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# Foreword

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# Budgeting for loans and guarantees: The United States Federal Credit Reform Act

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## Introduction

### *Purpose*

Providing support through the provision of credit is one of many tools that governments can employ to accomplish public policy goals. When properly targeted, government credit programmes can provide many benefits including addressing particular gaps where private lenders may not be serving a market well, assisting in improving resource allocation across an economy, or providing a means to convey a subsidy to further a specific public policy objective.

This paper does not aim to discuss the policy rationale or programmatic outcomes of government decisions to extend credit. Instead, it focuses on the methods used to budget and account for the risks and uncertain budgetary claims resulting from the provision of credit. It examines the United States experience with the US Federal Credit Reform Act (FCRA), highlighting an alternative to cash budgeting and accounting for government loan and guarantee programmes. It briefly addresses issues countries may be experiencing with cash budgeting and credit programmes that do not recognise cost/create uncertain future budgetary claims. This includes new credit programmes implemented in response to the COVID-19 pandemic. Finally, this analysis presents challenges and lessons learned within the US approach.

In June 2020, the Working Party of Senior Budget Officials paper, "OECD Best Practices for Managing Fiscal Risks: Lessons from case studies of selected OECD countries and next steps post COVID-19" (OECD, 2020) called attention to the importance of "the management of balance sheet risks and guarantees and other contingent liabilities risks that dramatically increased in the wake of the COVID-19 crisis." The paper summarised challenges and lessons to be considered and included a listing of "uncertain budgetary claims risks" in programmes associated with the COVID-19 response. This list showed multiple

new guarantee and loan schemes, and also expansion of existing programmes and extended availability, favorable terms, and expedited processing to borrowers.

The paper noted that these new credit programmes implemented in response to the COVID-19 pandemic created uncertain and unprecedented budgetary claims risks, stating, “very large guarantee schemes have been established in most countries as part of the COVID-19 response, well beyond what had been done during the previous global crisis in 2008.” It also noted that these guarantee schemes create uncertainties around expenditure forecasts in the future. The nature of cash budgeting for credit programmes, especially new credit programmes implemented in response to the COVID-19 pandemic, contributes to this uncertainty.

### *Reformed approach to budgeting for credit*

In the fall of 1990, a budget summit of senior US government officials resulted in US Congressional enactment of the US Budget Enforcement Act (BEA) which was intended to control future budgetary actions. This broad budget reform legislation replaced fixed deficit targets with a process designed to enforce compliance with deficit-reduction measures. It established caps on discretionary spending and a pay-as-you-go process which required that legislative actions increasing the deficit through changes in mandatory spending or revenues be offset. Credit reform was enacted as a separate title within the BEA putting credit programmes on an accrual basis for budgeting purposes for the first time. The intent of credit reform was to better measure the cost of credit programmes by assessing the upfront cost of the liability created through the extension of credit, taking into account the risk of default. The primary goals were to:

- Measure more accurately the cost of federal loan and guarantee programmes
- Place the cost of credit programmes on a budgetary basis equivalent to other federal spending
- Encourage the delivery of benefits in the form most appropriate to beneficiaries (e.g. loans vs. grants)
- Improve the allocation of resources among credit programmes and between credit and spending programmes

Credit reform mandated a form of accrual accounting for credit programmes by establishing that the President’s budget should show the “costs” – the “estimated long-term cost to the government” of direct loan and loan guarantee programmes as well as the planned level of new loan obligations or guarantee commitments. Under credit reform, the US Congress authorises and allocates funding for the “subsidy cost” of a credit program. This cost is calculated on a net present value basis, excluding administrative expenses. The cost is also re-estimated annually throughout the life of the loan or guarantee based on actual loan performance, and forward-looking costs are adjusted based on this experience.

This paper is intended as an overview of the US implementation of credit reform. It reviews the US experience prior to credit reform including the budgeting and accounting problems encountered using cash budgeting for credit programmes and notes political economy issues associated with its introduction. This paper outlines the new budgeting and accounting procedures associated with the reformed budgeting method for credit, and notes specific issues and problems identified with various aspects of implementation.

## US credit programme background

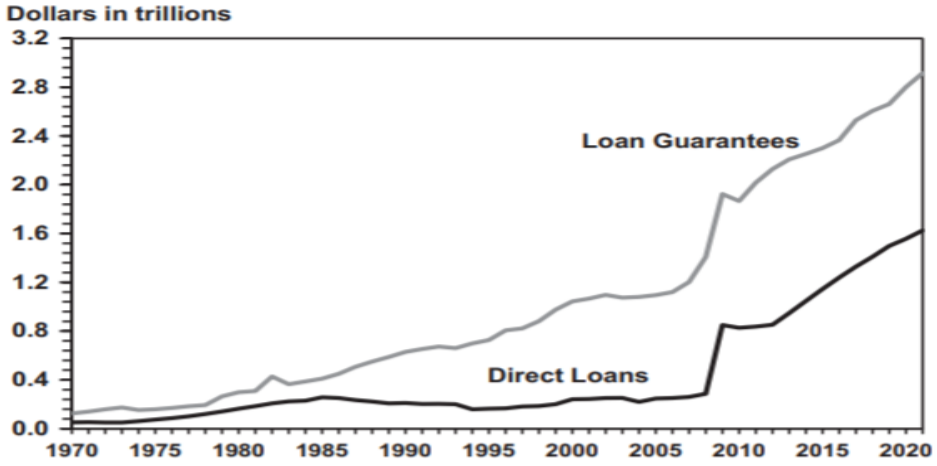
### *Background on US government provision of credit*

US Federal credit programmes provide assistance to borrowers through two principal methods: direct loans and loan guarantees. Direct loans are a disbursement of funds by the government to a non-Federal

borrower under a loan agreement that requires repayment with or without interest. Loan guarantees include any guarantee, insurance, or other pledge of payment any portion of principal or interest on any debt obligation of a non-Federal borrower to a non-Federal lender. It is important to note that under the credit reform legislation this does not include the most insurance programmes, including insurance of deposits in financial institutions and pension guarantees.

States and localities, and then the US federal government, began extending credit to support canals and railroads, and especially the transcontinental railroads, in the Nineteenth Century. In the early 20th century federal lenders such as the War Finance Corporation and Reconstruction Finance Corporation extended significant amounts of credit.[1] The US began using direct loans and loan guarantees for student loans in the mid-1960s. However, there are many reasons the government provides credit: expanding exports, construction of schools and hospitals, and bolstering specific sectors of the economy. While the US has been using these programmes for decades, the government faced issues with budgeting and accounting for such programmes for many years. In general, federal credit programmes are expected to operate at a loss (i.e. result in costs to the Treasury) because they are intended to provide more favorable terms to targeted borrowers and certain sectors of the economy than are available from private lenders. Many federal credit programmes focus on providing access to credit for borrowers considered to be poor credit risks, or borrowers where the credit risk is unknown, and for a very long time (prior to the current cycle of near-zero interest rates) often did so at less than the Treasury's borrowing rates. Hence, most loan programmes experiences losses from delinquencies and defaults whose value exceeds that of interest and fees received.

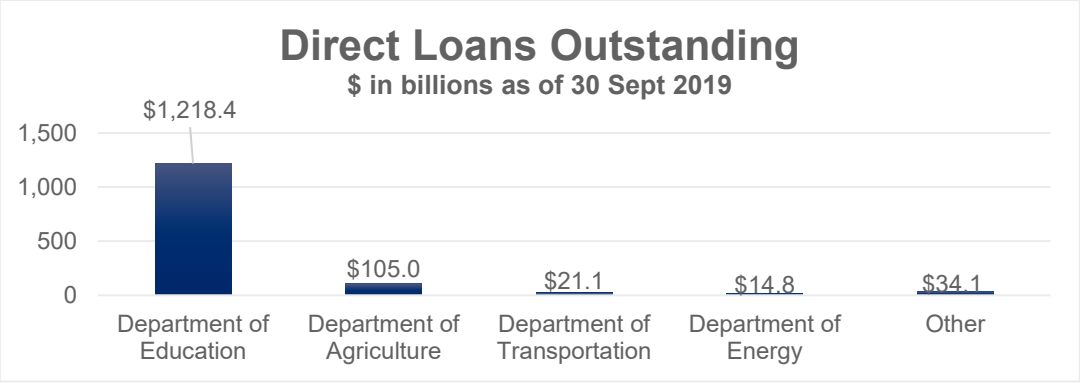
### Figure 1. Face Value of Federal Credit Outstanding as of 30 September 2019




Source: Office of Management and Budget, Fiscal 2021 Budget of the US Government, Analytical Perspectives, https://www.govinfo.gov/content/pkg/BUDGET-2021-PER/pdf/BUDGET-2021-PER.pdf

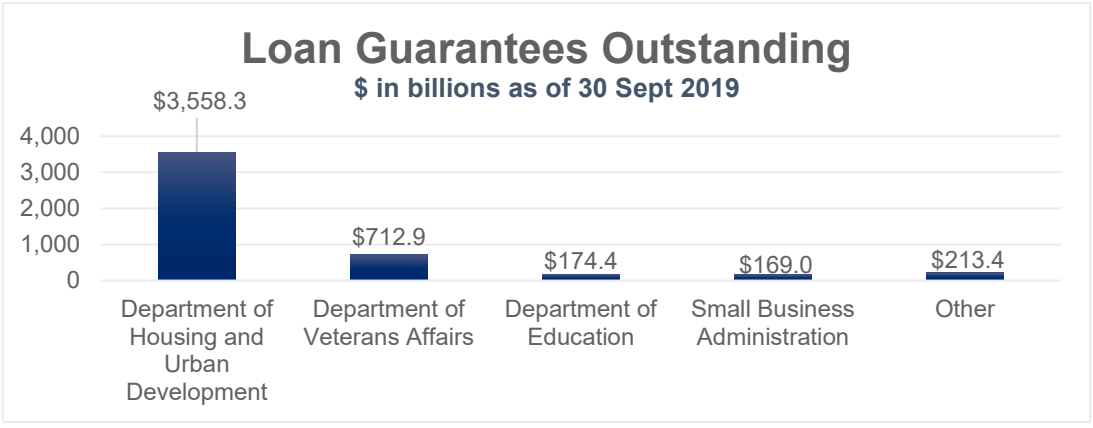
According to the US Office of Management and Budget, as of September 30, 2019 total direct loans outstanding exceeded USD 1 trillion, and total loan guarantees outstanding exceeded USD 3 trillion (see Figure 1 above). As shown in Figure 2 and Figure 3 below, the Department of Education (principally through direct student loans) and Department of Housing and Urban Development (HUD) (principally through the Federal Housing Administration (FHA) single-family housing mortgage guarantee program) represented the largest share of outstanding federal direct loans and loan guarantees, respectively.

### Figure 2. Direct Loans Outstanding as of 30 September 2019




Data Source: Office of Management and Budget, Fiscal 2021 Budget of the US Government, Credit Supplement, https://www.whitehouse.gov/wp-content/uploads/2020/02/cr_supp_fy21.pdf

### Figure 3. Loan Guarantees Outstanding as of 30 September 2019




Data Source: Office of Management and Budget, Fiscal 2021 Budget of the US Government, Credit Supplement, https://www.whitehouse.gov/wp-content/uploads/2020/02/cr_supp_fy21.pdf

### *Experience prior to credit reform: Cash-based accounting for credit programmes*

Prior to 1990, federal credit was treated under cash-based accounting along with the rest of the federal budget.[2] The accounting system used by the federal government for budgeting was well suited to measuring the cost of most cash transactions. Under this cash basis system, the budget cost of a transaction is cash paid out or cash received in a particular fiscal year.

Cash based budgeting resulted in the recording of costs of direct loans as the full face value of the loan in the budget, despite the likelihood that at least some portion would be repaid. In contrast, loan guarantees under cash-flow accounting often showed no cash outflows in the year the guarantee is made by the government but at a future time may represent a significant liability should the guarantee be triggered. Because cash-flow accounting had the effect of making loan guarantees look costless in the year the guarantee is made, loan guarantees were favored in the budgetary process over direct loans even when direct loans were a better choice for meeting a program's goals.

### *Shortfalls of cash-based budgeting for credit*

Since a large part of a credit contract consisted of amounts deferred for future payments, these amounts were not part of the cash-based budget. Failure to recognise the deferred payments of a credit contract overstated the costs of direct loans and understated the costs of loan guarantees. Credit transactions were only recorded when cash changed hands. For many reasons, which are examined below cash-flow accounting did not accurately capture the costs of credit programmes. These problems increased the difficulty of comparing credit programmes and non-credit programmes and distorted fiscal decision making.

#### *Problem 1: Direct loan cost overstatement*

For a direct loan, the credit contract with the government is an exchange of cash now for a promise of cash later, often much later. One shortcoming of a cash-based and annual accounting system for credit was that it could not recognise an essential feature of every credit transaction: this promise to pay. Under cash-basis accounting, when a direct loan by a federal agency was disbursed to a borrower, the full amount was recorded as an outlay--as if it was a grant. This treatment overstated the loan's true cost to the government because it ignores expected repayments.

Repayments were recorded as offsetting collections when they were received from the borrowers. If repayments from old loans equal new disbursements, the budget would show zero outlays for loans in a fiscal year in which a large volume of lending may have actually occurred.

#### *Problem 2: Loan guarantee cost understatement*

For a guaranteed loan, the government promises to pay cash later if the borrower defaults. On a cash-basis, guaranteed loans showed no positive outlays until a default occurred. The delay between commitment of funds and their outlay (for eventual potential defaults) resulted in an understatement of the costs of new guaranteed loans in the fiscal year in which the decision to commit to the guarantee was made. Treating guaranteed loans on a cash basis also required that any fees received for new guarantees would show as collections in the current year budget accounts, where they offset outlays for old guarantees, further obscuring the cost.

#### *Problem 3: Contrived deficit reduction*

The former US cash-basis treatment of credit encouraged attempted reductions in the budget deficit by substituting guarantees for direct loans and by selling old loans in order to show short-term reductions in the budget deficit. Similarly, refinancing direct loans with federally guaranteed private loans reduced the reported cash-based deficit because it results in prepayment of existing loans and no current outlays for the guarantees. This substitution did not improve the government's long-term financial position, but under the cash-based system it did have the effect of reducing outlays and thus reducing the deficit, while the actual programme benefits and true long-term costs were generally unaffected.

In another example, proceeds from loan sales were proposed to reduce the deficit because the proceeds were recorded as offsetting collections, which represented accelerated loan repayments. Although it is generally recognised that such transactions were not true long-term reductions in the deficit, they did count as deficit reduction for purposes of Congressional budget resolutions and the President's budget.

#### *Problem 4: Lack of incentive to collect cost data*

Credit data in the federal budget was frequently inaccurate and unavailable at the programme level. The data at the programme level was often unavailable because most credit programmes are financed from multiprogramme accounts where funds are commingled.

In addition, cost data was obscured because most federal loans and guarantees were financed through revolving funds that allowed loan collections from old loans to be used for new loans in place of appropriations. Collections included interest on loans, the repayment of principal, and loan sale proceeds. Many of these revolving funds also had indefinite authority to finance their activities by borrowing from the Treasury, further obscuring true costs.

The Government Accountability Office (formerly the General Accounting Office) reported in 1990 on weaknesses in agencies' credit management practices, including agencies failing to monitor private lenders whose loans were guaranteed, and certain agencies understating loan delinquencies by failing to report the full amount of loans due over 180 days.

#### *Problem 5: Bias in programme and budget decisions*

The cost distortion caused by cash treatment prevented the government from being able to accurately compare alternatives and assess tradeoffs. As a result, the government was not making the most efficient decisions with its limited financial resources. This led to problems in determining beneficiaries and the type of credit to be provided as well as ongoing monitoring.

