

Independent Fiscal Institutions: Developing Good Practices

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Outline

- **Motivation**
- **Evolution, experience, challenges**
- **The case of Hungary**
- **Comparison with the UK**
- **Lessons for good practices**

Motivation

- **Financial crisis exposed underlying vulnerabilities**
 - large structural deficits
 - worsened by financial crisis
 - debt sustainability problem
- **Insufficient fiscal transparency**
- **Free rider behavior (within EU)**
- **Goal: restoring policy credibility**
- **Need for independent fiscal watchdogs**
- **Need to develop good practices**

Evolution, experience, challenges

Characteristics, responsibilities

- **Independent surveillance of fiscal policymaking
(incl. monitoring compliance with rules, targets)**
- **Real-time forward-looking assessment
complementary to SAO, budget committees**
- **Costing, macro-fiscal forecasting**
- **No decision-making, limited advisory function**

Selected Countries

	Structure		Remit / Functions				
	Head	Staff	Compliance	Macro-fiscal	Sustainability	Costing	Advisory
United States (CBO)	individual	X		X	X	X	
Netherlands (CPB)	individual	X	rules	X	X	X	
Belgium (HCF)	collective	other	targets	X	X		X
Korea (NABO)	individual	X		X		X	
Sweden (FPC)	collective	other	rules	X	X		X
Canada (PBO)	individual	X	targets	X		X	
Hungary (former FC)	collective	X	rules	X	X	X	
United Kingdom (OBR)	collective	X	target	X	X	X	

Evolution, experience, challenges

Experience

- **Effectiveness must be evaluated against counterfactual**
- **Need to function over at least two government cycles**
- **Limited number of cases and brief track record**
- **So far, on balance, favorable experience**
- **Few failures**

Evolution, experience, challenges

Challenges

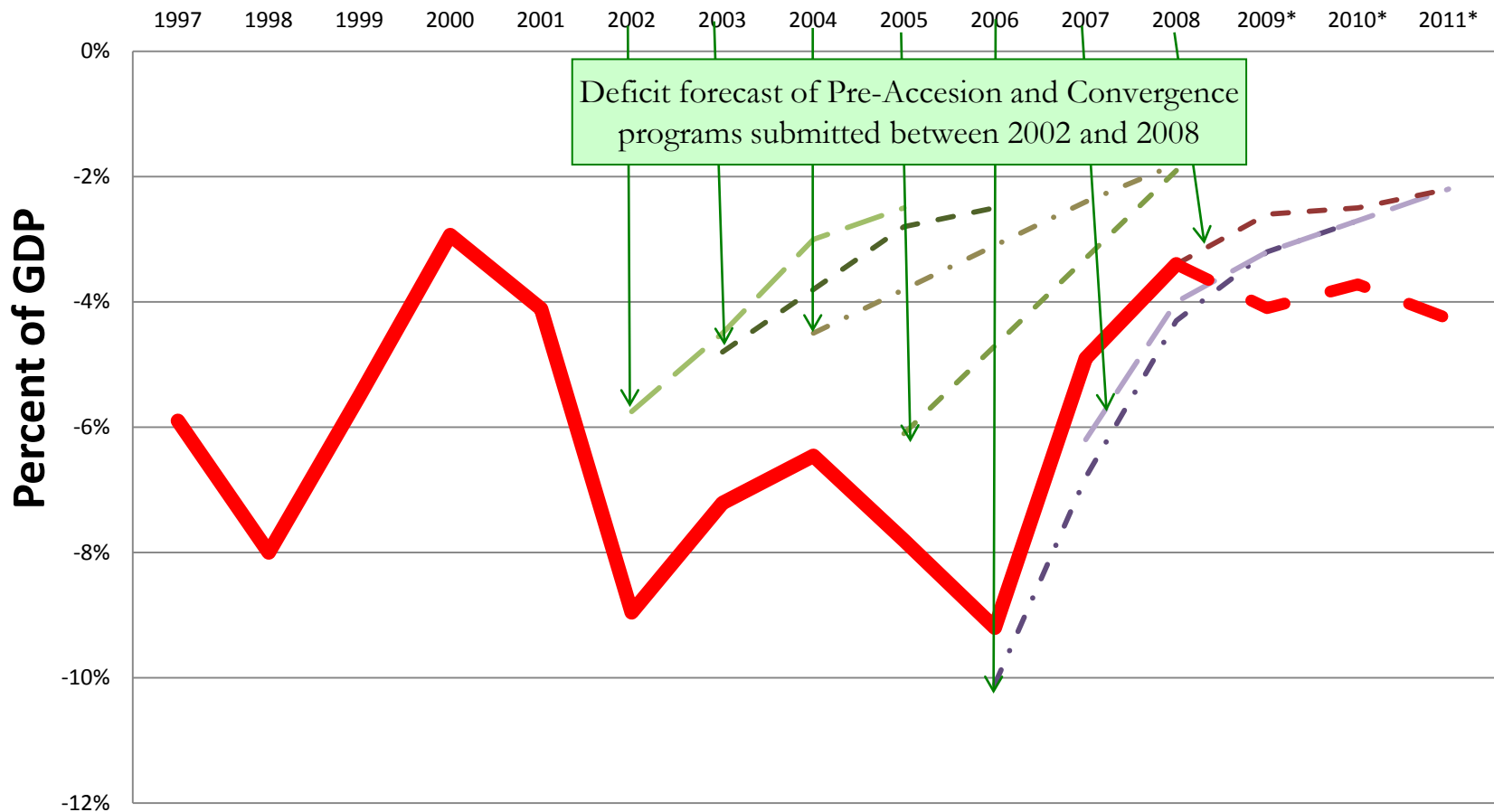
- **Conception and birth**
- **Establishing reputation**
- **Threats to funding**
- **Difficulties with timely access to data**
- **Survival threatened by a government with overwhelming legislative majority**

