt to compare fiscal performance by using indicators before and after the existence of a fiscal council, or before and after a fundamental change. Second, the European Commission (2006) drew inferences and conclusions about effectiveness from responses to its questionnaire, in conjunction with descriptive material and empirical studies. Third, using information collected by the European Commission's survey, Debrun and Kumar (2008) constructed a number of quantitative indicators that characterise the set-up, independence and desired influence of fiscal councils, which they use to gauge the impact of fiscal councils on fiscal discipline.

3.1. Country-specific studies

3.1.1. Belgium

Belgium is a useful case for assessing the possible effectiveness of fiscal councils, given the strong mandate handed to the HCF, and the fact that the government is legally required to adopt the macroeconomic forecasts of the Federal Planning Bureau (FPB). Indeed, the fiscal councils in Belgium have been purposefully given relatively strong mandates; Debrun and Kumar (2008) compute a comparatively high index of *de jure* influence for Belgium's fiscal councils. Belgium is also a good candidate because its experience with fiscal councils spans two decades of contrasting incentives emanating from the country's membership in the EU, with the 1990s dominated by policies to support euro adoption.

Two studies suggest that fiscal councils contributed to improved fiscal performance. While recognising the complexity of the exercise, Lebrun (2006) measures the extent to which reduced bias in macroeconomic forecasts prepared by the FPB (and used in budget formulation) via a decomposition of forecasting errors (specifically the mean square error) during the period 1994-2005 into the "bias proportion" (attributable to systematic over- or under-estimation), the variance proportion, and the covariance proportion. The very small values for the bias proportion provide strong evidence that "… FPB forecasts can be considered as unbiased" (Lebrun, 2006, p. 331). The author also painstakingly examines the reasons for which fiscal consolidation was stronger than already programmed throughout the period, and finds that growth surprises (*i.e.* higher GDP growth than on which the budgets were formulated) were not behind the better budgetary performance. In turn, discretionary policy actions must have contributed to better-than-expected outcomes. While cautioning that the roles of the fiscal councils need to be seen as complements to and not substitutes for political commitment, the author concludes that the reduced forecasting bias and the increased policy transparency arising from the strong co-ordinating role of the HCF, which have helped the government resist pressures for higher spending, contributed to better performance.[16]

In a more recent study, Coene (2010) assesses the effectiveness of the HCF by constructing a synthetic annual index of effectiveness.[17] Specifically, the index (values ranging from 0 to 5, with the higher value suggesting greater impact) each year depends on answers to five questions answered through a careful review of the extent to which HCF recommendations impacted fiscal policy. These questions were: *i)* Does each year's report contain a single clear recommendation for budget targets over the medium and long term? *ii)* Is the recommendation consistent with previous ("vintage") recommendations? *iii)* Does the recommendation simply mimic the government's Stability Programme? *iv)* Has the recommendation been explicitly adopted by the government? and *v)* Have the recommended budgetary targets been met? Succinctly, "… the highest value for the indicator is reached in cases where the section elaborates a clear recommendation, that is not at odds with the section's previous views and is independent from – or, at least, cannot be tracked back to – government intentions and that is formally adopted and, ultimately, complied with by the government"[18] (Coene, 2010, p. 14). While recognising the need for caution in interpreting the indicator (not least because of the substantial degree of expert judgment needed for its construction), the paper concludes that the HCF has been quite effective in promoting fiscal consolidation during the period 1990-1998. At the same time, the paper concludes that the section's effectiveness declined measurably during the next decade, which was likely due to the unusually strong political resolve during the 1990s to achieve euro adoption.

3.1.2. Chile

Fiscal policy in Chile has largely remained conservative during the past two decades. This is reflected in a trend decline in gross and net central government debt and growth in net foreign assets. This good performance is attributable to several factors: sustained political commitment to prudent policy; the adoption of a fiscal rule and a fiscal framework; and the enactment of a Fiscal Responsibility Law. Also present are the two independent advisory bodies – the Advisory Committee on Trend GDP and the Advisory Committee for the Reference Copper Price – that play a role in macroeconomic and budgetary forecasting without, however, having full responsibilities. The fiscal rule, in place since 2001, limits the growth of budgeted central government spending to an estimate of the growth of "structural" revenue, subject to achieving a targeted structural budget balance, which has remained set at a surplus of 1% of GDP. The over-riding objective is to ensure both fiscal sustainability and output stabilisation. As the rule focuses on a cyclically-adjusted budget balance, key determinants include the projected output gap and "structural" revenues. The former, of course, depends heavily on estimates of potential output, which in turn hinges on the growth of labour, capital and total factor productivity. Chile's revenue flows depend significantly on trend copper prices. In turn, the delegation of responsibility for projections of these key variables to non-partisan advisory bodies helps to limit potential forecasting bias. At the same time, the methodology itself for estimating the output gap remains the responsibility of the Ministry of Finance, which reserves a large margin for discretion. Schmidt-Hebbel (2010) has noted that back-casting of potential growth suggests that the output gap was likely over-estimated during 2001-2008, resulting in excessive spending and a pro-cyclical outcome. Over-estimates of trend copper prices also contributed to pro-cyclicality. Despite the legally-binding projections from the two advisory bodies, the Government (Ministry of Finance) is left with substantial leeway to define the overall resource envelope.