Cash-basis budgeting resulted in credit transactions that were equivalent in cost being treated differently, having the potential to result in higher overall costs or misallocation or overcommitment of resources. For example:

- The cash-basis cost of a direct loan would be shown equal to the cost of a grant. The long-term cost of a direct loan, however, may have been far less than a grant because the loan was expected to be repaid.
- A guaranteed loan may have had the same long-term cost to the government as a direct loan, yet a cash-based budget would have shown the cost of the direct loan equivalent to a grant, and the cost of the guarantee as zero.
- A direct loan with a high potential for default would be shown as the same first year cost as a direct loan with a lower potential for default.
- Direct loans at high interest rates would be shown as the same first year cost as loans at heavily subsidised terms.

### *Recognition of need to reform cash-based budgeting for credit*

The President's Commission on Budget Concepts in 1967 presented one of the first proposals aimed at correcting the deficiencies of the cash-based budget for credit. The Commission recommended budget parity through recognition of the government's expected costs in the budget at the time that costs can be controlled, which is generally the year in which a loan is obligated or guarantee commitment is made. The Commission also made recommendations that resulted in lending by government-sponsored enterprises to be taken off-budget.

Over the 23 years between 1967 and 1990, federal budget officials struggled with these shortcomings and staff proposed multiple solutions. Some of these solutions were implemented, including a separate credit budget which limited loan originations and guarantee commitments for certain programmes in the 1970s, guidelines applicable to federal credit programmes issued to federal agencies in the 1980s, and several iterations of credit budget reform based on market- or grant-equivalent costs of credit. Examples of such proposals included:

- Market-based plans that proposed to better recognise the cost of credit by selling newly originated direct loans to investors and reinsuring new guaranteed loans through private companies.

- A proposal to pay subsidy costs to an enterprise sponsored by the government that would disburse subsidised loans and issue subsidised guarantees; and a plan to replace some federal credit programmes with credit vouchers.
- A plan to convert promises to pay cash in the future into cash immediately through loan sales and reinsurance with control of credit programmes through the provision of appropriations sufficient to cover the net (subsidy) costs.

Throughout the many proposals, there was general agreement that costs should be calculated in terms of the present value of the long-term costs of extending credit assistance and that these costs should be recognised in the budget period when the decision is made to incur them.

## The Federal Credit Reform Act of 1990 (FCRA)

### *Enactment*

The US Congress passed credit reform in 1990 as part of a much larger legislative agreement on the budget that imposed limits/caps on funds available for obligation for annually-appropriated programmes and a pay-as-you-go process, which required that legislative actions increasing the deficit be offset, for programmes not subject to annual appropriations (i.e. spending on Medicare and Medicaid).

The first section of the Act states that purposes are to: 1) measure more accurately the costs of Federal credit programmes; 2) place the cost of credit programmes on a budgetary basis equivalent to other Federal spending; 3) encourage the delivery of benefits in the form most appropriate to the needs of the beneficiaries; and 4) improve the allocation of resources among credit programmes and between credit and other spending programmes.[3]

Under credit reform, funding is authorised and allocated for the "subsidy cost" of a credit program. The Act defines this cost as the estimated long-term cost to the Government of a direct loan or loan guarantee or modification thereof, calculated on a net present value basis, excluding administrative expenses and any incidental effects on governmental receipts or outlays.

The primary goal of credit reform was to substitute subsidy costs for cash flows so that budget decisions could be based on a more meaningful measure of cost. The budgetary application separates subsidy costs from the non-subsidized cash flows, moves them to separate accounts, and reports the non-subsidised cash flows in a part of the budget where they would carry less weight than subsidy costs in budgeting, analysis and policy decisions. There was no intention for credit programme operations to be changed, and no change was expected to be apparent to those receiving federal credit assistance.

### *Application of new budget and accounting concepts*

Credit programmes were first presented in the budget on a credit reform basis in the 1992 Budget transmitted to Congress in January 1991. Beginning then, Federal agencies were required to budget and account for their credit programmes on a net present value basis, rather than a cash basis, allowing the costs of credit programmes to be more easily compared with the costs of other federal spending. The requirements of credit reform covered nearly all federal direct loans and loan guarantees.

Under credit reform, agencies estimate all future expected cash flows between the government and the public for the life of the loans being made or guaranteed, including expected losses, etc. This also included secondary guarantees made by government entities, such as guarantees of timely payment of principal and interest on securities issued by the Government National Mortgage Association, which provides secondary guarantees on mortgages issued or guaranteed by the Federal Housing Administration, the Department of Veterans Affairs, and the Department of Agriculture).

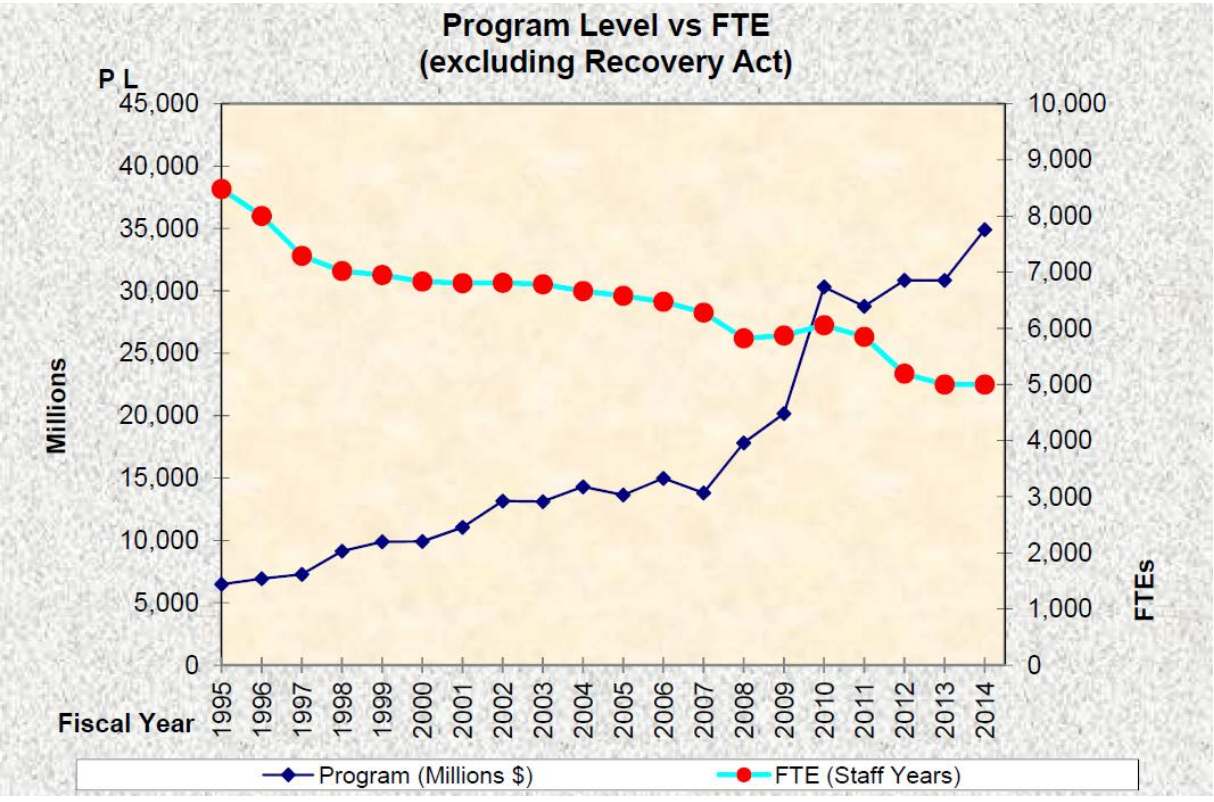
### *Legislated exclusions*

#### *Administrative expenses*

Credit reform legislation required that funding for agency administrative expenses of direct loan or loan guarantee programmes be excluded from the net present value subsidy cost calculation. This meant that credit programme administrative expenses would be on a cash basis, equivalent to the funding for all other government programme administrative expenses. While there is logic in the approach of paying for programme operating expenses (such as employee salaries) on a cash basis, it does cause misleading effects. For example, when a credit subsidy is calculated as zero (or less than zero) and appears to be budget neutral (or show savings) but may appear costly if the costs of administering the programme were included in the subsidy calculation.

Exclusion of administrative expenses also leads the Congress to increase spending on federal credit while constraining appropriations for administrative expenses. Figure 4 below, excerpted from testimony of the Department of Agriculture's Deputy Under Secretary for Rural Development, shows that credit programme levels grew while the number of staff available to service the loans declined. The testimony noted that, "…at a certain point we risk the integrity of the delivery of the programmes and the servicing of a burgeoning portfolio. The chart below illustrates the agency-wide challenge of rapidly increasing programme level funding and a steady decrease in staffing resources. This type of dynamic strains the agency's ability to responsibly deliver and service the programmes provided for and funded by Congress."[4]

**Figure 4. Programme Level vs FTE for US Rural Development Loan Programmes**




https://www.rd.usda.gov/files/testimony/rdHouseAppropsOBrienTestimony.pdf

### *Insurance programmes*

Credit reform legislation included a specific exclusion for insurance activities or deposit insurance[5]--the Pension Benefit Guaranty Corporation, the Tennessee Valley Authority, the National Insurance Development Fund, the Federal Crop Insurance Corporation, and the price support loans of the Commodity Credit Corporation--are excluded from credit reform. Hence, insurance of deposits, shares, or other withdrawable accounts in financial institutions, insurance for floods, bank deposits, and pension benefits were not subject to the provisions of the Act. Also not included were tax credits on bonds, and guarantees made by Government Sponsored Enterprises.

Although budgeting on an accrual basis for these programmes was considered at the time of passage of the legislation, and has been proposed on subsequent occasions including a budget proposal in fiscal year 1993, this step was generally seen as too complex. Many of these programmes cover types of risk that the private sector has either refused to or been unable to cover. Hence, implementing such a reform would require actuarial projections of the expected claims for insurance over long periods of time, and then measuring and recording them in the budget on an accrual basis. Adding this accrued liability to the budget would also increase the federal deficit. Hence, although these contingent liabilities represent significant financial exposure, they were not included in credit reform.

## *Budgetary and accounting display*

### *Programme accounts for credit subsidy costs and administrative expenses*

Credit reform created a substantial change in the measurement and budgetary treatment of cost for direct loans and loan guarantees – from the previous cash-based measurement of flows into or out of the Treasury at the time they occurred, to the expected estimated long-term cost to the Government on a present value basis, known as the subsidy cost. These subsidy costs are recorded in a credit programme account, which is a budget account that receives and obligates appropriations to cover the subsidy cost of a direct loan or loan guarantee and disburses the subsidy cost to the financing account. Programme accounts generally receive a separate appropriation for the administrative expenses associated with the credit program. As discussed in the previous section, these administrative expenses are appropriated on a cash basis.

Subsidy costs are estimated by the credit agencies and overseen by OMB. The process begins with agencies estimating expected cash outflows and inflows of the direct loans expected to be obligated that year, and/or the loan guarantees that are expected to be committed in that year. In order to create these estimates, agencies use historical information and using the Administration’s economic forecasts, create assumptions, often through predictive modeling, of the probabilities and potential timing of default, borrower prepayments, or recoveries.

The cashflows are loaded into the online credit subsidy calculator that is created and maintained by OMB. The calculator discounts the cash flow that is estimated for each time period using the interest rate on a marketable Treasury security with the same maturity as that cash flow from the date of disbursement. This discount rate is prescribed in legislation and is updated over the term of the loan disbursement to reflect the federal government’s actual borrowing cost. A credit subsidy rate (percentage) is then determined by dividing the subsidy cost by direct loan obligations or loan guarantee commitments estimated to be made in that year.

The subsidy cost represents the net present value cost of making or guaranteeing new loans and is included in the President’s Budget in the credit programme account. Agencies must receive appropriations for the subsidy cost before they can enter into direct loan obligations or loan guarantee commitments.

#### *Financing accounts for the unsubsidised credit components*

The actual cash flows are recorded in a separate financing account. These cash flows include loan disbursements, default payments to lenders, loan repayments, interest payments, recoveries on defaulted loans, and fee collections. This is often referred to as the unsubsidised component, as it represents the amount of the transaction that the government expects borrowers to repay fully over the life of the loan. These accounts are not included in the budget totals, but instead these financing accounts are treated as a "means of financing" which is defined as, "…monies received or paid by the Government that are not counted in the budget totals as either collections (governmental receipts, offsetting collections, or offsetting receipts) or outgo (outlays)."[6]

OMB guidance describes this type of financing as, "…the individual means of financing represent changes in assets or liabilities and therefore can either be a source of financing for the Government or require financing themselves. For example, if the disbursements from credit financing accounts exceed their collections, which is normal, the difference must be financed by receipts or the other means of financing; if the disbursements are less than the collections, the difference may be used to reduce borrowing or to provide any financing required by the other means of financing."[7]

The direct loan financing account combines the subsidy payment from the programme account with borrowing from Treasury to finance direct loans. It repays Treasury over time (with interest) using payments from the borrower. The loan guarantee financing account holds the subsidy payment from the programme account as a reserve against default claims on loan guarantees. The reserve, together with interest earnings on this reserve from Treasury, is used to pay default claims over the life of the loans.

#### *Liquidating accounts for pre-credit reform loans and guarantees*

All cash flows resulting from direct loan obligations and loan guarantee commitments made prior to the effective date of the credit reform legislation (in FY 1991 or previous years) are recorded in liquidating accounts. These accounts are recorded on a cash basis and are included in the budget totals. Liquidating account collections are available to pay obligations of the account, but they are not available to finance new direct loans or loan guarantees. If the collections are insufficient, the legislation provides liquidating accounts with permanent indefinite authority to pay for losses and to repay debt owed to Treasury or to other sources.

### *Mechanics of budgeting for expected costs*

#### *Direct loan subsidy costs*

Subsidy costs for direct loans are estimated as the long-term cost based on the terms and conditions of the loan contract. These are calculated as the net present value, at the time when the direct loan is disbursed to include all expected cash flows, such as amounts and timing of:

- Loan disbursements
- Repayments of principal and payments of interest and fees
- Effects of estimated defaults, prepayments, fees, penalties
- Recoveries or proceeds of asset sales
- Delayed, forgiven, or missed payments by the borrower
- Other payments by or to the Government over the life of the loan

### *Loan guarantee subsidy costs*

Subsidy costs for loan guarantees are calculated as the net present value basis, excluding administrative expenses. Estimated cash flows include the effects of expected Government actions and the exercise by the guaranteed lender or the borrower of an option included in the loan guarantee contract and may include cash flows such as:

- Payments by the government to cover defaults and delinquencies, including disposal costs if assets are acquired as a result of defaults
- Interest subsidies, and other contractual required government payments
- Payments to the Government, including origination and other fees, penalties, and recoveries to include proceeds after sale of acquired collateral after default

### *Initial subsidy cost estimates*

Estimating subsidy costs is central to implementing credit reform. Since the start of credit reform agency budget, CFO, and programme offices have endeavored to assemble relevant and reliable data and predictive models to form cash flow projections underlying these estimates. In the case of an existing loan or programme with multiple years of historical experience on programme and borrower performance, documentation on actual cash inflows and outflows may be available. This may include historical data and trends, sensitivity analysis or actuarial analysis that identifies the critical factors in predicting cashflows, reports from accounting systems, documentation of programme design factors relevant to the estimates including defined fees, grace periods, terms to maturity, borrower interest rates, legal definitions, enabling legislation, and programme eligibility requirements. In the case of loan guarantee programmes this may also include historical information on actual lender agreements detailing the terms of the guarantee

Agencies prepare estimates based upon the best available data at the time the estimates are made. However, in some cases, as in the case of a new guarantee programme with no historical experience, there may be no historical experience to support the cash flow assumptions underlying the subsidy calculation. In these cases, until there is substantial programme experience agencies often rely on outside data sources for these estimates. As shown in Table 1 below, these data sources can range from proxy data from another agency's relevant experience to expert opinions where outside experts are engaged to provide support for assumptions used by the agency to substantiate the initial estimate.