Hungary: Background

- ***Fiscal indulgence through 2006***
 - deficit bias
 - intertemporal inconsistency
 - moral hazard encouraged by EU accession
 - pro-cyclical expansionary fiscal stance
 - worst fiscal performance in the EU (2006)
- ***Adjustment from 2007 onward***
 - deterioration in investor sentiment after LB collapse
 - standby arrangement with IMF, EU
 - drastic pro-cyclical contraction

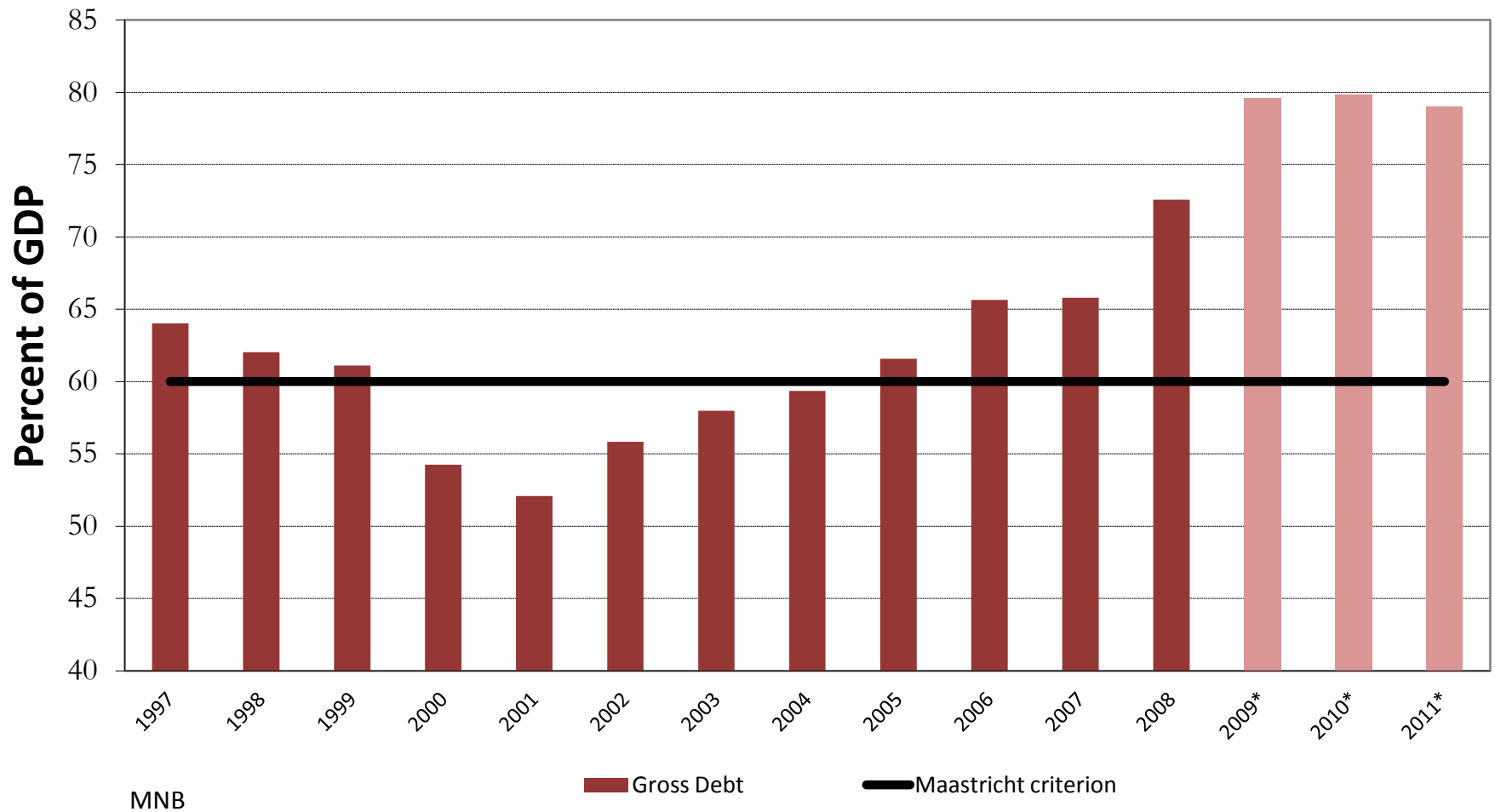
Hungary: Background

General Government Balance



Hungary: Background

Public Debt



Hungary: Birth of the Fiscal Council

- **Initial suggestions (2006)**
 - fiscal policy rules
 - procedural rules, transparency requirements
 - independent fiscal institution
- **Options, debate (2007-08)**
 - decision-making vs. surveillance
 - technical office vs. fiscal council
 - coercion vs. dissuasion
- **Fiscal Responsibility Law (Nov. 2008)**
 - policy rules: debt limit, expenditure limit
 - procedural rules: pay-go rule, MT budget planning
 - Fiscal Council, with technical support staff

Hungary: Goals and Characteristics

- ***Goals***
 - restoration of credibility to fiscal policymaking
 - improving transparency
 - restoring public debt sustainability
- ***Basic characteristics, functions***
 - independence (election, tenure of FC members)
 - arm's length relation, equal access
 - decisions by consensus
 - surveillance (evaluation, compliance)

Hungary: Surveillance functions

- ***Evaluation at an aggregate level***
 - baseline (current legislation) macro-fiscal projections
