Measuring IFI Independence: A first pass using the OECD IFI Database

This paper was prepared for a Vox eBook and include a link back to the book “Independent Fiscal Councils: watchdogs or lapdogs?” published in 2018.

OECD
BETTER POLICIES FOR BETTER LIVES

5 Measuring IFI independence: A first pass using the OECD IFI database

Lisa von Trapp and Scherie Nicol
OECD[1]

Countries across the OECD have established independent fiscal institutions (IFIs) to promote sound fiscal policy and sustainable public finances. As their name suggests, IFIs are expected to act independently, providing objective analysis free from political influence. The OECD Principles for Independent Fiscal Institutions (2014) offer guidance on issues to consider in the design and governance of IFIs, including key measures to safeguard independence. This chapter presents a preliminary measure of IFI independence using a set of variables drawn from the OECD Principles and new data from the OECD IFI Database (2017) of 26 IFIs in OECD Member countries. It shows that, despite the heterogeneity of these institutions, OECD IFIs exhibit high levels of independence across the board, particularly in the areas of legal independence, leadership independence, and transparency. There is some room for improvement in financial independence, operational independence and access to information. The chapter concludes with a brief discussion of whether there is a link to be made between an IFI's independence and its impact.

1 Senior Policy Analyst and Policy Analyst, Budgeting and Public Expenditures Division, Directorate for Public Governance, OECD. The information and views set out in this article are those of the authors and do not necessarily reflect the official views of the OECD. The authors would like to thank Jón Blöndal, Ronnie Downes, George Kopits, Michal Horvath and Joachim Wehner for their comments on earlier drafts.

Introduction

By providing an independent, non-partisan and objective assessment of fiscal policy and performance, Independent Fiscal Institutions (IFIs) serve to promote sound fiscal decision-making and sustainable public finances. They reduce information asymmetries and promote greater transparency of the public finances, thus raising reputational and electoral costs for governments that pursue imprudent policies or break key commitments. Consequently, they can help to address biases towards spending and deficits.

IFIs within the OECD are highly heterogeneous – there is no one size fits all model. The characteristics of this diverse group of institutions are informed by country-specific circumstances and, in the case of European IFIs, by supranational commitments leading to variations in terms of their institutional models, mandates, tasks, governance provisions and resources. Despite these differences, there is broad agreement on factors critical for ensuring the independence and good functioning of IFIs, as outlined in the *OECD Principles for Independent Fiscal Institutions* (OECD, 2014), and in line with the rich literature on independence for other independent institutions such as central banks and supreme audit institutions.

This chapter is the first attempt to build an index capturing these critical factors. It encompasses aspects such as leadership arrangements, operational autonomy, and resources. Recognising that access to information[2] and transparency are essential to the good functioning of IFIs, the index also takes these two aspects into account. The data underlying the index is drawn from the OECD IFI Database (2017) which currently covers 26 institutions.[3]

2 Access to information is also one of the eight pillars defining the independence of supreme audit institutions (INTOSAI, 2012).

3 This database is regularly updated to include new institutions. Several institutions are in the process of being added and may be included in future versions of this index. It should also be noted that where the categories are the same, the OECD IFI Database and IMF Fiscal Council Dataset have been aligned.