**Table 1. Data sources for estimates for programmes with no historical experiences**

| Category | Potential Data Source |
|---|---|
| **Proxy Data** | • Private sector proxies for risk, such as bond ratings to assess default risk. Examples may include:<br>  ○ Country credit risk rating for international lending<br>  ○ Comparable bond rating for a state agency that finances similar programmes, such as education, farm, or housing, with bonds<br>  ○ Credit scores or other assumptions used by underwriters for the purposes of determining eligibility or loan approval<br>• Extrapolations of predictive default curves from private sector lending experience to similar industries, borrower characteristics, or financial status<br>• Relevant experiences from other countries or agencies including historical experience of agencies with similar programmes in other countries (e.g. loans or guarantees in comparable industries issued by the US Small Business Administration) |
| **Limited Experience** | • Reports and studies on industry conditions of similar industries or borrowers<br>• Historical data (e.g. actual accounting records and economic experience) and documented industry or related industry trends<br>• Actuarial studies of industry or firms comparable to borrowers in size and capitalisation<br>• Economic data including industry studies, journal articles, trade papers, third-party studies |

| Category | Potential Data Source |
|---|---|
| **Informed Opinion** | • Expert opinion by a professional statisticians or academic to estimate cashflows using limited or imperfect data<br>• Previous academic studies of the industry or comparable industry including journal articles and third-party studies<br>• Judgment of agency staff based on programmatic knowledge combined with historical proxy data |

The appropriate data source will depend in many factors including relevance of the data to the new program, similarities in borrower profiles, qualifications of the expert (including professional or academic certification), documentation supporting the use of particular projection to apply to the new program.

Whether the programme is new or has been operating for many years, agencies are required to create auditable documentation to support the assumptions used in the subsidy calculations. This documentation facilitates OMB and Congressional review, and also provides an important internal control for the agency's annual audit.

#### *Costs of modifying loans and guarantees*

Credit reform legislation also required funding be provided prior to any Government action that changes the cost of an outstanding loan or guarantee. This may include altering the terms of existing contracts through extending repayment terms, loan forgiveness, forbearance, or converting guaranteed loans to direct loans by purchasing them from a private lender.

This provision also includes changes in cost that would result indirectly through legislatively changing the way in which a portfolio of direct loans or guaranteed loans is administered including new methods of debt collection, such as using tax refunds to repay loans and restrictions on debt collections. The cost of a modification is calculated as the difference between the estimate of the net present value of the remaining cash flows before the government action, and after the modification.

#### *Re-estimated costs*

Agencies are required to re-estimate the subsidy cost throughout the life of each cohort of direct loans or loan guarantees to account for differences between the original assumptions of cash flow and actual cash flow or revised assumptions about future cash flow. These re-estimates represent additional costs or savings to the Government and are recorded in the budget. Credit reform legislation included a "hold harmless" provision that provided indefinite authority to fund these re-estimates, so that errors in estimates would not need additional appropriations.

There are two types of re-estimates:

1. Interest rate re-estimates adjust for the effect on the subsidy of differences between actual interest rates and the discount rates assumed when estimates were made for budget formulation and obligation
2. Technical re-estimates adjust for revised assumptions about loan performance, such as differences between assumed and actual default rates or new projections of prepayments

### *Implementation logistics*

Putting programmes on a capitalised or accrual basis for budgeting purposes was a major departure from the cash flow measures used for most of the federal budget. The process impacted stakeholders involved in each federal credit program. Many systems and other enhancements were needed to accomplish the complex budgeting and accounting reform goals including: 1) long-standing deficiencies in credit programme financial systems and controls; 2) unreliable historical credit information; 3) inadequate staff resources; and 4) need for new budget, accounting, and reporting guidance and systems. Leadership for implementation of certain elements of these enhancements was centralised – for example, OMB was responsible for budget guidance and reviewing credit subsidy estimates – however, leadership of other systems and enhancements was decentralided with guidance disseminated by multiple stakeholders, and

much of the necessary data collection and credit programme execution logistics assigned to the individual credit agencies.

This de-centralisation, along with the very new processes involved caused considerable controversy within the agencies who managed each federal credit programme and the other stakeholders. Although the agencies and other stakeholders worked closely together to implement this substantial change to budget and accounting practices, and also to improve credit programme and financial management (as shown in Table 2), many inefficiencies resulted from a lack of a central clearinghouse for guidance, oversight, credit data, performance measurement, and risk management.

### Table 2. Multiple Credit Reform Implementation Stakeholders

| Stakeholder | Credit Reform Role | Sample Actions in Implementing Credit Reform |
|---|---|---|
| Office of Management and Budget (OMB) | Responsible for co-ordinating estimates, monitoring agency compliance, reviewing legislation pertaining to credit | • Establishing credit reform budget, execution, and reporting guidance to Agencies<br>• Providing credit training to credit agencies<br>• Reviewing Agency credit budget and reporting submissions<br>• Maintaining the Federal credit subsidy calculator used to calculate the cost of credit programmes<br>• Formulating and reviewing credit management and debt collection policy<br>• Preparing cross-cutting credit budget and reporting materials<br>• Designating Chairperson of the Federal Credit Policy Working Group |
| Executive Branch Agencies and Departments | Manage credit programmes and all non-tax receivables in accordance with their statutory authorities | • Credit programme execution, including disbursement of loans and guarantees<br>• Budget formulation and execution for credit programmes<br>• Credit subsidy estimation utilising the Federal credit subsidy calculator to calculate the cost of credit programmes<br>• Tracking status of loans and guarantees<br>• Federal credit programme reporting<br>• Financial reporting for credit programmes<br>• Formulating and proposing new or revised legislation, regulations, and forms as necessary to ensure consistency credit and debt collection policy |
| Department of Treasury | Works with OMB to develop Federal credit policies and/or reviewing legislation to create new credit programmes or to expand or modify existing credit programmes | • Through Financial Management Service (FMS), promulgating government-wide debt collection regulations implementing the debt collection provisions of the Debt Collection Improvement Act<br>• Working with Agencies to identify debt that is eligible for referral to Treasury for cross-servicing and offset<br>• Conducting offset of Federal payments, including tax refunds, and provides collection services for delinquent non-tax Federal debts |
| Congress | Authorises and funds credit programmes | • Enactment of legislation establishing the authority for loan and guarantee programmes or legislative changes to existing credit programmes<br>• Providing annual appropriations for new credit subsidy budget authority and/or limitations on loan obligations or guarantee commitments |
| Congressional Budget Office (CBO) | Co-ordinates with OMB in developing credit reform estimation guidelines, regulations, and criteria used by Agencies | • Co-ordinating the development of more accurate data on historical performance of direct loan and loan guarantee programmes<br>• Providing annual reviews of the performance of outstanding direct loans and loan guarantees to improve estimates of costs. |
| Government Accountability Office (GAO) | Examines how taxpayer dollars are spent and provides Congress and federal agencies with objective financial and programme review | • Studying agency implementation of credit reform<br>• Providing reports and testimony<br>• Providing recommendations for improved programme performance, cost savings, and efficient operations |
| Federal Accounting Standards Advisory Board (FASAB) | Issues federal financial accounting standards and provides guidance on financial reporting in conformity with generally accepted accounting principles. | • Managing Credit Reform Task Force, composed of members of Treasury, GAO, OMB and representatives from all the credit agencies to address accounting, auditing, budgeting and reporting issues encountered by agencies subject to credit reform<br>• Issuing accounting standards[8] to reflect credit reform accounting treatment<br>• Issuing Technical Releases to provide audit guidance under credit reform<br>• Issuing Model Credit Programme Methods and Documentation for Estimating Subsidy Rates |

| Stakeholder | Credit Reform Role | Sample Actions in Implementing Credit Reform |
|---|---|---|
| Federal Credit Policy Council | Interagency forum | • Co-ordinating members to include OMB, Treasury, Council of Economic Advisors, and major credit and debt collection Agencies and Departments<br>• Providing advice and assistance to the OMB and Treasury in the formulation and implementation of credit policy<br>• Serving as a mechanism to foster interagency collaboration and sharing of best practices |

## Lessons learned from a 30-year history of credit reform

### *Improvements and shortcomings*

Credit reform made substantial improvements in decision making by Federal agencies in developing programme terms, considering the need for and impacts of programme features including changes to interest rates or fees charged to borrowers, obtaining private sector ratings as proxies for defaults for new programmes, and increasing debt collection tools. One important result of the adoption of credit reform has been the visibility that it has brought to the programmes, and how it has enabled the US Congress, the Administration, and credit agencies to minimise the budget impact of many of these credit programmes by encouraging actions to reduce defaults and raise fees, thereby lowering their credit subsidy cost calculation.

However, implementation could have been improved. A study by the Congressional Budget Office (CBO) in 2000 covering implementation of credit reform from 1993-1999 found significant reporting deficiencies by agencies in some of the President's Budget documents, including the Federal Credit Supplement and the Budget Appendix. However, CBO also noted that with extensive assistance and additional information from the agencies and OMB, the corrected re-estimates did not reveal any pattern of bias in initial subsidy estimates, on which budget decisions are made.

Although improvements could have been made in credit subsidy cost estimates, oversight agencies such as CBO and GAO found **no evidence of systematic bias** in their evaluations of the cost estimates. In its September 2000 publication evaluating subsidy re-estimates from 1993-1999, CBO stated that although various incentives may exist for agencies to underestimate credit subsidies, the corrected re-estimates do not reveal any pattern of bias in initial subsidy estimates.[9] These findings were cited in a Congressional Research Service June 2014 publication.[10] In its January 2016 report evaluating credit subsidy cost estimates, GAO did not identify any overall consistent trends in under- or overestimates of subsidy costs across federal credit programmes government-wide.[11] GAO noted USDA was slow to make improvements to its cost estimates because of the lack of full-time dedicated staff and adequate funding for contractors, but it also noted a lack of systemic bias in cost estimates despite these shortfalls.[12] GAO also noted in a report specific to HUD's FY 2000 estimates that the estimates of loan programme costs included in the FY 2000 President's budget for the FHA single-family mortgage loan guarantee programmes were reasonable, given the nature of the estimates. GAO found that better data sources and correcting for formula errors in its cash flow model would have improved the estimates.[13]

### *Challenges and lessons learned*

The US experience in credit reform corrected many of the shortfalls of cash based budgeting and accounting for credit. Table 3 summarises improvements, but also outlines issues and lessons learned through credit reform implementation.

## Table 3. Survey of lessons learned based on 30-year history of credit reform

| Cash-based Shortfall | Credit Reform Improvements | Issues Identified with Credit Reform |
|---|---|---|
| **1. Direct loan cost overstatement** | • Placed cost on budget basis equivalent to other spending<br>• Removed bias created by budgeting for full value of loans even if repayments were expected in long-term | • **Administrative expenses** are excluded from subsidy cost, creating bias including:<br>○ Allows direct loans to be priced more advantageously to borrowers than guaranteed loans because guarantees are administered by private lenders<br>○ Contributing to anomaly of **negative subsidies**, in part a result of exclusion of administrative expenses<br>○ Underfunding of credit management and oversight<br>▪ Disincentive to provide additional resources to agencies and oversight agencies for additional staff<br>▪ Default prevention and improved servicing is not offset by savings created when more staff is added to administer, monitor, and account for credit<br>▪ Agencies often underfund administrative expenses separately on a cash basis to use limited agency funding on other priority programmes<br>▪ Funding administrative expenses as part of the subsidy cost would also allow for resources to be scalable as programmes grow or contract |
| **2. Loan guarantee cost understatement** | • Placed cost on budget basis equivalent to other spending<br>• Removed bias created by first year fee collection being counted as spending offset | • **Administrative expenses** excluded from subsidy cost<br>○ Creates difficulty in comparing direct and guarantee programmes (per above)<br>○ Anomaly of **negative subsidies**, in part a result of exclusion of administrative expenses<br>○ Underfunding of programme management (per above) |
| **3. Contrived deficit reduction** | • Removed bias created by loan asset sales being counted as deficit reduction<br>• Removed bias created by refinancing direct loans into guaranteed loans as a means of deficit reduction | • Negative subsidies often used to offset other spending, but are in part a result of exclusion of administrative expenses from subsidy calculation, and also in part due to use of federal borrowing rate to discount cashflows (see #5 below)<br>• Administrative expenses excluded from subsidy cost<br>• Allows for artificial savings to be created for programme shifts from loan guarantee to direct loan programmes, and for increased centralised debt collection methods (such as offsets to tax refunds for defaulted borrowers |
| **4. Lack of incentive to collect cost data** | • Placed oversight and monitoring responsibility with one entity - OMB<br>• Created incentives for agencies to collect additional data on costs and | • **Accuracy of estimates and re-estimate "hold harmless"** leads to lack of recourse in addressing errors in estimates due to broad hold harmless provisions. Some observers have noted potential issues including:<br>○ Incentive to underestimate initial cost estimate<br>○ No real penalties to agency budget if original estimate was incorrect |

| Cash-based Shortfall | Credit Reform Improvements | Issues Identified with Credit Reform |
|---|---|---|
| | risks of loans and guarantees in order to accurately measure credit subsidy cost<br>• Created incentives to closely monitor and track private lenders whose loans were guaranteed and compare lender performance across program | • **Administrative expenses** are excluded from subsidy cost, which caused a lack of substantial additional investments to effectively implement credit reform improvements.<br>o This issue caused government to stop short in bolstering resources to assist in estimating the unpredictable, including **implementation logistics to** create efficiencies and better measure costs, which might have included:<br>▪ Creating centralised office to create estimates across all programmes, monitor loan performance, and reduce incentives from agency personnel to underestimate subsidy costs of credit programmes<br>▪ Augment existing staff to add rigor to estimates and provide for continuity caused by government staff turnover<br>▪ Creating centralised data warehouse across credit programmes for cross-programme data sharing and comparisons<br>▪ More measured use of private market rating agency and other market-based information which is often biased towards lower risk due to lack of information in private lending repositories regarding subsidised lending for public policy purposes |
| **5. Bias in programme and budget decisions** | • Improved comparisons between alternatives across credit, grant, and other programmes<br>• Created incentives for debt collection and other cross-cutting initiatives to better manage programmes and control costs | • **Reflecting of market risk** was inhibited through use of federal borrowing rate as discount rate.<br>o Using federal borrowing rates may artificially lower the cost of most programmes – recent external evaluations have presented and evaluated one option originally presented by the Congressional Budget Office:<br>▪ **Fair value discount rate –** an alternative approach, that proposes to add a market risk premium to the Treasury rate and use the resulting higher interest rate as the discount rate to calculate credit subsidies. This measure would raise the cost of most federal credit programmes. It also diverges from current budgetary scoring of legislation, which measure costs to the government, and the fair value approach would utilise a private sector discount rate.<br>• **Administrative expenses** (per above) exclusion from subsidy cost allows direct loans to be priced more advantageously to borrowers than guaranteed loans because guarantees are administered by private lenders and discourages efficient **implementation logistics** (as discussed above)<br>• **Re-estimate "hold harmless"** (per above) leads to lack of discipline in estimating which may lead to bias in evaluating alternatives when making programme decisions<br>• Scoring conventions such as use of the federal discount rate can discourage loan asset sales even when it would be more efficient to allow private management of the loans**.** |

### *Lesson learned 1: Administrative expenses*

Credit reform did not include the cost of administering credit programmes in the subsidy calculation. This creates a dilemma for credit programme administrators, as the quality of the programme itself and ability of the programme to minimise defaults depends on investments in resources to administer the program. Removing administrative expenses also creates difficulty in comparing direct and guarantee programmes as guaranteed loans are more likely to be managed by private lenders. This also creates incentives for Congress to allocate appropriations to pay subsidy costs of increasing volumes of credit without simultaneous increases in appropriations for the administrative expenses needed to manage the growing programmes. Another consequence is that budget scoring discourages the sale of direct loan assets because the price paid would include the administrative expenses to service the purchased loans.