 - real-time macro-fiscal projections w/ policy proposals
 - long-term sustainability analysis
 - policy simulations, sensitivity tests
 - basis: enhanced DSGE model, plus expert opinion
- ***Evaluation at a disaggregate level***
 - real-time costing of mandatory programs
 - real-time assessment of fiscal risks
 - basis: parameter estimates, plus expert opinion

Hungary: Surveillance functions

- ***Compliance with standards, procedures***
 - public sector accounts
 - medium-term budget planning

- ***Compliance with fiscal rules***
 - pay-go rule
 - expenditure ceiling
 - real debt limit

Hungary: Enforcement

- ***Persuasion through multiple channels***
 - communication with parliament
 - communication with the government
 - communication with the general public

- ***Mixed success***
 - good start (strong staff, tailwinds from IMF-EU)
 - favorable press coverage
 - positive feedback from civil society
 - first gov't complied with some assessments
 - second gov't did not react until end-year

Hungary: Demise of FC

- **Context under new government**
 - two thirds majority, constitutional power
 - questions CC, CB, SAO, FC independence
- **Critical assessments by FC**
 - changes in accounting rules
 - effects of various changes in tax law, pension reform
 - forecasts of four-year macro-fiscal outlook
- **Reactions by government**
 - limited access to information
 - proposal to drastically cut funding
 - disbandment of FC staff
 - narrowing remit of FC to opinion on budget bill
 - appointment of new FC chair (following resignation of former)