Establishing IFI independence

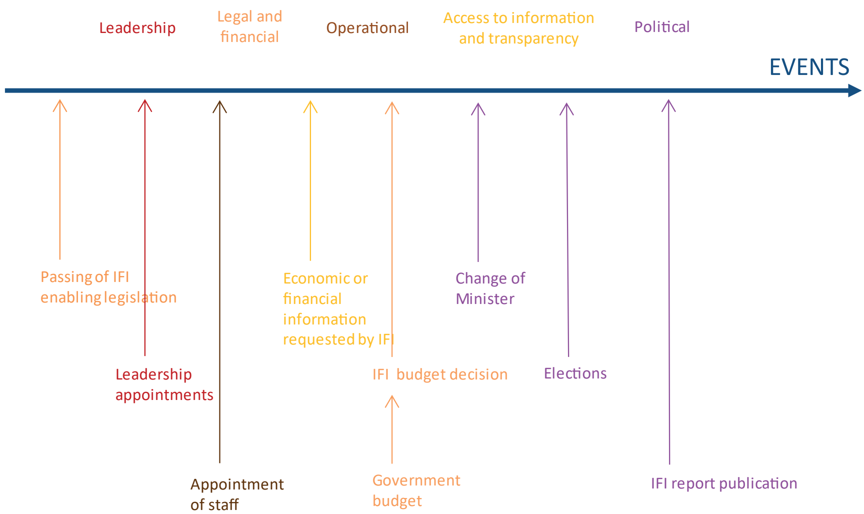
Independence and non-partisanship refer to the ability of an IFI to undertake its duties free from political pressure or influence. An IFI that is not independent may struggle to present a critical view of government plans and policy choices when it is most needed. Similarly, an IFI that attempts to take on board bi-partisan or multi-partisan views, rather than being strictly non-partisan, risks coming under political influence or moderating legitimate evidence-based expert criticisms in favour of cross-party consensus. Given that the influence of IFIs in fiscal policymaking is persuasive – rather than coercive by means of legal sanctions or other punitive measures – their reputation is among their most valuable assets. Even the perception that an IFI is not independent can seriously undermine an IFI's reputation and credibility as a politically neutral arbiter of the numbers.

An IFI's independence may come under stress at given 'pinch points' where there is potential for greater undue influence to be exerted (see Figure 1). For example, where there have been conflicts between the government (or the legislature which may have a strong government majority in place) and the IFI, there are cases of politicians attempting to curtail the independence of an IFI by restricting access to information, cutting or threatening to cut the IFI's resources (e.g. Canada, Sweden) and exerting control over its work programme. In the case of Hungary, not only were resources sharply curtailed and staff eliminated, but its mandate was changed.[4]

The extent to which independence is fostered within an IFI is significantly influenced by the legislation that establishes and governs the institution. Legislation gives the institution legal separation from the executive (and other public institutions) and typically contains provisions relating to the leadership appointment and dismissal process, the institution's resources, and rights to access information, among other things.

4 For discussion of individual country cases see IMF, 2013, and von Trapp *et al*, 2016. For an in-depth discussion of the Hungarian case see Kopits, 2011.

Figure 1. Pinch points: potential entry points for undue influence



It is important to note, however, that *de jure* independence does not always translate into *de facto* independence and may not capture the relationship culture of the IFI, government and other public institutions. Moreover, most IFIs work to gain *de facto* independence over time through their actions and analysis. For example, the decision by the United States Congressional Budget Office not to provide normative advice, while it was not prohibited from doing so in legislation, has arguably reinforced its *de facto* independence. Another of the oldest and most renowned IFIs, the Netherland's Bureau for Economic Policy Analysis (CPB), technically sits within the executive,[5] but in practice it acts with complete autonomy and its independence is respected by all. The CPB also does not have access to information underpinned by legislation but in practice does not experience difficulties accessing the information it needs. Others such as the Canadian Parliamentary Budget Office (PBO) and the Spanish Independent Authority for Fiscal Responsibility (AIReF) have legal underpinning for access to information but have experienced substantial difficulties leading both to bring their case before the courts. *De facto* independence is more difficult to capture in an index such as this one, although certain variables have been included in an attempt to capture both. Nevertheless, as with any index, the results should be interpreted with caution.

5 Indeed the CPB's *de facto* role as the institution responsible for macroeconomic projections was only recently formalised under the 2013 Sustainable Public Finances Act which embedded new European requirements in Dutch law.

Measuring IFI independence

The multi-dimensional nature of independence means that it can best be measured by a set of indicators that are simultaneously appropriate (they capture the relevant aspects of independence), accurate (they measure those aspects correctly) and reliable (the set of appropriate indicators remains stable over time).

As noted earlier, there is broad agreement on critical factors to ensure the independence and good functioning of IFIs, as outlined in OECD (2014), and in literature defining independence for other independent institutions. The OECD IFI Database (OECD, 2017) makes available new information on the key characteristics of IFIs across OECD member countries. Over 40 variables provide information on their context for establishment, legal basis, institutional model, relationship with the legislature, independence, leadership[6], resources, mandate and functions, publications, access to information, transparency, advisory support and evaluation arrangements. This data has allowed the OECD to build a fairly comprehensive measure of IFI independence.