Funding administrative expenses as part of the subsidy cost would also allow for resources to be scalable as programmes grow or contract and avoid risks of applying too few resources to growing amounts of credit.

This exclusion also means that the credit subsidy appropriation does not pays the full cost to the government of extending credit. This cost mismatch contributes to some programmes identifying costs as zero or negative, whereas if administrative expenses were included in the subsidy calculation, these same programmes would need to charge higher interest rates or raise fees and premiums if the intended policy of the programme was defined as ensuring that taxpayers were not subsidising the borrowers.

### *Lesson learned 2: Negative subsidies*

Negative subsidies are defined as subsidy costs that are less than zero. This is often the result of the exclusion of administrative expenses from the subsidy calculation. FCRA did not explicitly refer to negative subsidies although its definition of subsidy cost as a net amount implies that the costs could be less than zero (negative). After enactment of FCRA, OMB provided implementation guidance for programmes with negative subsidies, and in some cases, Congress appropriated estimated negative subsidy receipts to offset other spending.

Negative subsidies occur if the present value of cash inflows to the Government exceeds the present value of cash outflows. In such cases, appropriations bills must still provide specific authority before direct loans or loan guarantees can be made, generally in the form of a loan limitation. When a direct loan obligation or loan guarantee commitment is made that has a negative subsidy, an amount equal to the negative subsidy will be obligated in the financing account. When the loan is disbursed, the financing account will pay the negative subsidy to the negative subsidy receipt account. The collections are recorded as offsetting receipts, and they offset the agency's budget authority and outlays.

### *Lesson learned 3: Accuracy of estimates and treatment of re-estimates*

Agencies are required to re-estimate the subsidy cost throughout the life of the loans, however, the credit reform legislation included a “hold harmless” provision that provided indefinite authority to fund these re-estimates, so that errors in estimates would not need additional appropriations.

One question that has been raised over the 30-year history of credit reform is whether the re-estimate hold harmless provision leads to lack of recourse in addressing errors in estimates including a potential incentive for agencies to underestimate initial cost estimates and no real penalties to agency budgets if original estimate was incorrect. It is unclear if systematic bias exists. As shown in Table 4 below, for purposes of budgeting, re-estimates are divided into two types: interest rate re-estimates (which are adjustments for differences between actual interest rates and the discount rates assumed when estimates were made); and technical/default re-estimates (which are adjustments for revised assumptions between assumed and actual loan performance – including differences in defaults or prepayments).

For direct loan re-estimates, the Department of Education's Direct Student Loan Program was the source of the largest share of upward subsidy re-estimates during the 30-year programme history. These increased subsidy estimates were largely the result of changes in interest rates between the time of initial loan obligation and subsequent actual disbursements and repayments. Direct student loan subsidy estimates were also underestimated because of changes in policies applied to the loans – including the impact of greater borrower use of income driven repayment plans, public service loan forgiveness initiatives and rising borrower defaults.

## Table 4. Loan Disbursements and Re-estimates

Cumulative Loan Disbursements and Credit Subsidy Re-estimates
**Fiscal Years 1990-2019 (Dollars in millions)**

| Program/Department | Loans Disbursed 1990-2019 | Re-estimate Due to Technical/Default | Re-estimate Due to Interest |
|---|---|---|---|
| **Direct Loans** | | | |
| Department of Education | USD 1 698 586 | USD 145 564 | USD 33 478 |
| Department of Agriculture | USD 204 218 | USD -1 459 | USD -1 099 |
| Department of Transportation | USD 22 170 | USD -1 571 | USD 82 |
| Department of Energy | USD 23 495 | USD -2 838 | USD 115 |
| Other | USD 89 030 | USD 3 564 | USD 1 397 |
| **Totals:** | **USD 2 037 498** | **USD 143 260** | **USD 33 972** |
| **Loan Guarantees** | | | |
| Department of Housing and Urban Development | USD 2 944 624 | ISD 71 992 | USD 8 639 |
| Department of Veterans Affairs | USD 454 190 | USD -10 157 | USD -2 113 |
| Department of Education | USD 24 624 | USD -64 869 | USD -12 112 |
| Small Business Administration | USD 268 397 | USD 4 534 | USD 963 |
| Other | USD 140 458 | USD -5 933 | USD -1 560 |
| **Totals:** | **USD 3 832 292** | **USD -4 434** | **USD -6 182** |

Data Source: Office of Management and Budget, Fiscal 2021 Budget of the US Government, Credit Supplement, https://www.whitehouse.gov/wp-content/uploads/2020/02/cr_supp_fy21.pdf

As for loan guaranteed re-estimates, the Department of Housing and Urban Development's FHA Mutual Mortgage Insurance Fund was the largest source of underestimates during the period analysed by the GAO. The MMI loan guarantee programme incurred a string of losses for the period 2008-2012 as FHA's mortgage loan guarantee programme was hit by the impact of the collapse in housing prices and the resulting spike in mortgage defaults during the financial crisis. Credit subsidies for the full period studied (2001-2014) were underestimated by USD 75.3 billion. A large swing in the other direction for the Department of Education's Federal Family Education Loan (FFEL) programme served to offset this figure and helped reduce total upward re-estimates for the federal government as a whole. The GAO report findings suggests that the main housing and education loan programmes of the federal government need to be monitored carefully in terms of the accuracy of their credit subsidy estimates.

### *Lesson learned 4: Reflecting market risk in subsidy costs*

Over time, there have been calls to amend credit reform in various ways. Perhaps the most vocal have been advocates of changes in discount rates from Treasury borrowing rates to a private sector rate. CBO has in the past expressed strong support for using "fair value" methodology, i.e. discount using private sector interest rates, to calculate cost estimates for credit programmes.

**Fair Value Discount Rate Proposal:** The appropriate discount rate to be used in credit reform was actively debated during the consideration of the Federal Credit Reform Act in 1990. Currently, credit reform requires the discounting of expected cash flows at the interest rate on Treasury securities (the rate at which the government borrows money). One recent proposed approach, known as "fair value," was first presented by CBO in a report on federal credit subsidies examined two ways of including the market price for risk: risk-adjusted discount rates and options-pricing methods. The risk-adjusted discount rate (ADR) method "adds a spread—the difference between the interest rate on a Treasury security and the rate on a risky security—to Treasury rates and uses the resulting adjusted rate to discount expected cash flows associated with a loan." The ADR method results in a higher discount rate for both costs and revenues and, with a few exceptions for negative subsidies, raises the net cost of credit programmes.

This alternative approach would add a market risk premium to the Treasury rate and use the resulting higher interest rate as the discount rate to calculate credit subsidies. This measure would raise the cost of most federal credit programmes. It is supported by CBO and has been the focus of numerous CBO reports since 2004. Its usage was mandated for the first time in the legislation creating the Troubled Asset Relief Program (TARP) in 2008. Legislation was introduced in 2012 to adopt this approach but was not enacted into law. However, there is a budget rule that Congressional committees can request a fair value estimate from CBO, and CBO has created a new division, the Financial Analysis Division (FAD), that has created significant infrastructure for creation of fair value estimates.

Proponents of fair value accounting believe, as CBO has stated that current credit reform cost estimates do not provide a full accounting of what federal credit programmes actually cost the government because they do not incorporate the full cost of the risk associated with the loans. This position has been supported through multiple journal articles, a sample of which is included in Table 5 below, including articles published by the American Enterprise Institute, the Brookings Institution, the Heritage Foundation, American Action Forum, National Taxpayers Union, among others.

### Table 5. Sample of Journal Articles and Congressional Testimony in Support of Fair Value Accounting

| Organisation | Links to sample materials: |
|---|---|
| Congressional Budget Office | https://www.cbo.gov/publication/43027<br>https://www.cbo.gov/publication/55278<br>https://www.cbo.gov/publication/53886 |
| American Enterprise Institute | https://www.nationalaffairs.com/publications/detail/the-case-for-fair-value-accounting |
| The Brookings Institution | https://www.brookings.edu/wp-content/uploads/2015/06/lucas-slides.pdf |
| The Heritage Foundation | https://www.heritage.org/education/report/the-unknown-cost-federal-student-loans |
| American Action Forum | https://www.jec.senate.gov/public/_cache/files/ae9b775d-fbf5-485a-abac-88fa98d9f670/dhe-jec-testimony-fair-value-v-fcra-6-17-15-final.pdf |
| National Taxpayers Union Foundation | https://www.ntu.org/foundation/detail/fair-value-analysis-of-federal-loan-programs-provides-fairness-for-taxpayers |

From a practical standpoint, much of the debate about the proper interest rate revolves around the purpose and use of the federal budget. Defenders of the current practice, which include GAO[1] and the Center for Budget & Policy Priorities[2], argue that the federal budget is primarily a compilation of the costs of federal programmes that measures, in the aggregate, the fiscal position of the United States and the macroeconomic impact of its spending. They also note that fair value accounting diverges from current budgetary scoring concepts, which call for the measurement of costs to the government, rather than benefits to the borrowers. Whereas proponents of the fair value methodology argue that the budget process is also about making efficient resource allocation.

*Lesson learned 5: Implementation logistics*

As discussed in Table 2, multiple stakeholders engage in implementing credit reform to accomplish the complex budget, accounting, and reporting reforms. One lesson learned from the US experience would be to increase centralised implementation, including potential creation of a single entity independent of programmatic interests to create and re-evaluate estimates and centralise programme monitoring and risk management guidance and procedures. A list of potential enhancements to the current OMB oversight role are included in Table 6 below. These include the creation of a single entity that would be responsible for centralised programmatic credit programme guidance, monitoring, data collection, risk and programme management, and credit subsidy estimates.

Centralised implementation could also support increases in overall credit data quality. Several GAO reports highlighted data variance issues among budget documents, between budget and accounting data, and from year to year. As was noted by both CBO and GAO, agency budget and accounting offices often used their own data sources for creation of estimates. Centralising implementation of estimates and creating a single system for collection of credit budget, accounting, and loan data across all programmes would improve estimates, accountability, and would enable more systematic response to questions raised by oversight agencies, such as OMB, CBO, and GAO.

## Table 6. Current OMB Oversight Role and Lessons Learned

| Category | Current OMB Credit Oversight Role | Lessons learned - Centralised implementation |
|---|---|---|
| Guidance/Tools & Training | • Establishes credit reform-compliant instructions and guidance for agencies on budget preparation and execution of credit programmes to agencies (included in OMB Circular A-11)<br>• Provides annual and ad hoc credit training to agencies in credit reform principles, guidance and standard practices<br>• Creates and maintains credit subsidy calculator, incorporating most recent economic assumptions used to calculate the subsidy cost of credit programmes<br>• Creates and maintains tools for agencies to calculate financing account interest | • Reduce the number of implementation stakeholders:<br>○ Create a single entity, independent of programmatic interests to establish and re-evaluate credit subsidy estimates for all programmes<br>○ Centralise programme monitoring and risk management guidance and procedures |
| Oversight & Approvals | • Oversees agency estimation and re-estimation of credit subsidy costs<br>• Reviews subsidy cost estimates and re-estimates for consistency with Federal Credit Reform Act requirements and OMB Circular A-11 guidance and for inclusion in the annual Budget submission<br>• Reviews and comments on legislative proposals related to credit programmes to assess consistency with existing policies, standards and guidance | • Have a single entity responsible for centralised programmatic credit programme monitoring and risk management across all federal credit programmes |
| Credit Policy Setting | • Formulates and reviews credit management and debt collection policies (included in OMB Circular A-129)<br>• Designates chairperson of and participates in the Federal Credit Policy Council<br>• Co-ordinates with CBO and Treasury in developing credit reform estimating guidelines, regulations, and criteria used by agencies including policies around expansion or modification of existing credit programmes | • Create a centralised entity with a Board (consisting of credit agencies and current stakeholders) to create:<br>○ Credit programme policies and regulations<br>○ Guidance and procedures for oversight, monitoring and risk management |
| Data Collection and Reporting | • Collects and reviews all agency annual credit budget and reporting submissions (both initial estimates and re-estimates)<br>• Prepares total federal credit budget including aggregate programmatic analysis and reporting materials for publication in the federal budget documents including:<br>○ Descriptions of major credit programmes, intended borrower populations, and programmatic impacts<br>○ Estimated new and total outstanding loan obligations/loan guarantee commitments/disbursements | • Centralise data collection across credit programmes into a centralised source to increase accuracy of estimates and transparency<br>• Centralise all credit subsidy estimates and re-estimates<br>• Create a single system for collection of credit budget, accounting, and loan data across all programmes to improve |

| Category | Current OMB Credit Oversight Role | Lessons learned - Centralised implementation |
|---|---|---|
| | ○ Key programme terms, e.g. average loan size, borrower interest rates, grace periods, etc.<br>○ Estimated default and recovery rates<br>○ Historical credit subsidy rates and costs<br>○ Re-estimated costs of previously-disbursed direct and guaranteed loans | estimates, foster accountability, and enable more systematic response to questions from Congress, auditors, and oversight agencies |

*Lesson learned 6: Aligning programme decisions with accurate subsidy calculations*

The application of credit reform may contribute to avoidant behavior by policy makers designed to reduce the amount of subsidy scored for classes of federal credit, including programme design decisions that reduce the amount of subsidy scored. For example, the current application of credit reform budgeting can create incentives to provide government-backed loans through off-budget entities such as government-sponsored enterprises, because these contingent liabilities are not included under credit reform.

In another example, the design of the Federal Student Loan programme allows for credit subsidies to be artificially underestimated in several ways including:

- Defaults on Federal Student Loans are recorded only when a loan has been delinquent for 270 days, rather than the 90 days used to designate a default for other federal credit or in the private sector. This reduces the initially budgeted credit subsidy cost.
- A statutory provision that makes it extremely difficult for a borrower to declare bankruptcy on his or her student loan, thereby postponing recognition of losses on a student loan potentially for many years.

### *Application of lessons learned*

As countries are exploring alternatives to cash budgeting for credit programmes, especially new credit programmes implemented in response to the Pandemic, there is value in review of the lessons learned from the US experience with credit reform. Important considerations in budgeting and accounting for government loan and guarantee programmes under credit reform include:

- Acknowledging and budgeting for the lifetime administrative costs of extending the credit at the time the loan obligation or guarantee commitment
- Retaining any estimated negative subsidies as a reserve to pay future programme costs, including administrative expenses
- Acknowledging market risk in discount rates for calculating net present value costs
- Eliminating incentives for avoidant behavior by policy makers by reflecting all policy decisions in subsidy calculations
- Centralising logistics for implementation of reforms to include:
  - Centralising data collection across credit programmes into a transparent, centralised source to increase accuracy of estimates
  - Reducing the number of implementation stakeholders through creation of an entity that is independent of programmatic interests to create and re-evaluate estimates and centralise programme monitoring and risk management guidance and procedures

### *Conclusion*

The US experience with credit reform as a new way of budgeting and accounting for government loan and guarantee programmes has been successful in many ways, including:

- Bringing transparency through placing the cost of credit on budgetary basis equivalent to other spending and improving comparisons across credit, grant, and other programmes
- Addressing risk by budgeting upfront for cost of a liability created through the extension of credit, taking into account the risk of default
- Removing bias created by budgeting for full value of loans even if repayments were expected in the long-term, and by guarantee fee collection being counted as a spending offset
- Increasing oversight and monitoring of credit programmes through:
    - Creating and correcting incentives for agencies to collect additional data on costs and risks of loans and guarantees
    - Creating incentives for agencies to closely monitor and track private lenders whose loans were guaranteed and compare lender performance across program
    - Creating incentives for debt collection and other cross-cutting initiatives to better manage programmes and control costs

Improvements could be made to the current treatment, including the incorporation of administrative expenses and a market risk premium to the Treasury discount rate. However, credit reform has improved resource allocation and budgeting in general in the US.