3.1.3. United Kingdom and Hungary

Kopits (2011) provides an illuminating comparison of the experiences of the United Kingdom and Hungary during 2010. As he notes, ignoring the many differences between the two countries, some "stylized" facts about the influence of policy signaling on market expectations can be gleaned from the concurrent demise of the Fiscal Council of Hungary (see Box 1) and the establishment of the broadly similar OBR. In the United Kingdom, the newly-elected centre-right Government, bolstered by the presence of the OBR, immediately took steps to restore fiscal sustainability through entitlement reforms and revenue measures. By contrast, the new centre-right Government of Hungary quickly abandoned the rules-based framework in place for several years, and adopted budgetary measures that in fact have no impact on the structural budget balance. During 2010, market reactions were favourable to the former and unfavourable to the latter. Short- and long-term interest rate spreads on sovereign paper widened in Hungary while they fell continuously in the United Kingdom. The contrasting market reactions are also evident in divergent credit default swap spreads in the two countries (Kopits, 2011).

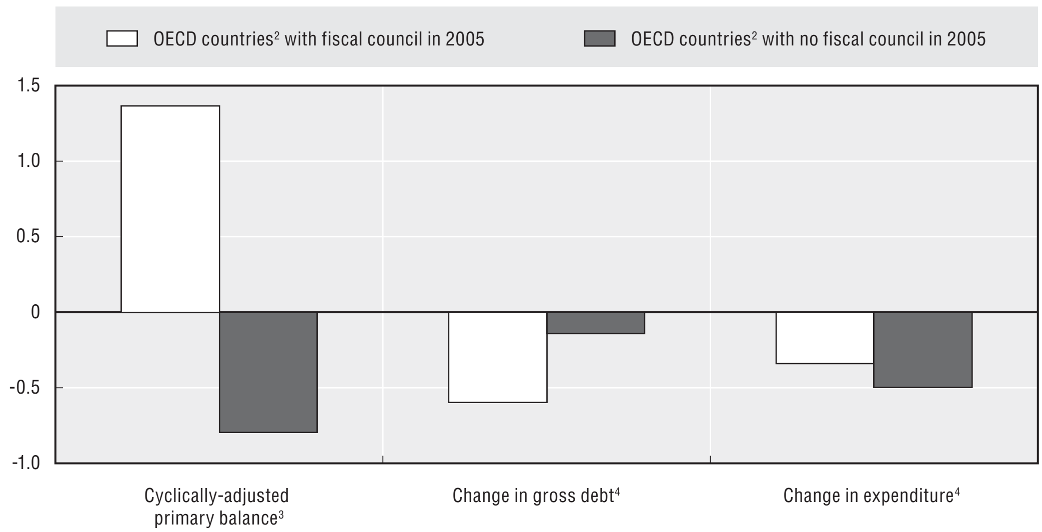
3.2. European Commission Survey

The European Commission combined inferences from answers to select questions with descriptive analyses and numerous studies in the literature in arriving at a number of conclusions about the potential effectiveness of independent fiscal institutions covered in its survey.

First, as previously noted, pro-cyclical bias arising from overly-optimistic macroeconomic or budgetary forecasts can be reduced or eliminated by delegating responsibility to an independent agency. Second, by a large majority, fiscal councils have a perceptible impact on the public's awareness of fiscal issues, often triggering public debate. Third, while not controlling for a number of variables that could account for such differences, the Commission noted that fiscal performance (measured by several fiscal indicators) during the period 1995-2005 was superior in countries having at least one surveyed institution than in countries with none. Figure 3 shows the same indicators of fiscal performance over the same period as covered by the European Commission, but updated to take into account data revisions and extended to include non-EU OECD countries.