Table 1. Index of IFI Independence and key related OECD Principles

Index Pillar	Key related OECD Principles
Leadership independence	Principles 2.2, 2.3 - selection on basis of merit and technical competence; defined term length different from political cycle; defined criteria for dismissal
Legal and Financial independence	Principles 3.1, 4.1 - established in higher level legislation; published and treated in the same manner as the budgets of other independent bodies; multi-annual funding commitment
Operational independence	Principles 2.1, 2.5, 3.2 – no normative policy-making responsibilities; full freedom over hiring process for staff; set own work programme and scope to produce reports and analysis at own initiative
Access to information and Transparency	Principles 6.1, 6.2, 7.1, 7.2 – access to information (and any restrictions) in legislation and underpinned by MoU; full transparency in work and operations; reports, analysis and methodologies published

6 Including whether it is collegial or individual, the appointment process, etc.

The proposed index of IFI independence covers sixteen variables under four broad pillars: leadership independence, legal and financial independence, operational independence, and access to information and transparency (see Annex 1).[7] In the interest of objectivity and transparency, the pillars and variables have been given equal weights.[8]

The index does not include variables related to specific functions (e.g. the role in the provision or assessment of official forecasts or the monitoring of fiscal policy rules). There are other potential variables, for example whether the institution's resources are commensurate to its mandate which were also not included as they were deemed to involve too much judgement without a clear evidence-base at this time.[9]

Leadership independence

The leadership of an IFI ultimately takes the decisions for which the institution will be held accountable, and can be exposed to greater pressures than professional staff. The variables in this pillar include whether leadership appointments are made on the basis of merit and technical competence; there are clearly defined term limits that are delinked from the political cycle; there are clearly defined criteria for dismissal of the leadership; and whether the institution has experienced dismissal of leadership not for cause.

Legal and financial independence

This pillar refers to the grounding of an IFI's independence in higher level legislation and to protections for its financial resources.[10] Working independently requires predictable financial resources free from interference, e.g. the government should not have the

7 Early research supports certain of these variables as important to effective IFIs (see for example, Debrun and Kinda 2014, Debrun and Beetsma 2017, Jankoviks and Sherwood 2017).

8 Institutions are given a full score where they fully comply with a variable in the index, and a half score where they partially comply. The selection of indicators and weighting is based primarily on expert judgement. Correlation analysis was conducted and showed no signs of redundancy/collinearity among variables selected.

9 Inclusion of this variable could, for example, impact the place of the German Independent Advisory Board which meets the measures on financial independence but is one of the least resourced IFIs within the OECD.

10 In broad terms financial independence refers to the legal and practical arrangements identifying the finances of an IFI and the extent to which the IFI is subject to outside influence in this regard.

discretion to alter the budget of the institution. The variables in this pillar include whether the IFI is established in constitutional or primary law; has a separate budget line; has a multiannual funding commitment; and whether the IFI has experienced an imposed budget cut.

Operational independence

This pillar captures aspects of an IFI's autonomy over its operations. It also considers whether or not the IFI makes normative recommendations, which, according to the OECD Principles, poses a risk to their non-partisan reputation. For many institutions, not making normative recommendations has been an operational choice rather than a legal restriction. The variables in this pillar include whether the IFI can set its own work programme within the bounds of its mandate; is able to undertake research and analysis at its own initiative; makes policy recommendations; has its own staff; and has its own website. The latter is taken as an indicator of operational control over its communications.

Access to information and transparency

On the one hand IFIs require full access to information in order to fulfil their mandate effectively and independently. On the other they have a special duty to provide information and to act in as transparent a manner as possible. Full transparency in their work and operations both demonstrates IFI independence and provides the greatest protection of that same independence. The variables in this pillar include whether the IFI has access to information secured through legislation or a Memorandum of Understanding (MoU); the institution's work plan or other operational documents are published; all reports are published; and underlying methodologies are published.