## Glossary

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| **Above the Line/Below the Line** | Above-the-line cash flows affect the deficit. Below-the-line cash flows do not affect the deficit but are regarded as a means of financing the deficit. Loan disbursements and collections are recorded above the line. Federal borrowing and repayments of federal debt are recorded below the line. |
| **Accrual Basis of Accounting** | An accounting practice by which revenues are recorded when earned and expenditures are recorded when goods are received, services performed, or losses incurred. |
| **Administrative Expenses** | All costs that are directly related to credit programme operations, including payments to contractors. |
| **Book Value** | The unpaid balance of a loan. |
| **Budget Authority** | Authority provided by law to enter into obligations (but not guarantee commitments) that will result in immediate or future outlays of government funds. |
| **Capitalise** | To convert future payments into a single present value. The market price of afinancial asset is the capitalised present value of future expected payments. |
| **Cash Flows** | Cash receipts and payments. |
| **Claim Payment** | A payment made to private lenders when a guaranteed loan defaults. |
| **Cohort** | Refers to the fiscal year of obligation for direct loan obligations, or loan guarantee commitments of a program. |
| **Credit Agencies** | Any executive branch department, independent commission, board, bureau, office, orother establishment ofthe federal government that administers a direct loan or guaranteed loan program. |
| **Credit Authority** | Authority to incur direct loan obligations or issue primary loan guarantee commitments. |
| **Credit Subsidy Calculator** | The discounting tool issued by OMB for agencies to calculate credit subsidy costs and financing account interest for post-1991 direct loans and loan guarantees. Subsidy rates and re-estimates, and actual interest income or expense for financing accounts, must be calculated with the online Credit Subsidy Calculator. |
| **Direct loan** | A disbursement of funds that is contracted to be repaid with or without interest. Three other types of transactions are also considered direct loans: (1) acquisition of defaulted private loans that the government had guaranteed and for which the government makes direct payment to the lender to honor the guarantee; (2) the purchase by the government of a private loan in the secondary market; and (3) a sale of agency assets on credit terms of more than 90 days. |
| **Direct Loan Obligation** | A binding agreement by a Federal agency to make a direct loan when specified conditions are fulfilled by the borrower |
| **Direct loan subsidy cost** | The estimated long-term cost to the Government of a direct loan, calculated on a net present value basis, excluding administrative expenses. Specifically, the cost of a direct loan is the net present value, at the time when the direct loan is disbursed from the financing account, of the following estimated cash flows:<br>• Loan disbursements;<br>• Repayments of principal;<br>• Payments of interest;<br>• Recoveries or proceeds of asset sales; and<br>• Other payments by or to the Government over the life of the loan |
| **Discount Rates** | The interest rate used in determining the present value of future payments. |
| **Discounting** | The calculation of the present value of an amount to be paid in the future. |
| **Economic Assumptions** | The interest rates used for discounting cash flows, the rate of inflation, the interest rate charged to the borrower of the loan and may include other assumptions as applicable to a particular program. Agencies must use the appropriate President's Budget economic assumptions for credit subsidy calculations. |
| **Entitlement ("Mandatory") Programmes** | Programmes that make payments to any person, business, or unit of government that seeks the payments and meets the criteria set in law. |
| **Face Value (of a Loan)** | Generally, represents the amount of money borrowed to be repaid at a future date. |
| **Financing Account** | A non-budgetary account (i.e. its transactions are excluded from the budget totals) that records all of the cash flows resulting from post–1991 direct loans or loan guarantees. |
| **Government-Sponsored Enterprises** | Privately owned enterprises established and chartered by the federal government to perform specific financial functions, usually under the supervision of a government agency, and whose transactions are excluded from the unified budget. |
| **Guaranteed Loan Commitment** | A legal or binding agreement by the federal government to guarantee, in whole or in part, the principal and/or interest on non-Federal loans when issued. |
| **Liquidating Account** | A budget account that records all cash flows to and from the Government resulting from pre–1992 direct loan obligations or loan guarantee commitments (unless they have been modified and transferred to a financing account). Liquidating account collections in any year are available only for obligations incurred during that year or to repay debt. |
| **Loan asset sale** | A sale of one or more loans to a non-Federal buyer, individually, pooled, packaged, securitised, or as a joint venture, at a single point in time, subject to parties fulfilling the terms and conditions of the Government's offer. Loan assets consist |

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| | of direct loans and loan receivables resulting from defaulted guaranteed loans. |
| **Loan Guarantee** | Any guarantee, insurance, or other pledge with respect to the payment of all or a part of the principal or interest on any debt obligation of a non-Federal borrower to a non-Federal lender, except for the insurance of deposits, shares, or other withdrawable accounts in financial institutions. Loan guarantees do not include 100% guaranteed loans that are financed by the FFB pursuant to agency loan guarantee authority; these are treated as direct loans rather than loan guarantees. |
| **Loan Guarantee Commitment** | A binding agreement by a Federal agency to make a loan guarantee when specified conditions are fulfilled by the borrower, the lender, or any other party to the guarantee agreement. |
| **Loan Guarantee Subsidy Cost** | The estimated long-term cost to the Government of a loan guarantee, calculated on a net present value basis, excluding administrative expenses. Specifically, the cost of a loan guarantee is the net present value, at the time when the guaranteed loan is disbursed by the lender, of the following estimated cash flows:<br>• Payments by the Government to cover defaults and delinquencies, interest subsidies, and other requirements; and<br>• Payments to the Government, including origination and other fees, penalties, and recoveries. |
| **Loan Terms** | Terms made explicit in the contract between the Government and the borrower or in the federally-guaranteed contract between a private lender and the borrower. These assumptions are forecast in the formulation subsidy cost estimate but are known at the time of loan origination. They may include: the interest rate charged on loans, the extent of a guarantee, fees, repayment terms, collateral held, grace periods, options, and other terms and conditions. |
| **Maturity** | The time at which the last payment on a debt is due. |
| **Means of Financing** | Ways in which a budget deficit is financed, or a budget surplus is used. |
| **Methodological Assumptions** | The technical practices used to develop subsidy cost estimates and loan modification cost estimates. These assumptions include methods and models or cash flow estimation, discounting methodology, and mathematical equations used in subsidy cost estimation. |
| **Modification** | A Government action that (1) differs from actions assumed in the baseline estimate of cash flows and (2) changes the estimated cost of an outstanding direct loan (or direct loan obligation) or an outstanding loan guarantee (or loan guarantee commitment). |
| **Modification Cost** | The difference between the estimate of the net present value of the remaining cash flows assumed for the direct loan or loan guarantee contract before and after the modification. |
| **Negative Subsidies** | Subsidy costs that are less than zero. They occur if the present value of cash inflows to the Government exceeds the present value of cash outflows. |
| **Negative Subsidy Receipt Accounts** | Budget accounts for the receipt of amounts paid from the financing account when there is a negative subsidy for the original estimate or where a modification results in a savings. |
| **Non-subsidised Cash Flows** | Cash flows arising from the non-subsidised component of a federal loan or guarantee. In a loan or guarantee, all cash flows except for the subsidy are non-subsidised. |
| **Offsetting Collections from the Public** | Collections from the public that are the result of business-type charges and are reported in expenditure accounts rather than in revenue accounts. |
| **Off-Budget** | Federal spending excluded from the budget totals under provisions of the law, even though these outlays are part of total government spending. |
| **On-Budget** | Federal spending that is included in the budget totals as part of total government spending. |
| **Outlays** | Payments to liquidate obligations that usually take the form of checks, cash, or electronic funds transfer. |
| **Present Value** | The current value of a claim on an amount or series of amounts of money to be paid in the future. |
| **Programme Account** | A budget account that receives and obligates appropriations to cover the subsidy cost of a direct loan or loan guarantee and disburses the subsidy cost to the financing account. |
| **Re-estimates** | Revisions of the subsidy cost estimate of a cohort (or risk category) based on information about the actual performance and/or estimated changes in future cash flows of the cohort. |
| **Risk Categories** | Subdivisions of a cohort of direct loans or loan guarantees into groups that are relatively homogeneous in cost, given the facts known at the time of obligation or commitment. Risk categories will group all direct loans or loan guarantees within a cohort that share characteristics predictive of defaults and other costs. They may be defined by characteristics or combinations of characteristics of the loan, the project financed, and/or the borrower. Examples of characteristics or indicators that may predict cost include:<br>• The loan-to-value ratio;<br>• The relationship between the loan interest rate and relevant market rates;<br>• Type of school attended for education loans;<br>• Country risk categories for international loans;<br>• Various asset or income ratios; and<br>• Major contract terms. |
| **Subsidy** | A payment, benefit, or service underwritten by the federal government for which the cost of provision exceeds the value of payments received. |
| **Subsidy Accounts** | This account receives appropriations and makes subsidy payments to the financing accounts. |

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| **Subsidy Costs** | The loss to the government on federal credit transactions. |
| **Subsidy Estimates** | Estimates of budget authority and outlays for direct loan and loan guarantee subsidy costs for a cohort or risk category of direct loans or loan guarantees. |
| **Treasury Securities** | Debt instruments of various maturities sold by the Treasury. |
| **Workouts** | Plans that offer options short of default or foreclosure for resolving troubled loans or loans in imminent default, such as deferring or forgiving principal or interest, reducing the borrower's interest rate, extending the loan maturity, or postponing collection action. |
| **Write-Offs for Default** | The amount of loans that are deemed uncollectible and subtracted from the cumulative face value of the loan portfolio. |

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## Notes

[1] See Goodrich, C. *Government Promotion of American Canals and Railroads* (1960); Willoughby, W. *The Capital Issues Committee and War Finance Corporation* (1934); Saulnier, et al., *Federal Lending and Loan Insurance: A Study by the National Bureau of Economic Research* (1958); Gentry, C. "Federal Credit Programs: An Overview of Current Programs and their Beginnings in the Reconstruction Finance Corporation (1980).

[2] The basis for US budgeting is obligation-based where transactions are recorded through the obligation of "budget authority" in the accounts when goods and services are ordered, regardless of when cash paid or "outlayed." Budget authority represents a limit on new financial obligations that may be incurred (by signing contracts, for example), and is generally the focus of budgetary decisions.

[3] Federal Credit Reform Act of 1990, https://fiscal.treasury.gov/files/ussgl/fcra.pdf

[4] https://www.rd.usda.gov/files/testimony/rdHouseAppropsOBrienTestimony.pdf

[5] The exclusion of deposit insurance was made at least in part because the goal of deposit insurance was more related to monetary policy than fiscal policy, including its mission of maintaining stability and public confidence in the US financial system.

[6] OMB Circular A-11, Section 20.7(h), https://www.whitehouse.gov/wp-content/uploads/2018/06/s20.pdf

[7] Ibid

[8] Reference material regarding credit reform accounting including sample general ledger entries: https://www.fiscal.treasury.gov/ussgl/resources-creditreform.html

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# OECD Review of Finland's Independent Fiscal Institution

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## Abbreviations and acronyms

| | |
|---|---|
| CAM | EU Commonly Agreed Methodology |
| CBR | Slovak Council for Budget Responsibility |
| CFP | Public Finance Council (Portugal) |
| EPC | Economic Policy Council (Finland) |
| EU | European Union |
| EU-IFIs | EU Independent Fiscal Institutions (autonomous network initiated by European IFIs) |
| EUNIFI | EU Network for Independent Fiscal Institutions (initiated by the European Commission) |
| FTE | Full-Time Equivalent |
| GDP | Gross Domestic Product |
| IFI | Independent Fiscal Institution |
| NAOF | National Audit Office of Finland |
| OBR | Office for Budget Responsibility (UK) |
| PBO Working Party | OECD Working Party of Parliamentary Budget Officials and Independent Fiscal Institutions |
| UK | United Kingdom |

## Executive summary and recommendations

The Independent Monitoring and Fiscal Policy Evaluation Function was established in the National Audit Office of Finland (NAOF) in January 2013 and later renamed the Team for Fiscal Policy Monitoring (hereafter "the IFI Team"). It serves as Finland's independent fiscal institution (IFI) and, together with the Economics Department of the Ministry of Finance, fulfils Finland's domestic institutional requirements for fiscal governance in the euro area. The IFI Team is tasked with monitoring national fiscal rules under EU treaties and the fiscal management objectives set out in the General Government Fiscal Plan.

The IFI Team has had a positive impact on the fiscal framework in Finland and is poised to have more influence in the years ahead, particularly as the government confronts the fiscal consequences of the COVID-19 pandemic. To maximise its effectiveness in the future, the NAOF and its IFI Team should address the following three key issues:

- **Institutional arrangements**. It is rare among OECD countries to place the responsibilities of an IFI under the governance structure of an audit institution. Although the NAOF has carved out a special status for the IFI Team under its Rules of Procedure, the IFI Team's management does not have explicit final say on analytical conclusions. Combining two different focuses of independent scrutiny – an IFI on plans before money is spent, and an audit authority on financial statements and value after it is spent – carries operational and reputational risks. For example, an IFI must comment publicly on policy issues that are more subjective and controversial than the work of a traditional national audit authority. Further, the project-based team structure of the NAOF divides the IFI Team's analysts between IFI work and other audit activities. Fiscal monitoring is a full-time activity. A divided focus carries the risk of missing important developments.
- **Depth of analytical work**. Stakeholders reported that the quality of the IFI Team's work has improved over time; however, they would like to see the IFI Team deepen its analysis on EU methodologies and develop more of its own analytical tools to produce independent benchmarks. Staff turnover and a high data collection burden hindered such depth in the past, but now that those challenges have largely been overcome, the IFI Team is positioned to invest more in its analytical capacity.
- **Visibility**. Placing the IFI responsibilities within a project team of the NAOF without a clear identity or control of its communications also limits the function's public visibility, which is crucial to an IFI's influence. Stakeholders are unsure precisely what to call the IFI Team and often confuse its work with the NAOF's traditional audit functions. The IFI Team's performance measurements, such as parliamentary mentions and website traffic, are difficult to separate from the rest of the NAOF. A greater distinction between the IFI Team's work and the NAOF's other impact areas is essential, as an IFI requires different communications strategies to effectively engage policy makers and the public.

This report expands on these key issues and others raised by stakeholders. Overall, the review found that the IFI Team is playing a successful role in the NAOF as the body responsible for independent monitoring of fiscal policy within Finland. In particular, the IFI Team is regarded as credible, independent, and technically focused.

While the review found that the IFI Team generally aligns with the OECD Principles for Independent Fiscal Institutions, the report makes the following key recommendations for the IFI Team to increase its effectiveness:

1. **Stronger walls should be established to safeguard the IFI Team's analytical independence within the NAOF.** Although stakeholders unanimously felt that the IFI Team should not be split off entirely from the NAOF, they acknowledged that the arrangement is out of step with international peers and carries limitations and risks. An appropriate compromise that reflects Finland's institutional environment would be for the IFI Team to mirror the arrangement of the Economics Department of the Ministry of Finance, which Finland designated as the independent producer of

macroeconomic forecasts for the domestic implementation of the EU fiscal surveillance framework. Under the Economics Department's arrangement, it has sole discretion over its forecasts and reports, which are released under the signature of the Director General of the Economics Department. The department's analysis cannot be influenced or overruled by other senior public servants in the Ministry of Finance or its political office. This independence is prescribed under statutory law. The same operating model for the IFI Team in the NAOF should be prescribed in the NAOF's Rules of Procedure in its next renewal and eventually should be enshrined in legislation.