Figure 3. **Budgetary developments and fiscal councils**[1]

1995-2005



1. Fiscal councils as defined in EC (2009), *Public Finances in EMU – 2009* and OECD calculations.
2. OECD countries excluding Chile, Mexico, Slovenia and Turkey.
3. Average balance over the period.
4. Average yearly change over the period.

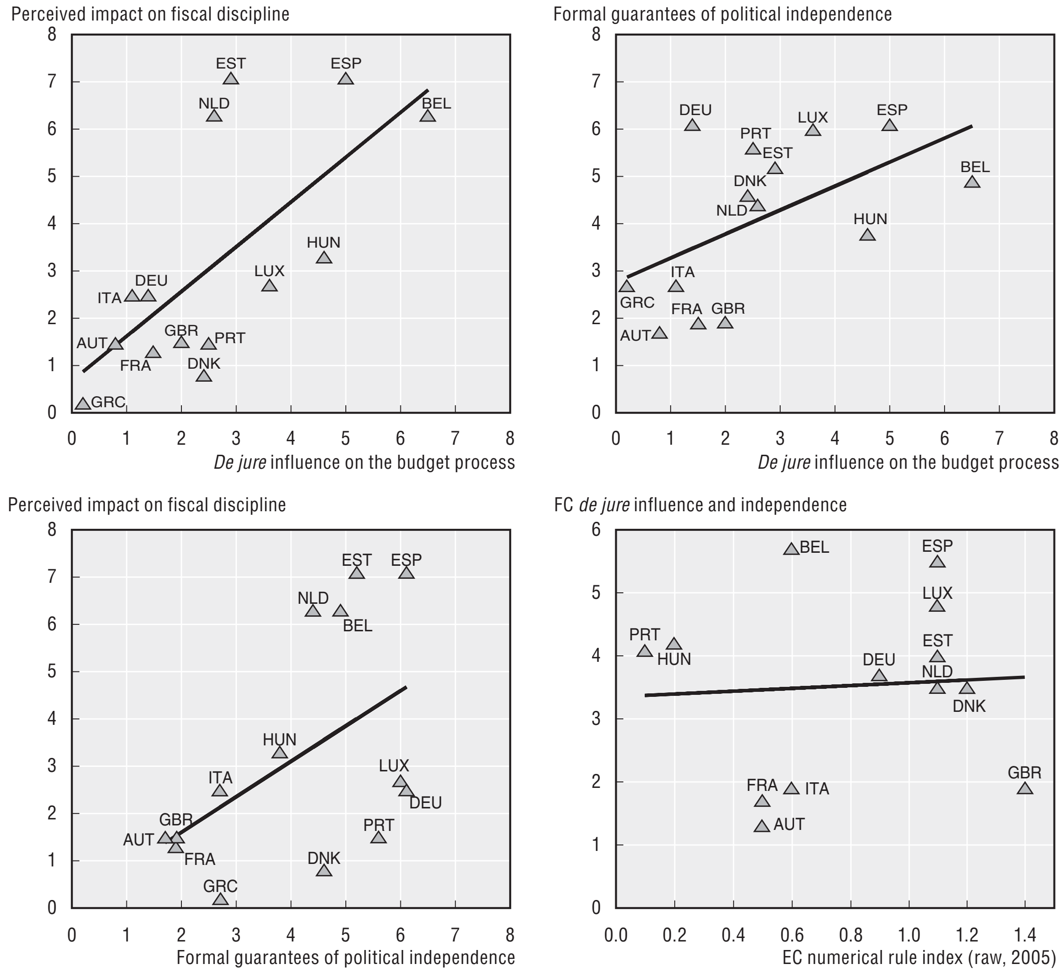
Source: OECD, *OECD Economic Outlook Database*.

3.3. Cross-country evidence

A pertinent empirical question is the extent to which fiscal councils, without delegated fiscal policymaking authority, have measurable influence on fiscal outcomes. Debrun and Kumar (2008) set out to investigate this question using the detailed information on the features of fiscal institutions collected in the EC's survey of independent fiscal institutions. The authors constructed indices that characterise the set-up, independence and the potential influence of the agencies on the budgetary process, including via public debate. They use a weighting scheme that emphasises the agencies' role in preserving fiscal discipline, and in helping to implement rules where relevant. The authors' particular interest is in the channels through which the councils might have an impact. One premise is that the greater the degree of restraint exercised by the fiscal council or the greater the guarantee of independence from political interference, the greater the likelihood of perceived or actual impact on performance.