Results of the Index of IFI Independence

Figure 2 shows the results of the Index of IFI Independence in 2017 for the 26 institutions currently included in the OECD IFI Database.[11] Several messages emerge:

- Most IFIs exhibit a high level of independence, with 19 of the 26 institutions receiving an independence score of 75% or more, and eight institutions scoring 90% or more, meaning that they generally fall down in relation to just one or two of the 16 variables.
- IFIs consistently score very highly in relation to leadership independence, with 16 out of the 26 institutions exhibiting all the measures of independence in this area. Where institutions do fall short, it is most often because they do not have clearly defined criteria for dismissal of leadership (Austria, Belgium, Germany, Greece, Iceland, Korea, Luxembourg, and Sweden). In the Korean case, changes in leadership are also linked to the political cycle as there is a tradition that the Chief submits his resignation when the Speaker of the National Assembly changes every two years.
- IFIs also scored relatively highly in the access to information and transparency pillar, with over half of the 26 institutions exhibiting all four measures of independence in this area. However, this masks some variation between the indicators relating to transparency and those relating to access to information. While institutions tend to score very highly in relation to transparency, fewer score full points in the area of access to information. Three of the 26 institutions only have access to information secured through a MoU (Australia, Belgium and Ireland) and five institutions do not have access to information secured through any means at all (Austria, Denmark, Germany, Netherlands and Sweden). However, as previously mentioned, access to information in practice often depends on good relations between the IFI and institutions within government rather than legal rights.

11 For a full list of institutions currently included in the database see Annex 2. The data for Canada reflects new legislation adopted in 2017 which has yet to be tested in practice. Similarly, the new Slovenian Council has only just started operations. While the index shows the strength of its legislation it cannot capture its *de facto* independence with any certainty at this time. Its place in the ranking should be interpreted with this caveat.

- There are mixed results for the pillar on operational independence. Just ten institutions meet all measures of independence in this area. Seven IFIs do not have their own staff (e.g. seconded from the central bank), or hire staff that are part of another institution's service.[12] It should be noted that, provided that the IFI has full hiring and firing powers, in some cases, particularly for very small institutions, there may be useful efficiencies to having staff linked to another institutions' service. A number of institutions also provide normative advice. However, in the case of OECD IFIs, normative advice is usually strictly limited in scope and relates to providing recommendations to ensure compliance with fiscal policy objectives.[13]
- IFIs score lowest in relation to the legal and financial independence pillar. While all of the institutions, except one (Sweden), are established in constitutional or primary legislation, only three out of 26 obtain full scores in relation to financial independence (United Kingdom, Australia and Germany). Just 54% of institutions have their own budget line, and only 38% benefit from some kind of multi-annual funding commitment.

There are three main institutional models for IFIs observed across the OECD: Parliamentary Budget Offices (PBOs), Fiscal Councils, and IFIs that sit within supreme audit institutions. The average independence score is relatively similar for IFIs that are either PBOs or Fiscal Councils. The independence of IFIs within Audit Institutions, however, is slightly below the OECD average due to integration into their host institution. This should be interpreted with some caution. Placing an IFI within the supreme audit institution arguably allows it to benefit from the independence of its host; this was the argument in the case of France for example where the Court of Audit has a strong reputation for independence. Nevertheless, there are risks that the IFI could be too integrated into its host institution creating confusion around their respective mandates and functions (IMF, 2013).

12 Interestingly, while not captured in this measure, an independent review of the UK Office for Budget Responsibility found that it was ultimately "dependent on approximately 125 full-time equivalent (FTE) employees from other government agencies to produce its core reports." (Page, 2014)