Comparison with the UK

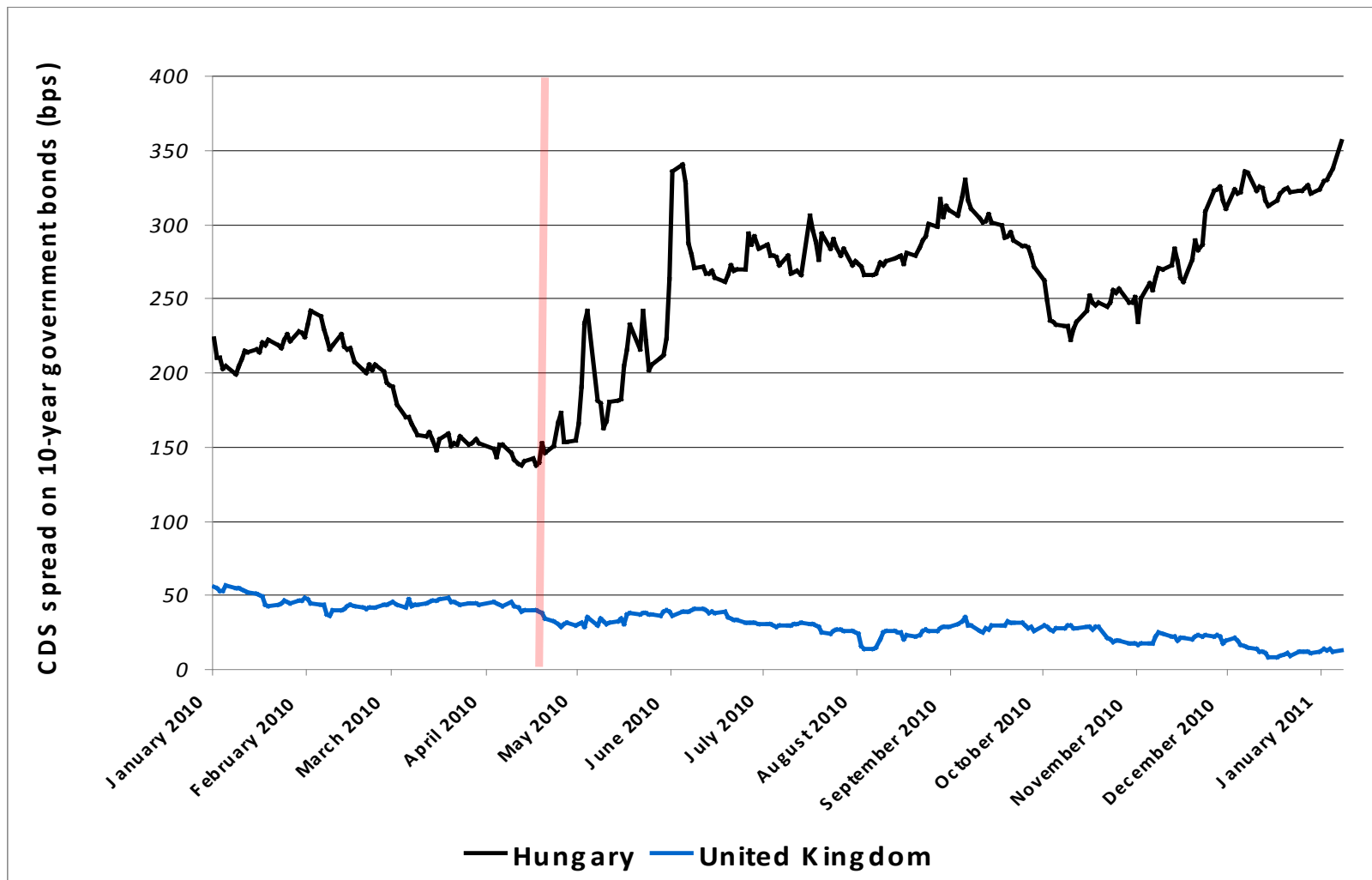
Stylized illustration

- **Common features**
 - fiscal sustainability problem
 - low policy credibility
 - contemporaneous election of center-right governments
- **United Kingdom**
 - clear medium-term fiscal target
 - front-loaded adjustment program
 - adoption of Office for Budget Responsibility
- **Hungary**
 - mixed and opaque policy signals
 - emphasis on distortionary stopgap measures
 - abolition of Fiscal Council

Hungary and UK: sovereign risk premium



Hungary and UK: sovereign default risk premium



Lessons for good practices

- **Institution must be home-grown and home-owned**
 - credibility cannot be imported, change political culture from within
- **Independent, nonpartisan, competent, and accountable**
- **Technical infrastructure (staff, access to data)**
- **Remit**
 - surveillance of compliance with fiscal rules, targets, transparency
 - assessment of fiscal stance and debt sustainability
 - macro-fiscal forecasting (baseline and policy), costing
 - exclusion of normative or decision-making functions
- **Identifying itself and operating as soon as possible**
- **Early development of effective communication channels**