The authors' results suggest that fiscal councils may indeed be influential. Their results are reproduced in Figure 4. There is a strong relationship between *de jure* influence exerted by a fiscal council and its perceived impact on fiscal performance, as well as between the perceived impact on fiscal performance and formal guarantees of independence. There is also a positive relationship between *de jure* influence and the guarantees of independence, which the authors interpret as suggesting "countries instituting such agencies seemed serious in their willingness to strengthen the council's effectiveness". (Debrun and Kumar, 2008, p. 490). At the same time, these results should be interpreted with caution given the heterogeneity of the independent fiscal bodies included in the data set. For instance, the data set includes state audit offices, most of which, as previously noted, are tasked solely with *ex post* assessment of fiscal and budgetary performance, whereas fiscal councils are expected to have an *ex ante* impact on fiscal policy formulation.

Figure 4. **Potential channels of impact of fiscal councils and relationship between fiscal councils and fiscal rules**



Source: Debrun and Kumar (2008).

4. Conclusions

This paper has attempted to provide an overview of the reasons for and experience with independent fiscal councils. Theoretical arguments for delegating some aspects of fiscal policy to independent institutions have become widely accepted. Deficit bias can become entrenched in fiscal systems plagued by inadequate transparency, which politicians can exploit in the pursuit of their own individual interests (*viz.* re-election) with insufficient regard for the average voter and the nation as a whole. As well, medium-term fiscal commitments can be breached through time-inconsistent policies that future governments find more convenient *ex post* than deemed appropriate *ex ante*. Institutional reforms, including all those that increase the transparency of fiscal policy formulation and implementation, are now widely seen as a necessary condition for restoring and sustaining fiscal discipline.

Some types of reform are more compelling than others. Where fiscal policy has not been anchored by a medium-term focus and fiscal targets that can ensure growth-promoting and sustainable fiscal stances, numerical rules can potentially play a helpful role. But experience has shown that rules can be easily breached, even as appearances may suggest otherwise for a while through creative accounting and off-budget transactions. In turn, there is growing advocacy for independent fiscal institutions to play a stronger role in helping both to enhance the transparency of policy in a number of ways and to depoliticise key aspects of fiscal policy.

Totally depoliticising fiscal policy via full delegation of responsibility for the fiscal balance is neither theoretically founded nor democratically advisable. First, there is considerable uncertainty regarding the optimal level of the deficit and debt, and consequently little hope for political consensus regarding the appropriate target to set. Second, fiscal policy in all respects has distributional consequences; deficits can redistribute to or from future generations, and within generations, depending upon the reasons for which debt is incurred. With accountability in democracies imposed through the ballot box, deferring full responsibility to technocrats in fiscal institutions would interfere with a fundamental right of the voter. Thus, while fiscal councils can in many instances be handed normative mandates – to offer views of what is technically deemed an appropriate fiscal stance – an illuminated legislature ought to remain the final arbiter.

At the same time, and well short of delegating full policymaking authority, independent fiscal councils can be assigned mandates that contribute to more disciplined fiscal policy. These include responsibility for, or contributions to, macroeconomic forecasting for the purposes of budget formulation, to reduce bias. These also include independent forecasts of key budgetary variables that can be prone to politically-motivated bias, such as overly optimistic revenue projections (which create fiscal "space" to boost unfunded spending) and under-projection of long-run costs of legislative initiatives. Given the complexities of many public programmes, and the associated challenges of understanding their impacts in terms of both efficiency and distribution, the general public can be well served by the funding of independent institutions mandated to undertake analysis of fiscal issues, simulate policy alternatives, make macroeconomic forecasts under different fiscal scenarios, etc. By informing politicians and the public about the larger implications of fiscal initiatives, a fiscal council can help pre-empt deficit bias arising from common pool problems. More informed voters are more able to hold politicians accountable, which in turn contributes to better democratic decision-making.

Influence through such fiscal councils hinges on several factors. First, the agency must have full autonomy to establish its work priorities within the scope of its mandate. Second, there must be active and unfettered dissemination of the agency's analyses and reports. Indeed, surveys of fiscal councils throughout the EU reveal considerable conviction that dissemination and media support have visible impact on the debate over policy issues. Third, credibility is gained through sustained, high quality and visibly independent analyses (*i.e.* political feathers get ruffled occasionally) over long periods of time. Indeed, the most effective institutions may well be those, such as the CBO in the US and the HCF in Belgium (among others), that are given the time needed to establish credibility, which in turn reduces their vulnerability to political tampering. The recent experience in Hungary is instructive in this regard.