13 Where institutions provide only very limited normative advice, their score was adjusted to reflect this.

Figure 2. Index of IFI Independence

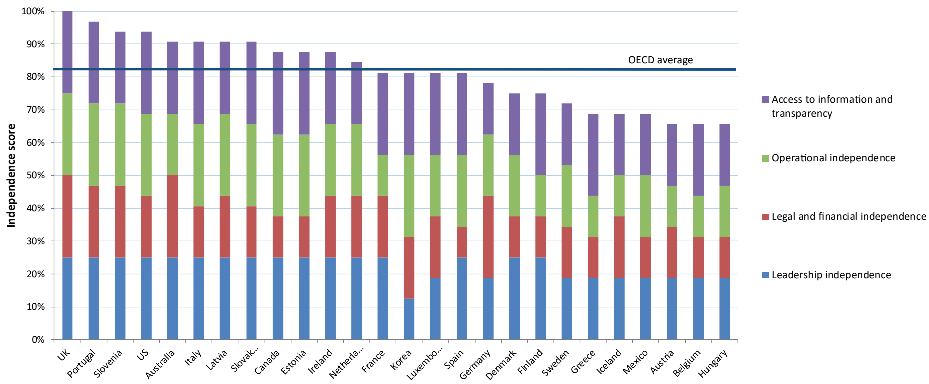
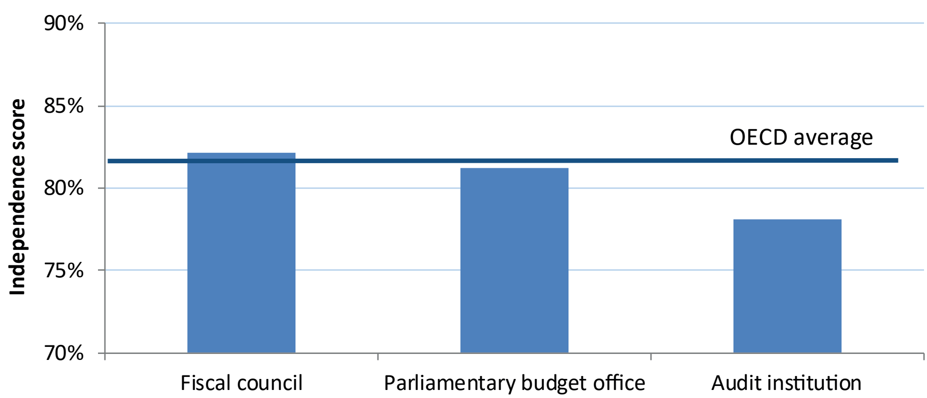


Figure 3. Independence by Institutional Model



Independence and the impact of IFIs

The mere existence of an IFI does not automatically generate better fiscal policy. Observers have noted the difficulties in quantifying the impact of IFIs due to several factors. Most of these institutions are relatively new and their considerable heterogeneity complicates any empirical assessment. Moreover, as Jankovics and Sherwood (2017) note, it is difficult to disentangle the influence of IFIs from other elements in national fiscal frameworks. The individual country context in which they operate is also important.

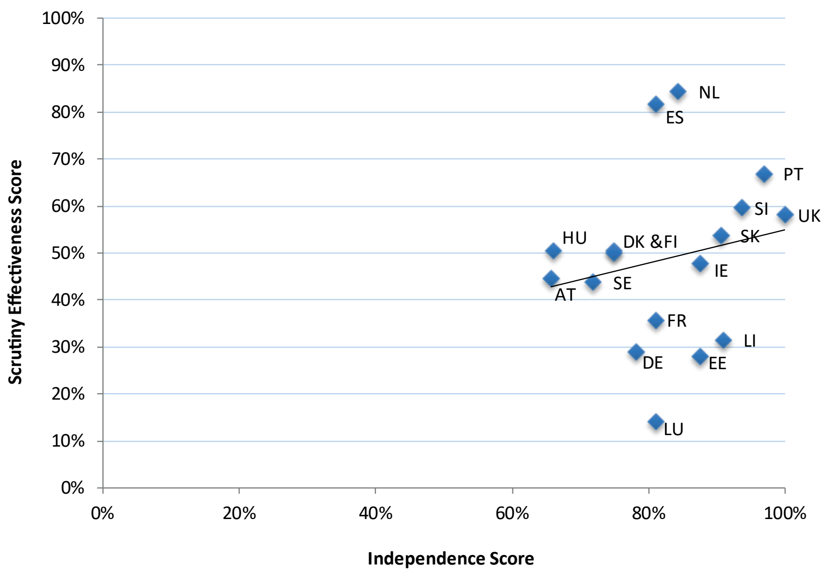
Any investigation of an IFI's impact needs to take into account sources of deficit bias in the country (Calmfors, 2015) or whether governments have traditionally shown a preference or strong commitment to sound public finances.