2. **Given that the IFI Team's work overlaps with projects delivered by other fiscal policy audit teams, these activities should be merged under the more independent IFI Team to increase its full-time capacity.** Projects worked on by other fiscal policy audit teams in the NAOF have the purpose of "[determining] whether a true and fair view has been given of the central government finances and the sustainability of general government finances." These projects include, for example, evaluating how the government presents the impact of new employment measures on the public finances and evaluating the effectiveness of local government expenditure limits in achieving national fiscal targets. As these projects match the typical work areas of an IFI, it would make strategic sense to assign the fiscal policy audit projects to the IFI Team. This extension of the IFI Team and the merging of fiscal policy audit resources would then merit a full-time director who can dedicate full attention to the IFI Team's staff and its work, in line with the OECD Principles.
3. **Most IFI Team members should focus full time on IFI work.** The part-time assignment of several IFI Team members to other audit projects divides the focus of staff, posing a risk to the IFI's effectiveness. Monitoring the public finances requires year-round vigilance and technical knowledge, model capacity, and professional connections that can only be built and maintained in the time outside of the busy reporting cycles. While some flexibility for part-time assignments within the NAOF could be kept for professional development, morale and retention, most staff should devote full time attention to IFI research. This can largely be accomplished by consolidating other fiscal policy audit projects into the IFI Team's responsibilities.
4. **The NAOF should establish more concrete multi-year commitments to the IFI Team's funding.** The IFI Team does not have its own dedicated line within the national budget, but rather receives its funding under the discretion of the Auditor General out of the NAOF's annual appropriation from Parliament. Although the NAOF has a multi-year planning provision for the IFI Team in its internal management documents, it should also publish specific medium-term commitments to the IFI Team's financial and staff resources, either in a standalone document or in the NAOF's regularly published five-year strategies.
5. **The IFI Team's analytical work should be deepened by expanding its in-house modelling capacity to produce independent fiscal and economic benchmarks.** Stakeholders reported that the IFI Team's initial focus was weighted too heavily toward mechanical assessments of the fiscal rules and comparisons to forecasts of other institutions and not enough toward its own independent analysis. The IFI Team should deepen its analysis in areas that will add maximum value to the policy debate in Finland, for example by expanding its scrutiny of fiscal rules to include assessing the merit of those rules and the methodological appropriateness by which they are calculated against the IFI Team's own in-house revenue elasticity estimates and forecasts.
6. **The IFI Team should be free to develop new analytical areas, provided it does not compromise its core responsibility to assess compliance with the *Fiscal Policy Act*.** The IFI Team should have the flexibility to expand its coverage of areas of interest to stakeholders such as long-term fiscal sustainability. However, it should be mindful that building such capacity may require considerable time and effort. The IFI Team should also consider co-ordinating with other independent institutions in Finland, where appropriate, to avoid encroaching on other mandates and duplicating effort.

7. **The IFI Team should have a unique brand identity, including its own web section under the NAOF's site and a distinct report template and logo.** IFIs are most influential when they have an independent public voice. Presently, many stakeholders do not draw a distinction between the IFI Team's work and the NAOF's other reports. Distinctive branding of the IFI Team's reports and web presence could help address that lack of visibility.
8. T**he IFI Team should take greater ownership of monitoring the impact of its communications.** The IFI Team benefits from the support of the NAOF's communications team and should continue to take advantage of those resources, given its small size. But to be most effective in its communications, the IFI Team should track its web and media activities and other performance indicators such as parliamentary mentions separately from the NAOF's other impact areas.
9. **The IFI Team should increase its outreach to Members of Parliament, offering individual or group briefings on its work and products.** All relevant stakeholders – parliamentary committees, individual legislators, and the IFI Team members – reported the desire to interact more to improve the legislature's understanding and oversight of fiscal policy. Engaging parliamentarians is one of the most direct avenues for policy influence and the IFI Team should build greater relationships with parliamentary members and staff to promote its research, for example, through one-on-one briefings. The IFI Team should do so transparently and with efforts to provide equal opportunities to members to preserve its reputation for non-partisanship.
10. **To strengthen its identity and leverage its networks, the IFI Team should collaborate more with other Finnish institutions working on fiscal policy and with external experts.** The IFI Team could also do more to engage with other experts in the Finnish economic and fiscal community, building networks and organising peer reviews of its work. As a step toward doing so, the IFI Team could take greater advantage of the NAOF's Scientific Council, using it more regularly for peer review of its work and for guiding its vision and work programme. Another option with international precedence is to have regular conferences or workshops organised by the IFI Team to allow economists from different institutions to share and discuss their work.

## 1. Adherence to OECD Principles

### *Introduction*

This review of Finland's *Team for Fiscal Policy Monitoring* (hereafter the "IFI Team") within the National Audit Office of Finland (NAOF) uses an evaluation framework anchored in the OECD Recommendation on Principles for Independent Fiscal Institutions, adopted by the OECD Council on 13 February 2014 (OECD, 2014[1]).

The OECD Recommendation provides a set of Principles to assist Member countries in designing independent fiscal institution (IFIs) that are effective and viable over the long run. There are 22 Principles across nine headings:

1. Local ownership
2. Independence and non-partisanship
3. Mandate
4. Resources
5. Relationship with the legislature
6. Access to information
7. Transparency
8. Communications
9. External evaluation

### *Results*

Overall, the IFI Team's design and operations satisfy the OECD Principles and its analysis meets international standards. On **local ownership**, its role and structure reflect the historical role the NAOF has played in monitoring national rules and procedures for fiscal policy. However, it is rare among OECD countries to place an IFI under the governance structure of an audit institution, which may not always have the same objectives and strategies as the IFI for influencing government policies and procedures.

On i**ndependence and non-partisanship**, stakeholders universally reported that the IFI Team's work is impartial, nonpartisan, and of high quality. The director in charge of the IFI Team is chosen on merit and is required to have a minimum level of education and experience defined under the NAOF's Rules of Procedure (National Audit Office of Finland, 2019[2]). The Rules of Procedure are the detailed provisions on internal administration that the NAOF is required to prepare and adopt under the *Act on the National Audit Office*. The director's three-year term lengths are independent of the political cycle; however, there are no term limits, in contrast to the recommendation of the OECD Principles. The director is full time and remunerated, but divides attention between the IFI Team and other teams in the NAOF. The director in charge of the IFI Team makes recruitment decisions in practice; however, the IFI Team is staffed by members of the NAOF and their assignments are ultimately decided by the Auditor General.

On **mandate,** very few of the IFI Team's responsibilities, reports, and timelines are specified in legislation. The *Fiscal Policy Act*, Finland's domestic law implementing fiscal rules under EU treaties and other national budget management objectives, simply names the NAOF as the monitoring body for the Act.[1] However, the Act clearly prescribes the government's fiscal management obligations and so the NAOF's monitoring responsibilities and their relation to the budget cycle can be inferred. The director in charge of the IFI Team is given the independence to determine the IFI team's work programme under the NAOF's Rules of Procedure. There is a risk that an Auditor General could override the director's autonomy; however, in practice, the IFI Team has no concerns over its freedom to work at its own initiative.

On **resources**, the IFI Team's expenditure is planned and monitored separately within the NAOF budget. The NAOF's budget is part of the annual appropriation to parliament and is a parliamentary decision. Although it is set annually, in practice there is medium-term planning within the NAOF and allocations for salaries, the main expense, automatically increase each year along with the rest of the NAOF's salaries. If the IFI Team needs more resources or additional staff, the director in charge is entitled to make proposals that will be addressed in one of the management forums. But the final decision is up to the Auditor General.

On **relationship with the legislature**, the IFI Team's work is overseen by the Audit Committee of Parliament under the NAOF's channels of accountability prescribed in the *Act on the National Audit Office;* however, there is no specific responsibility of the NAOF or IFI Team in relation to committees under the *Fiscal Policy Act*. The IFI Team reported that it has sufficient time during the budget cycle to complete its analysis and report to the legislature. Parliamentarians reported that they have sufficient time under the calendar to debate the IFI Team's reports and call upon IFI Team members to provide evidence.

On **access to information**, the IFI Team is able to leverage the NAOF's rights to information and its rights to inspect all public bodies. These rights are clearly defined in legislation, including the restrictions under which they do not apply. Staff reported that they have not had any issues securing the data they need to fulfil the team's mandate.

On **transparency**, the NAOF's annual corporate governance reports are submitted to the legislature and published online; however, they cover the IFI Team's activities only at a high level. There is no standalone annual activities report for the IFI Team. A regular analytical reporting cycle has been established, although timelines are not specified in legislation. Reports are not released in the IFI Team's name, but rather are published under the NAOF's banner. The IFI Team publishes many details of its methods, particularly for its macroeconomic error assessments and cyclical indicators, but some peer EU IFIs are more proactive in publishing spreadsheets for fiscal rule calculations.

On **communications,** the IFI Team relies heavily on the NAOF's communications team and policies; it is difficult to disentangle the IFI Team's activities from the rest of the NAOF's activities to gauge the effectiveness of its communications.

On **external evaluation**, the IFI Team has initiated this external OECD review. The team's reports are also reviewed by the Scientific Council of the NAOF, which consists of experts primarily from Finnish universities, and the Advisory Board of the NAOF, which includes permanent subject-matter experts and temporary representatives from all political parties.

A detailed assessment of the IFI Team's adherence to the OECD Principles is given in Table 7. The remainder of this report expands on these discussions and provides recommendations for bringing the IFI Team into greater alignment with the OECD Principles and the best practices of peers. The recommendations are grouped into four areas:

- **Mandate and governance**: The IFI Team's responsibilities, organisation and rights to information.
- **Reports and influence:** The IFI Team's reports and how it communicates them to engage stakeholders and influence fiscal management practices.
- **Methods**: The IFI Team's approaches, workflows and models for producing its reports.
- **Financial and human resources**: How the IFI Team has been empowered with the budget and staff to achieve its mandate.

## Table 7. Does Finland's IFI Team adhere to the OECD Principles for Independent Fiscal Institutions?

| 1. LOCAL OWNERSHIP | Key: ● = yes; ◖ = partially; ○ = no |
|---|---|
| **1.1 Broad national ownership, commitment, and consensus across the political spectrum. Models from abroad should not be artificially copied or imposed.**<br>Finland has a long history of fiscal rules monitored by an independent body (the NAOF). Although the designation of an IFI was in large part because of EU treaties, it was embraced by the consensus of stakeholders and was largely a continuation of existing practices under a new name. | ● |
| **1.2 Local needs and the local institutional environment should determine options for the role and structure of the IFI.**<br>The model was chosen because the NAOF was already playing a role in monitoring national rules and procedures for fiscal policy such as the spending limit system. The placement of an IFI in an audit office is rare among OECD countries. Additional effort should be made to solidify the IFI Team as a separate identity within the NAOF. | ● |
| **2. INDEPENDENCE AND NON-PARTISANSHIP** | |
| **2.1 Does not present its analysis from a political perspective; strives to demonstrate objectivity and professional excellence, while serving all parties. IFIs should be precluded from any normative policy-making responsibilities to avoid even the perception of partisanship.**<br>Stakeholders universally reported that the IFI Team's work is impartial, nonpartisan, and of high quality. While it is required to perform some normative guidance on the appropriateness of both the broad fiscal stance and individual programmes to return to balance, the proposals are initiated by the executive government and the IFI Team's commentary avoids politics. | ● |
| **2.2 The leadership of an IFI should be selected on the basis of merit and technical competence, without reference to political affiliation. The qualifications should be made explicit.**<br>Under the Rules of Procedure of the NAOF, the director of fiscal policy monitoring must hold an applicable master's degree and have knowledge of audit, evaluation activities, public finances, central government and fiscal policy, as well as proven leadership skills and management experience. | ● |
| **2.3 Term lengths and number of terms that the leadership of the IFI may serve should be clearly specified in legislation along with dismissal criteria and process.**<br>The director for the IFI Team is appointed for a 3-year term. However, no limit is specified in legislation. The director for fiscal policy monitoring is subject to the dismissal procedures of public servants regulated in law, such as performance hearings. | ◖ |
| **2.3 The leadership's term should optimally be independent of the electoral cycle.**<br>The director for the IFI Team is currently appointed for a 3-year term. Parliamentary elections are held every four years (presidential elections every six years). | ● |
| **2.4 The position of head of the IFI should be a remunerated and preferably full-time position. Strict conflict-of-interest standards should be applied.**<br>The director for the IFI Team is remunerated but only devotes roughly 50% of his time to the IFI Team. As monitoring is a full-time activity, not simply during the preparation of reports, the IFI Team's director should devote all of their attention to the IFI work. | ◖ |
| **2.5 The leadership of the IFI should have full freedom to hire and dismiss staff in accordance with applicable labour laws.**<br>The IFI Team is staffed by members of the NAOF, but the director has influence over recruitment decisions. The Auditor General ultimately decides on the allocation of staff to the IFI Team. Many IFI Team members are currently assigned to both IFI activities and other audit functions, particularly fiscal policy auditing. | ● |
| **2.6 Staff should be selected through open competition based on merit and technical competence, without reference to political affiliation, in line with civil service conditions.**<br>The IFI's staff are hired under open competition based on merit, in line with recruitment process of the NAOF and civil service hiring procedures. | ● |
| **3. MANDATE** | |
| **3.1 The mandate should be defined in legislation, including types of reports and analysis they are to produce, who may request them and timelines for release.**<br>Very few of the IFI Team's responsibilities, reports, and timelines are specified in legislation. Subsection 7 of the *Fiscal Policy Act* (869/2012) merely names the NAOF as the monitoring body of the Act, although it is clear in the Act what this entails. The *Act on the National Audit Office* (676/2000) empowers the NAOF to create its own Rules of Procedure for delivering its responsibilities. | ◖ |
| **3.2 IFIs should have the scope to produce reports and analysis at their own initiative and autonomy to determine their own work programme within their mandate.**<br>The activities of the IFI Team are determined by its director (that is, the director of the impact area for Sustainable General Government Finances) but are ultimately approved by the Auditor General. There is a risk that an Auditor General could override the workplan and autonomy of the IFI Team. | ● |
| **3.3. Clear links to the budget process should be established within the mandate.**<br>Strictly speaking, there are no mandatory reports. However, it is clear in the *Fiscal Policy Act* which reports would be required to fulfil the NAOF's responsibilities for monitoring the government's compliance with the Act and when they would be required within the budget cycle. | ◖ |
| **4. RESOURCES** | |
| **4.1 The resources allocated to IFIs must be commensurate with their mandate.**<br>The IFI Team's resources are sufficient to fulfil the NAOF's minimum requirements under the *Fiscal Policy Act*. However, monitoring the public finances is a full time role, and currently many members of the IFI team's staff divide their attention between monitoring and other NAOF | ● |

projects.

**4.1 The appropriations for IFIs should be published and treated in the same manner as the budgets of other independent bodies.** ◖

The IFI Team does not have budget autonomy within the NAOF, although its expenditures are planned and monitored separately. The NAOF budget is part of the decision on Parliament's budget and is funded solely from the appropriation for Parliament.

**4.1 Multiannual funding commitments may further enhance the IFI's independence and provide additional protection from political pressure.** ◖

The IFI Team's budget is set annually, based on its expected staff requirements and other costs. In practice, there is medium-term planning under the NAOF and an understanding that the IFI Team's resources will be maintained and increased with expected increases in salary expenses.

**5. RELATIONSHIP WITH LEGISLATURE**

**5.1 Mechanisms should be put in place to encourage appropriate accountability to the legislature.** ●

The NAOF is overseen by the Audit Committee of Parliament. The committee consults stakeholders for feedback on the IFI Team's reports. The IFI Team's leadership appears an average of three times a year before parliamentary committees.

**5.1 The budgetary calendar should allow sufficient time for the IFI to carry out analysis necessary for parliamentary work.** ●

The IFI Team reports that it has sufficient time to complete its analysis and is not overburdened in meeting the demands of its reporting cycle. Parliament has sufficient time under the calendar to debate the IFI Team's reports and call IFI Team members to expert hearings when necessary.

**5.2 The role of the IFI vis-a-vis the Parliament's budget committee (or equivalent), other committees, and individual members in terms of requests for analysis should be clearly established in legislation.** ◖

The NAOF's general responsibilities toward committees are clearly laid out in the *Act on the National Audit Office*, but the specific role of the NAOF or IFI Team in relation to committees under the *Fiscal Policy Act* is not.