Experience and empirical evidence suggest that delegating macroeconomic forecasting to an independent fiscal council can indeed reduce forecasting bias and, therefore, the deficit bias that would otherwise follow. Given the intertwining of the macro economy and budget policy, the most effective delegation of economic forecasting will be obtained when there is close interaction between the government agency or agencies most responsible for budget formulation and the forecasting fiscal council, as in several countries, including Belgium and the Netherlands. While the forecasts of some agencies are binding (*e.g.* the FPB in Belgium), influence can also be achieved by lesser requirements, as in Germany, where the government has to justify an alternative outlook from that of independent experts.

There is some empirical evidence that fiscal institutions can buttress a government's capacity to comply with a numerical rule. Such support can come through a range of activities to ensure compliance, including the preparation of baseline macro forecasts and a current services budget, and verifying adherence to transparency standards and best budgeting practices.

A key question surrounding the decision to create a fiscal council is why such an entity would have a potentially greater disciplining effect than existing unofficial and academic bodies or persons? In smaller countries with a relatively less-developed infrastructure of unofficial bodies, the creation of a fiscal council enables the pooling of local expertise (creating analytical synergies) and access to financial and informational resources not otherwise available to unofficial bodies. In larger countries, however, where unofficial bodies are prevalent and potentially influential through the media and by active participation in public policy debates, a principal advantage gained from the creation of a fiscal council is the latter's access to the more detailed confidential data normally restricted to legislative and executive agencies. In all countries, however, a desired benefit to the government of creating an official fiscal council is to signal the government's commitment to good behaviour.

Good fiscal institutions are a necessary condition for achieving disciplined fiscal performance. Experience demonstrates, however, that their existence is not sufficient. Without strong and sustained political commitment to a medium-term fiscal goal and, where relevant, to the mandate of a fiscal council, durable improvements in fiscal performance will remain elusive.

Notes

1. A fiscal council was also established in Hungary in 2009. It experienced a tumultuous short life, however, having been *de facto* terminated in late 2010 following the elections in May 2010. See Box 1.
2. This can pose a particular problem in monetary unions where the centralisation of monetary policy can reduce each member's incentive to maintain a disciplined fiscal stance (Beetsma and Bovenberg, 1999).
3. Reinhart and Rogoff (2009) find that public debt levels of 90% of GDP and higher in industrialised economies are associated with noticeably lower rates of economic growth.
4. See Wachtel and Young (1987), Balassone *et al.* (2004), Engen and Hubbard (2004), and Gale and Orzag (2004).
5. See, for instance, Kopits and Symansky (1998) and Kopits (2001).
6. Output stabilisation is occasionally an additional objective. In some countries, the unemployment rate is also a partial objective of monetary policy, as in the United States.
7. This is less pertinent for the overall levels of taxes and spending than for their structure.
8. This may be a greater concern in small countries with relatively fewer private institutions providing independent macro forecasts than in larger countries.

9. This is not to say, however, that there are not countries in which the government, out of fiscal prudence, purposefully projects revenues conservatively at times.
10. Some have suggested that international organisations themselves, such as the IMF, OECD, and European Commission, also play a role as quasi-independent institutions, since their macroeconomic and fiscal analyses and policy prescriptions are in principle unaffected by purely political considerations. At the same time, none of these has either the resources or the detailed country-specific knowledge needed to undertake the adequate and real-time analysis needed for thorough fiscal oversight (Kopits, 2010).
11. Fiscal councils in non-EU OECD countries are not included in the table because of the absence of information on these entities collected from a similar questionnaire as used by the European Commission. Inclusion of the Fiscal Council of Hungary (which commenced operations after the European Commission's 2008 survey) in the table has been done in consultation with the Fiscal Council of Hungary.
12. The National Accounts Institute (NAI) also plays a significant independent role in Belgium, since it provides macroeconomic forecasts.
13. See *Portuguese Fiscal Policy Council Working Group*: *www.cfinpub.org/en-US/OsEstatutos/Pages/OsEstatutos.aspx*.
14. See *www.hm-treasury.gov.uk/data_obr_index.htm*.
15. See "Establishment of Irish Fiscal Advisory Council", *www.finance.gov.ie/viewdoc.asp?DocID=6927*.
16. More recently, however, the government was required, due to the inflexibility of the law, to use the somewhat dated macro projections of the FTB notwithstanding that these, due to rapidly changing economic circumstances, had become overly optimistic.
17. It should be noted that the author of the paper is a senior member of the HCF.
18. Here, "section" refers to the Public Sector Borrowing Requirement Section of the HCF.

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