Direct influence is also difficult to assess as, unlike central banks, IFIs do not have a direct lever on fiscal policy. Their main channel of influence is public debate, typically through media or discussions in parliament. As such, their influence may be measured not only by whether they have been shown to push governments towards adopting more prudent fiscal policies but also by whether their analysis is at the forefront of any timely debate on fiscal policy. One of the worst fates for an IFI is to be ignored. Early analysis undertaken by the IMF suggests that countries where IFIs have a higher media impact tend to exhibit better fiscal outcomes. Interestingly they also found evidence that the credibility of the independence of the IFI is an important pre-condition for its views to be reflected in the public debate (IMF, 2013).

Further research has shown that countries with IFIs, either with legal guarantees of independence through legislation, or with operational guarantees through adequate human resources, have, on average, better fiscal outcomes (Debrun and Kinda 2014). Based on a stylised model showing how a fiscal council can effectively promote fiscal discipline, Beetsma and Debrun (2017) found evidence that a strong majority of fiscal councils exhibit the independence required to send the necessary signals on fiscal policy but that a number of institutions would benefit from stronger guarantees of independence, including through increased and secure resources and guaranteed access to information.

Horvath (2017) has developed a first indicator of EU IFIs' aggregate scrutiny effectiveness, which measures how well a given IFI is equipped to carry out their scrutiny role. Comparing his results with those in this article (Figure 4) suggests that, in general, higher protections of independence are associated with higher potential scrutiny effectiveness. However, there are a number of outliers, reflecting once again the importance of country-specific circumstances in which IFIs operate.

Figure 4. Comparing independence and effectiveness scores for EU IFIs



Conclusions

Using IFIs to promote prudent fiscal policymaking and sound public finances is an idea that is enjoying considerable popularity. The preliminary index of IFI independence in this article seeks to further the debate on IFI independence. It shows that the majority of OECD IFIs have been designed to be highly independent and that most score particularly well on variables related to leadership independence and transparency. However, local context remains an important factor when discussing IFI independence. Even where they have been well designed from a legal standpoint, IFIs may lack the necessary information and resources they need and be hampered from carrying out their functions freely. Indeed, institutions tended to score less well on variables related to access to information, financial independence and operational independence.

The index is subject to two important limitations. As discussed, it cannot fully capture *de facto* or effective independence that distinguishes IFIs with a track record of evidence-based active engagement with the government (as is the case of the US CBO, Canada's PBO, the Netherland's CPB, Sweden's FPC), from IFIs that seem to pander to the government. Second, it should be acknowledged that the index refers to a current situation that might be rather volatile, insofar as IFIs are, to a greater or lesser extent, fragile institutions when exposed to threats by a government, especially one with a populist orientation (Beetsma *et al*. 2017). This index helps to further pinpoint potential risks to independence should a government seek to put pressure, particularly at one of the 'pinch points' discussed earlier.

The importance of independence is highlighted in the theory and early analysis of IFI performance. Despite good indications, further work is needed to more explicitly link independence to IFIs good performance.

References

Beetsma, R. and X. Debrun (2017), 'Fiscal Councils: Rationale and Effectiveness', Chapter 5 in Odor, Ludovit (ed.), *Rethinking Fiscal Policy After the Crisis*, Cambridge University Press.

Beetsma, R., X. Debrun and R. Sloof (2017), 'The Political Economy of Fiscal Transparency and Independent Fiscal Councils', ECB Working Paper No 2091, European Central Bank.

Calmfors, L. (2015), 'The Roles of Fiscal Rules, Fiscal Councils and Fiscal Union in EU Integration', IFN Working Paper, No 1076, Research Institute of Industrial Economics, Stockholm

Debrun, X. and T. Kinda (2014), 'Strengthening Post-Crisis Fiscal Credibility: Fiscal Councils on the Rise – A New Dataset', IMF Working Paper, WP/14/58, IMF, https://www.imf.org/external/pubs/ft/wp/2014/wp1458.pdf

Horvath, M. (2017), 'European Fiscal Compact in Action: Can Independent Fiscal Institutions Deliver Effective Oversight?', Council for Budget Responsibility Discussion Paper No. 1/2017, https://www.rozpoctovarada.sk/eng/rozpocet/343/european-fiscal-compact-in-action-can-independent-fiscal-institutions