**6. ACCESS TO INFORMATION**

**6.1 IFIs should have full access to all relevant information in a timely manner.** ●

The IFI Team is able to leverage the strong legislated powers of the NAOF to request information and inspect public bodies. The relationship-based culture of Finland also helps the IFI Team secure its data. The IFI Team reports no issues securing data.

**6.2 Any restrictions on access to government information should be clearly defined in legislation.** ●

The *Act on the National Audit Office* granting the NAOF's access to data specifies restrictions on its access, which relate mostly to the investigation of private individuals.

**7. TRANSPARENCY**

**7.1 The IFI should act as transparently as possible, including full transparency in their work and operations.** ◖

The NAOF's annual corporate governance reports are published online but include descriptions of the IFI Team's work and operations only at a very level. More transparency could be provided by publishing an annual activities report.

**7.2 The IFI's reports and analysis (including underlying data and methodology) should be published, made freely available to all and sent to Parliament.** ●

All of the IFI Team's reports are submitted to the legislature and published online.

**7.3 The release dates of major reports and analysis should be formally established, especially in order to co-ordinate them with the release of relevant government reports and analysis.** ●

A regular reporting cycle has been established, although timelines are not specified in legislation.

**7.4 IFIs should release their reports and analysis, on matters relating to their core mandate on economic and fiscal issues, in their own name.** ◖

Reports are released in the NAOF's name, which is the only body defined in legislation. However, in promoting its identity and activities, the IFI Team should build an independent identity for its reports.

**8. COMMUNICATIONS**

**8.1 IFIs should develop effective communication channels from the outset.** ◖

The NAOF's communications channels and policies are used; the IFI Team does not have ownership of its own communications. It is difficult to disentangle the IFI Team's activities from the rest of the NAOF's activities for performance monitoring.

**9. EXTERNAL EVALUATION**

**9.1 IFIs should develop a mechanism for external evaluation of their work.** ●

The IFI Team initiated an OECD external review in 2020-2021. The Scientific Council of the NAOF intermittently reviews the NAOF's work. The Audit Committee of Parliament occasionally requests feedback on the IFI Team's report from stakeholders.

## 2. Mandate and governance

# Key findings

The OECD Principles recognise that there is no one-size-fits-all design for a country's IFI. An IFI's mandate and structure should reflect the country's local needs and institutional environment. Finnish stakeholders reported that the existing mandate and placement of the IFI Team within the NAOF is appropriate given its history of doing similar analysis, and that the relationship is working well.

That said, stakeholders acknowledged that the institutional arrangement is out of step with international peers, that fiscal policy monitoring is fundamentally different than financial statement and performance audits, and that the arrangement carries limitations and reputational risks.

The NAOF has mitigated some of these limitations and risks by granting the IFI Team special status in the formal Rules of Procedure it sets itself under the *Act on the National Audit Office*; however, further adjustments could improve the IFI Team's alignment to international peers, including:

- The NAOF should establish strong walls to secure the IFI Team's analytical independence from other sections of the audit office in a public memorandum and in its next renewal of the Rules of Procedure. Eventually this independence should be enshrined in legislation. The operating model should mirror the independence of the Economics Department of the Ministry of Finance (Finland's independent producer of forecasts). Statutory law prescribes that the Director General of the Economics Department has sole discretion for the department's outputs, which are issued under the Director General's signature and cannot be influenced or overruled by others in the ministry. Such a wall would require the IFI Team to be established as a standalone unit, separate from the NAOF's other impact areas.
- Given the similarity between the IFI Team's mandate and fiscal policy audit projects carried out by other teams under the Sustainable General Government Finances impact area, the IFI Team's scope should be expanded to include fiscal policy audit projects. This broader and more independent IFI Team should have a full-time director who can dedicate all their attention to the IFI Team members and IFI work.
- The director in charge of the standalone IFI Team should be given clear final say on analytical and communications decisions related to the IFI Team.

### *Introduction*

This section assesses the mandate that the IFI Team has been given under legislation and other governance documents, the institutional arrangement that has been created to deliver the mandate, and the access to information that empowers the IFI Team to carry out the mandate.

As a member state of the European Union and the euro area, Finland is bound by the Fiscal Compact in the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union. The Fiscal Compact and other EU legislation on economic policy co-ordination brought the need for Finland to nominate an independent institution to monitor the domestic implementation of the EU fiscal rules and other national fiscal policy guidance. The National Audit Office of Finland (NAOF) was named in the *Fiscal Policy Act* as that monitoring body.

The NAOF is under the authority of the Parliament of Finland, making it independent of the government and the Ministry of Finance. Section 90 of Finland's Constitution guarantees the independence of the NAOF and the *Act on the National Audit Office of Finland* provides further protections for the position of Auditor General. The Auditor General is appointed by Parliament through a secret vote for a six-year renewable term.

### *Mandate*

The NAOF created the IFI Team under its Rules of Procedure (described in Section Internal organisation and autonomy) to fulfil the NAOF's legislated mandate to conduct fiscal policy monitoring. The IFI Team does not therefore have a legislated mandate in its own name, but rather its responsibilities stem from the NAOF's mandate. These responsibilities primarily include monitoring compliance with the following national laws implementing the EU fiscal surveillance framework requirements:

- The *Fiscal Policy Act* passed by Finland's parliament in 2012 requires the government to set medium-term structural budget objectives as specified under the EU's Fiscal Compact. The Act also creates requirements for the government to follow the Fiscal Compact's corrective mechanisms and definitions of exceptional circumstances. Section 7 of the Act names the NAOF as the body responsible for monitoring the government's compliance with the Act's provisions. By naming the NAOF as the monitoring body, Finland fulfils the requirements for independent monitoring laid out in EU Regulation No 473/2013 of the European Parliament and of the European Council.
- The Decree on the General Government Fiscal Plan (120/2014), issued under the *Fiscal Policy Act*, fulfils the EU's requirement under the EU Budgetary Frameworks Directive (2011/85/EU) that governments lay out their targets for public financial management. The NAOF's responsibility, as recognised by the Ministry of Finance, is to support Article 4(6) of the EU Directive on establishing safeguards for the reliability of macroeconomic and budgetary forecasts. The IFI Team assesses the credibility of the macroeconomic forecasts, rather than formally endorsing them, because the official macroeconomic forecasts are produced by the Economics Department of the Ministry of Finance under institutional walls and legal protections that ensure that the department fulfils the EU's criteria for an independent body. Finland is the only euro member state that has designated a Ministry of Finance department as the independent forecast producer to comply with EU regulations (European Commission, 2020[3]).

In practice, the NAOF and its stakeholders have interpreted the body of EU legislation and national legislation as requiring the IFI Team to perform **five assessment tasks**.

**Task 1.** Assessing compliance with the Stability and Growth Pact, including:[2]

- Adherence to a medium-term objective, set in structural terms, and a medium-term benchmark, that are consistent with a deficit limit of 3% of GDP, or 1% in structural terms, and a debt rule of 60%, including implicit liabilities.
- Adherence to the Expenditure benchmark (expenditure net of discretionary revenue, interest payments, EU funded programmes, cyclical unemployment benefits, and smoothed national-financed investment), which has a ceiling of the medium-term rate of potential growth if at the medium-term objective.
- Compliance with stability/corrective arm deficit and debt criteria.

**Task 2.** Assessing the preparation and implementation of the General Government Fiscal Plan, including:

- Compliance with legislation for minimum contents in the budget plan.
- Monitoring sector-specific fiscal balance and debt objectives and the prerequisites for achieving them, including long-term sustainability.

**Task 3.** Assessing the economic forecasts issued by the Ministry of Finance, including:

- *Ex ante* reasonability of the forecasts.
- *Ex post* forecast error and bias assessments of the forecasts.

**Task 4.** Assessing compliance with central government spending limits, including:

- Adherence to the domestic spending limits system, which is different than the Stability and Growth Pact framework. The Finnish government must set limits for its expenditure in real terms for the parliamentary term on about 80% of expenditure (excluding automatic stabilisers, interest, and financial investments). Reallocations between departments are permitted. Price and cost level adjustments are made annually.

**Task 5.** Assessing the fiscal policy stance, including:

- Whether fiscal policy has been contractionary or expansionary, and whether it is likely to be so in future years.

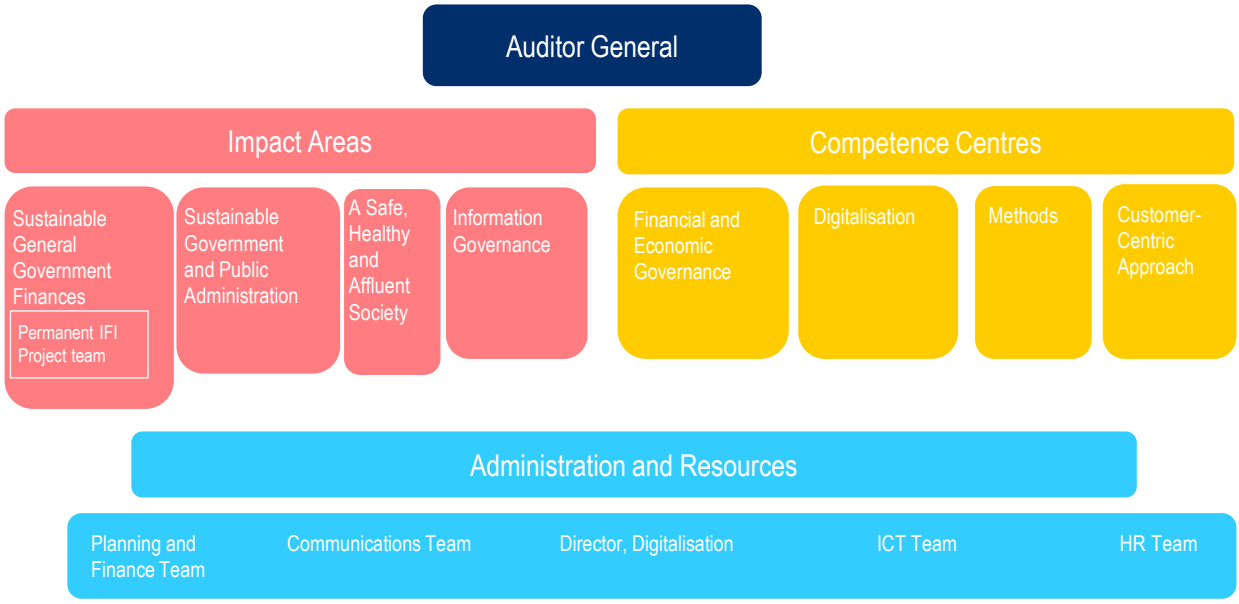
### *Internal organisation and autonomy*

The NAOF is required under Section 20 of the *Act on the National Audit Office of Finland* to establish its own Rules of Procedure to specify its decision-making processes, the handling of administrative matters, and other matters related to internal administration. In January 2013, the NAOF used this power to create the Independent Monitoring and Evaluation of Fiscal Policy Function as a team within its organisation to fulfil the IFI role. Following a reorganisation of the NAOF in 2019, the most recent update of the Rules of Procedure creates four impact areas, under which teams are formed to work on individual audit projects as needed. In recognition of the importance of the NAOF's IFI responsibilities, a special exception to the project-based workflow was carved out in the Rules of Procedure to make the IFI Team a permanent project team known as the "team in charge of fiscal policy monitoring" within the Sustainable General Governance Finances impact area (Figure 5).

The Director of Sustainable General Government Finances is appointed by the Auditor General for a three-year term and also acts as first Deputy Auditor General. The IFI Team is managed day-to-day by a Principal Fiscal Policy Auditor.

Other teams under the Sustainable General Government Finances Impact Area are devoted to a wide range of projects assessing the management of central government assets, liabilities, and investments; financial risks; and ownership steering of state-owned companies, among others. All staff, including those on the permanent IFI Team, divide their time at least partly between teams. The NAOF director in charge of the Sustainable General Government Finances impact area is responsible for both the permanent IFI Team and the other teams.

**Figure 5. Organisational chart of the National Audit Office**




The placement of an IFI within a national audit office is rare, although not unprecedented (see Box 1). A key reason why the Finnish IFI was set up within the NAOF is that the audit institution was already playing a role in monitoring national rules and procedures for fiscal policy such as the spending limits system that requires new governments to commit to a ceiling for central government budget expenditure for the four-year parliamentary term.

Placing an IFI within the audit office comes with two significant risks. First, a country's supreme audit authority and IFI may not always have the same objectives in their analysis. An auditor looks into the past, while an IFI looks into the future. Budget planning and financial reporting have different goals. The former aims to help decision makers take action under conditions of uncertainty. The latter aims to provide oversight bodies and the public with objective facts of the consequences of past decisions. Box 2 describes a case study from Canada where these aims were at odds and an auditor's recommendations sparked controversy. Because the IFI was a separate institution, it was able to provide independent analysis that went against the auditor's position.

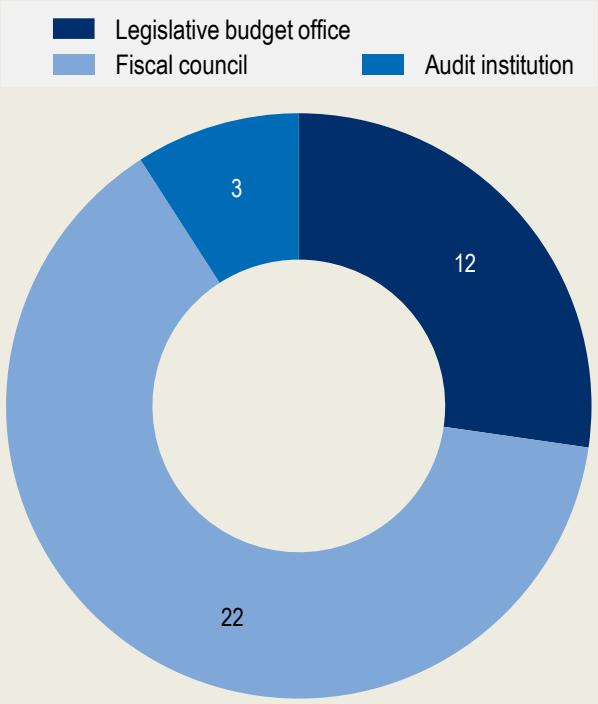
Second, IFIs must engage publicly on issues that are more subjective and political than the traditional auditing of financial statements and performance. While the IFI Team benefits from the history, reputation, and visibility of the NAOF, the public does not generally have a nuanced understanding of the IFI Team's unique role in Finland's economic and fiscal ecosystem. This lack of a distinction in public perceptions poses risks to the reputation of the NAOF's traditionally policy-agnostic audit activities. For example, it is likely that the IFI Team will be more active in the coming years of the pandemic in commenting on the appropriateness of individual policy actions for returning to strategic medium-term objectives. This part of its mandate has required only a light touch in the past. The choices a government makes to consolidate the public finances tend to be subjective and controversial, which is why nearly all EU countries created a standalone fiscal council of experts to shoulder the burden. A stronger wall of independence, heavily promoted to the public, would prove valuable in sheltering the NAOF's traditional activities from the reputational risk of these coming policy disputes.

## Box 1. Audit Institution models within the OECD PBO Working Party

Only three OECD member countries have placed the IFI Team within the supreme audit institution: Finland, Lithuania, and France.

The Finnish IFI Team is most similar to the Lithuanian IFI. The Lithuanian Budget Policy Monitoring Department was established within the Lithuanian National Audit Office in 2015. It is headed by the Auditor General, who has overall responsibility for decisions and hiring of IFI activity staff. Day-to-day management of up to 10 staff is carried out by the team's director. Reports are signed by the Auditor General after consultation with deputy auditors general. The National Audit Office is accountable to parliament.