International Monetary Fund (IMF) (2013), 'The Functions and Impacts of Fiscal Councils', IMF Policy Paper, IMF, https://www.imf.org/external/np/pp/eng/2013/071613.pdf

Jankovics, L. and M. Sherwood (2017), 'Independent Fiscal Institutions in the EU Member States: The Early Years', European Economy Discussion Paper 067, https://ec.europa.eu/info/sites/info/files/dp_067_en.pdf

Kopits, G. (2011), 'Independent Fiscal Institutions: Developing Good Practices', OECD Journal on Budgeting, Vol. 11/3, http://dx.doi.org/10.1787/budget-11-5kg3pdgcpn42

Nerlich, C. and W. H. Reuter, 2013, 'The Design of National Fiscal Frameworks and their Budgetary Impact', ECB Working Paper No 1588, Frankfurt: European Central Bank. https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1588.pdf?a7b3bc425c8f13a6cbfb802304d0da96

OECD (2014), 'Recommendation on Principles for Independent Fiscal Institutions', http://www.oecd.org/gov/budgeting/recommendation-on-principles-for-independent-fiscal-institutions.htm

OECD (2017), OECD IFI Database, http://www.oecd.org/gov/budgeting/OECD-Independent-Fiscal-Institutions-Database.xlsx

OECD (2017), 'Designing effective independent fiscal institutions', http://www.oecd.org/gov/budgeting/designing-effective-independent-fiscal-institutions.pdf

Page, K. (2014), 'External review of the Office for Budget Responsibility', Office of Budget Responsibility, London, http://budgetresponsibility.org.uk/wordpress/docs/External_review_2014.pdf.

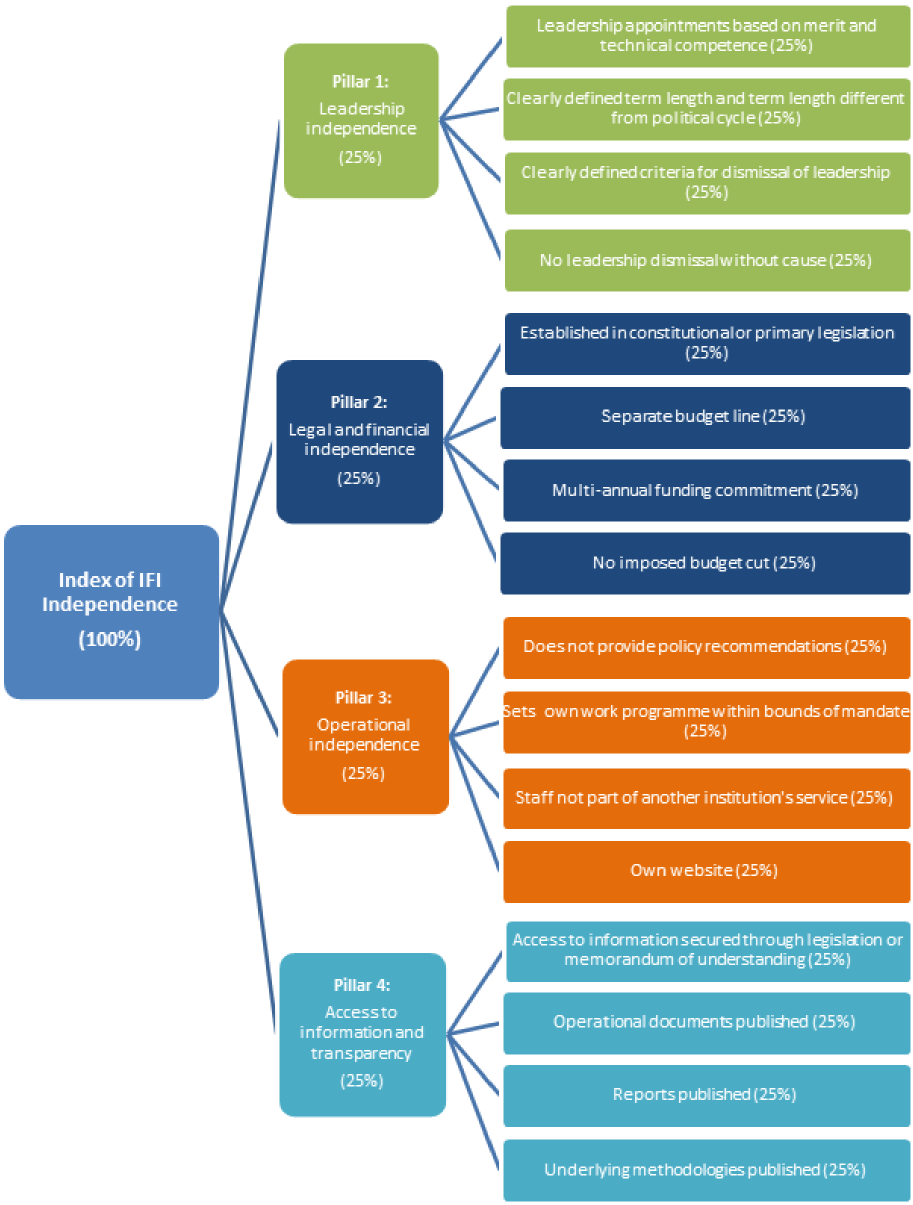
von Trapp, L., I. Lienert and J. Wehner (2016), 'Principles for independent fiscal institutions and case studies', OECD Journal on Budgeting, Vol. 15/2. DOI: http://dx.doi.org/10.1787/budget-15-5jm2795tv625

About the authors

Lisa von Trapp is a Senior Policy Analyst in the Budgeting and Public Expenditure Division, Directorate for Public Governance, OECD. She leads the Division's work on the role of parliaments and independent fiscal institutions in the budget process. Prior to joining the OECD, she served as an advisor and representative to Europe for the World Bank's Parliamentary Strengthening Programme. As a parliamentary development practitioner, Lisa has worked on governance issues with UNDP, SIDA, and Parliamentarians for Global Action. Lisa holds a dual Master's degree in international security policy from Columbia University's School of International and Public Affairs (Phillip E. Mosely fellow) in New York and in political science from the Institut d'études politiques ('Sciences Po') in Paris.

Scherie Nicol is a Policy Analyst in the Budgeting and Public Expenditure Division, Directorate for Public Governance, OECD. She began her career as an economist for the economic development agency for the Highlands and Islands of Scotland. She moved to the Scottish Parliament in 2008, providing research support to the elected members in areas relating to public finance and the economy. In this role she helped set up the Financial Scrutiny Unit and worked on the devolution of increased fiscal powers to Scotland. She holds a Master's degree in Applied Economics from University of Strathclyde in Glasgow.

Annex 1 Index of IFI Independence and its component indicators



Annex 2: Institutions included in OECD IFI Database

Country	Institution name	Acronym
Australia	Parliamentary Budget Office	PBO
Austria	Fiscal Advisory Council	FISK
Belgium	High Council of Finance	HCF
Canada	Parliamentary Budget Office	PBO
Denmark	Danish Economic Council	EC
Estonia	Fiscal Council	FC
Finland	National Audit Office of Finland – Fiscal Policy Evaluation	NAO - FPC
France	High Council for Public Finances	HCFP
Germany	Independent Advisory Board to the Stability Council	IAB
Greece	Parliamentary Budget Office	PBO
Hungary	Fiscal Council	FC
Iceland	Icelandic Fiscal Council	FC
Ireland	Irish Fiscal Advisory Council	IFAC
Italy	Parliamentary Budget Office	PBO
Korea	National Assembly Budget Office	NABO
Latvia	Fiscal Discipline Council	FDC
Luxembourg	National Council of Public Finances	CNFP
Mexico	Center for Public Finance Studies	CEPF
Netherlands	Netherlands Bureau for Economic Policy Analysis	CPB
Portugal	Public Finance Council	CFP
Slovak Republic	Council for Budget Responsibility	CBR
Slovenia	Fiscal Council	FC
Spain	Independent Authority for Fiscal Responsibility	AIReF
Sweden	Swedish Fiscal Policy Council	FPC
United Kingdom	Office for Budget Responsibility	OBR
United States	Congressional Budget Office	CBO

www.oecd.org/gov/budgeting