### Figure 6. Institutional models in the OECD PBO Working Party




Source: OECD IFI Database 2019

The French High Council of Public Finances has stronger walls to protect its independence from the Court of Auditors than the Finnish IFI Team. It was established in 2012 as an independent body attached to the Court of Auditors. It is fully independent from both the government and the parliament and has a special separate status from the Court of Auditors. The IFI is presided over by the First President (Premier président) of the Court of Auditors, and the Chief of Staff (Rapporteur général) is also a magistrate of the Court. However, legislation contains several provisions to guarantee the independence of the members of the IFI from the Court of Auditors. For example, members of the Council are appointed by six different authorities, including the National Assembly, Senate, and their finance committees and representatives from opposition parties.

In recognition of these two concerns, the NAOF has strengthened the autonomy of the IFI Team in several ways:

1. The Rules of Procedure recognise the special status of the IFI Team and specify its responsibility for the independent fiscal policy monitoring and evaluation tasks laid down in the *Fiscal Policy Act*. The Rules of Procedure give the director in charge of the IFI Team (that is, the Director for Sustainable General Government Finances) the responsibility for decisions related to the team's reports, memoranda, opinions, hearings, and international co-operation with the European Commission and other international organisations and peers.
2. Beginning in 2020, only the director in charge of the IFI team signs the IFI Team's reports. The reports are no longer co-signed by the Auditor General.
3. The IFI Team's work programme is distinguished separately within the NAOF's four-year workplan, which must be presented once a year to the Parliament. The workplan is updated twice a year and is flexible enough to allow quick integration of new developments.

### Box 2. When auditors and IFIs clash

**A case study from the Province of Ontario, Canada**

In 2015-16 and 2016-17, the Auditor General of the Province of Ontario published adverse audit opinions that the provincial government's financial statements were not a reasonable presentation of Ontario's finances. The Auditor General questioned the government's recognition of public pension plan assets in the determination of net debt. The government argued that the Auditor General's advice did not reflect emerging international accounting standards and would not be as valuable for budget planning. An independent third-party Pension Asset Expert Advisory Panel was established to resolve the dispute. The findings would have significant political implications for the governing party's promises to balance the budget.

While the panel was being set up and conducting its investigation, the Financial Accountability Office, Ontario's IFI, used its independence to proactively prepare and publish two scenarios of fiscal plans and outturns – one under the Auditor General's assumptions and one under the government's assumptions (Financial Accountability Office of Ontario, 2017[4]). The scenarios provided the Ontario legislature, the independent review panel and the public with the complete range of information while the dispute was being resolved.

Eventually, the independent advisory panel determined that the government's preferred accounting method presented the picture of the public finances that was most useful for budget planning and that was in greatest alignment with international standards (Province of Ontario, 2017[5]). Had the Financial Accountability Office been institutionalised within the Auditor General, it may not have been granted the freedom to continue publishing alternative fiscal plans and budget implementation data under the government's assumptions, given the heated tensions at the time.

Despite these protections, the Auditor General formally has authority over the entire NAOF and could significantly influence the IFI Team's capabilities. That influence extends to setting the workplan, hiring staff, allocating staff time, and allocating resources for publications and other communications. The IFI Team has been fortunate to have auditor generals well-versed in fiscal policy issues that recognise the unique work of IFIs. There is a risk that a future Auditor General could limit the autonomy, resources, and work programme of the IFI Team.

With that in mind, the NAOF should enhance the autonomy of the IFI Team. As the EU requirements are fulfilled by two independent bodies, the IFI Team and the independent Economics Department in the

Ministry of Finance, it would be institutionally symmetric if the IFI Team mirrored the arrangements of the Economics Department. Under the Economics Department's arrangement, its Director General has sole discretion over forecasts and reports, which are released under the signature of the Director General. The department's analysis cannot be influenced or overruled by other senior public servants in the Ministry of Finance or its political office. This independence is prescribed under statutory law, but is also a convention in Finnish government going back several decades. The same operating model for the IFI Team in the NAOF should be defined in the NAOF's Rules of Procedure in its next renewal and eventually in statutory legislation.

Other fiscal policy audit teams in the NAOF have the purpose to "determine whether a true and fair view has been given of the central government finances and the sustainability of general government finances." For example, fiscal policy audit teams publish reports that evaluate how the government presents the impact of new employment measures on the public finances, and reports on the effectiveness of local government expenditure limits in achieving national fiscal targets. As these projects match the typical work areas of an IFI, it would make strategic sense to assign the fiscal policy audit projects to the IFI Team.

These combined activities should be operationally autonomous from the NAOF's traditional audit activities (for example, financial reporting and performance audits). The staff that currently divide attention between these policy activities and other traditional audit work could then focus their attention on the consolidated IFI work and it would then be justifiable to have a full-time director for the IFI workstream, in line with the OECD Principles. To fill the position of this director, it is worth considering an appointment process that is separate from the NAOF's general staffing procedure. For example, the IFI Team's director could be recruited through an open selection process and attend a hearing by a parliamentary committee before being appointed by the Auditor General.

### *Access to information*

One of the main benefits of the IFI's attachment to the NAOF is the legal powers it enjoys for accessing information from the government administration. The NAOF's right to access to information is enshrined in both the Constitution of Finland, which prescribes generally that that the NAOF has "the right to obtain the information required for the performance of their duties from public authorities and other entities that are subject to their control (Section 90)," and in the *Act on the National Audit* Office, which prescribes specifically that the NAOF has:

- The right to inspect a ride range of public bodies listed as state authorities, institutions, business enterprises, enterprise groups and state funds, among others.
- The right to receive without delay reports, records and other information that are necessary for the Audit Office to perform the task prescribed. The information is to be provided for free, whether hard copy or electronic.

The Act also sets out limitations on the NAOF's access to information. The restrictions relate principally to individuals who have received funds or other financial support for personal needs.

Together, these constitutional and statutory provisions for access to information compare very favourably to peer IFIs, and staff reported having everything they require to perform their role. Further, Finland's public service has a culture of informal openness to collaborating to provide information toward common goals of better policy and fiscal management.

That said, the IFI Team's close association with the NAOF was also reported to hamper some informal channels of discussion with government departments and economic research institutions. Potential collaborators tend to view the IFI Team as part of the overall auditing framework, which can hold back informal economic and fiscal discourse. Counterparties at departments can be reluctant to disclose problems or have frank discussions with staff of the IFI Team out of concern that the IFI Team may have

an audit agenda. This reluctance is not as prominent for IFIs that are composed of academic economists. This disadvantage may be addressed by reinforcing the IFI Team's independent identity as recommended elsewhere in this review.

## 3. Reports and influence

# Key findings

The IFI Team's reports are comprehensive for delivering its mandate. Managers and staff have made an effort to make reports more concise and readable. Empirical assessments and stakeholder feedback show that they have achieved this goal. Due in part to this effort, reports have been influential in the public debate, featuring regularly in parliamentary committees, the media and the decisions of policy makers.

The IFI Team benefits from the services of the communications team at the NAOF; however, the relationship means that the IFI Team has less direct responsibility and ownership for promoting its research and monitoring its impact than other IFIs.

To strengthen the IFI Team's influence, there are several areas related to the IFI Team's reports and communications that are worth developing further:

- The IFI Team should deepen the coverage of its reports on long-term fiscal sustainability to assist stakeholders in tackling Finland's challenges from population ageing. However, it should be mindful that it may require considerable time to build the capacity to do so. When expanding analytical scope, the IFI Team should also consider co-ordinating with other independent institutions in Finland, where appropriate, to avoid encroaching on other mandates and duplicating effort. While the IFI Team should retain the flexibility to engage in new areas, this should not compromise its core responsibility to assess compliance with the *Fiscal Policy Act*.
- Other IFIs have found that one-on-one briefings to interested Members of Parliament are an effective channel for increasing take-up of fiscal analysis. The IFI Team should develop such relationships but ensure that opportunities are equal and transparent to avoid accusations of political interference.
- The IFI Team should develop a distinct branding in its communications to help distinguish its function from the rest of the NAOF by using a unique template and heading formats, colours, and an IFI Team logo. Having a unique identity will emphasise the team's independence and help staff communicate and engage stakeholders with the same standing as international peers. This will have the added benefit of increasing visibility and awareness among the public of the unique work of the team and its importance to Finland's public financial management framework.
- The NAOF should also enhance the IFI Team's visibility as a distinct function on the homepage of the NAOF's website. It should create a separate web section under the NAOF's site that goes beyond the current overview page, presenting all the IFI Team's publications in one archive.
- The IFI Team should develop methods to track its web and media activities and other performance indicators such as mentions in parliament separately from the rest of the NAOF. This will be easier following other actions to emphasise the team's work as a distinct brand.
- The IFI Team should build upon its new unique identity by collaborating more with other Finnish institutions working on fiscal policy and doing more to engage national economists, build networks and professional skills, and organise peer reviews of its work. One option with

international precedence is to have regular conferences or workshops organised (or sponsored) by the IFI Team to allow economists from different institutions to share and discuss their work.

### *Introduction*

IFIs do not generally have legal tools or formal levers to compel their government to change its fiscal management. An IFI Team's foremost tool is persuasion. Achieving an impact through persuasion means developing quality reports and strong communication channels, especially with the media. Easily accessible reports and widespread coverage of an IFI's work in the media foster an informed legislature and electorate that can exert timely pressure on a government to manage fiscal matters transparently and responsibly.

Like many of its peers, the IFI Team of the NAOF is a relatively young service and some of its activities are new. Further, the NAOF underwent a reorganisation and relaunched its website and tracking methods in recent years. The lack of long time series for performance measurements makes impact evaluation difficult. Nevertheless, stakeholders were clear that the IFI Team has improved the public's understanding of fiscal issues through its reports, participation in legislative debates, leveraging of the media, and online footprint. In doing so, the IFI Team has achieved a positive impact in several key areas, improving the government's transparency and official forecasting practices (Box 3).

#### Box 3. The IFI team has made an impact

Stakeholders noted several specific areas where the IFI Team has strengthened analysis of fiscal policy issues through its work:

- The IFI Team's review of macroeconomic and fiscal forecasts has improved transparency around forecasting at the Ministry of Finance and has helped improve the analytical rigour underpinning forecasts.
- The IFI Team's debt sustainability calculations have prompted interesting policy debates and have been particularly appreciated by stakeholders.
- The IFI Team's economic heatmap and corresponding index present new information to help assess the economic cycle and provide another data point against which to compare the EU's output gap calculations. The IFI Team makes a convincing case that the new index is more stable and has greater predictive power for the ultimate fiscal gap calculation than the EU's metric, which for Finland is very volatile in successive rounds of preliminary national accounts data until final revisions are published.
- In 2018, the IFI Team pointed out that the Ministry of Finance did not provide enough information on the medium-term budget framework and that it was missing important elements. In the subsequent Ministry of Finance report, that additional information was provided.
- In spring 2020, the IFI Team expressed concerns that the Ministry of Finance was optimistic in its forecasts for Finnish exports. The forecasts were subsequently revised down in the summer.

While examples of confrontations may not be as frequent or dramatic as in some countries, the overall picture reported by stakeholders is that this is because the monitoring framework is successful and the IFI Team's greatest influence is in discouraging noncompliance in the first place.

### *Reports and their timing*

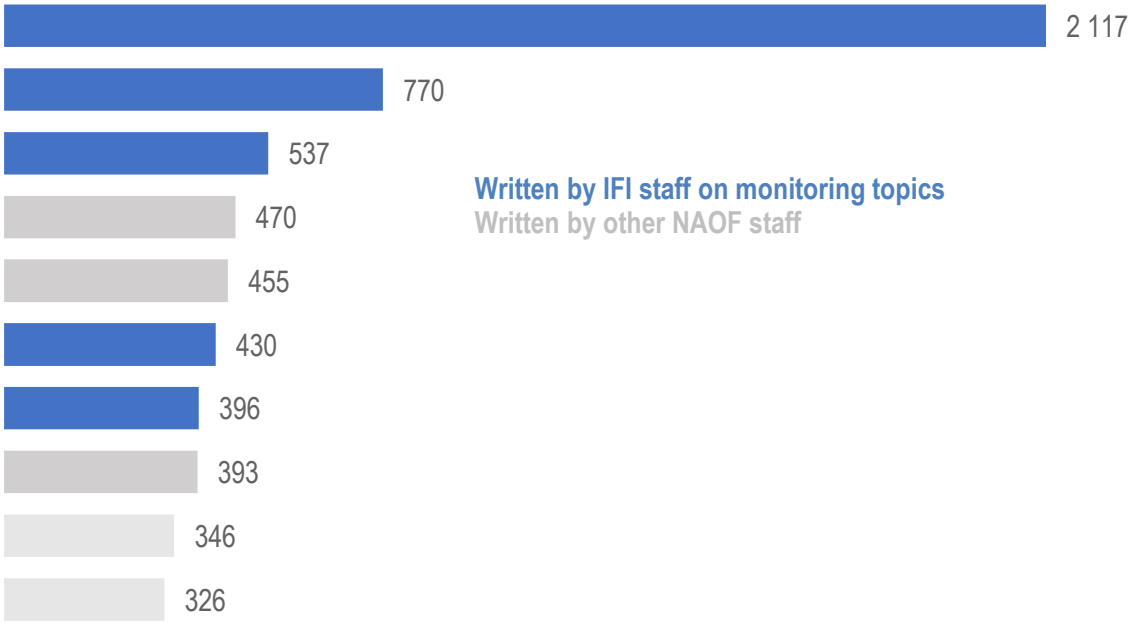
The IFI Team publishes two key reports each year that largely fulfil the tasks of its mandate. The main report is currently known as the *Fiscal Policy Monitoring Report*. This report is typically published and provided to parliament at the end of the year, although its timing varies at the discretion of the IFI Team. Earlier in the year, usually in the second quarter, the IFI Team produces an annual *Fiscal policy monitoring assessment on the management of general government finances*, which is a shorter publication.

For its role in monitoring the *ex post* performance of official forecasts, the IFI Team has also published regular reports on the *Reliability of Macroeconomic Forecasts* that assess the Ministry of Finance's current and one-year-ahead forecasts of GDP growth, unemployment rates, and inflation over history, must recently for the the 1976–2016 period (National Audit Office of Finland, 2018[6]).

The IFI Team contributes to other reports published by the broader NAOF impact area on Sustainable General Government Finances. For example, the NAOF publishes an electoral period report that comes at the end of the parliamentary term (every four years). This report summarises the main findings from the IFI Team and fiscal policy audit projects over the government's term. It includes assessments of the government's fiscal management and the effectiveness of the expenditure ceilings as a constraint. The IFI Team has also contributed to several one-off, in-depth audit reports on special fiscal topics in recent years such as a report on the *Contingent Liabilities of General Government*, the purpose of which was to assess how an increasing number of contingent liabilities were being managed by the state (National Audit Office of Finland, 2018[7]). The results developed in these publications are often used directly or indirectly in the IFI Team's core publications and have been well-received by stakeholders.

In additional to these formal reports, the IFI Team occasionally publishes shorter notes and blog posts. The NAOF has created a blogging platform for staff to draft faster responses on topical issues in their own voice and under their own opinion, with fewer official publication hurdles. The IFI Team's blog posts were prominent as five of the top 10 most popular blog posts on the NAOF's website in 2020 (Figure 7). A blog post written by the IFI Team's senior economists on the economic impacts of the coronavirus was by far the most-viewed publication on the NAOF website during 2020, with more than 2 000 views and an average of 16 minutes spent on the page, which is very long relative to other NAOF publications. Blog posts are an efficient use of the modest time and effort to create them and increase the visibility of the IFI Team, especially to those with a more casual interest in fiscal policy monitoring.

**Figure 7. Page views of the NAOF's top ten blog posts in 2020, highlighting the IFI Team's contribution**




Source: NAOF media monitoring and Google analytics.

### *Key issues for reports*

#### *Coverage*

Overall, the number of core reports is appropriate for the IFI Team's mandate and resources. The IFI Team is not overstretched in meeting the demands of its regular reporting cycle. However, the IFI Team would like to do more ambitious analysis that it has felt constrained from doing in the past due to limited resources. For example, staff would like to produce more in-depth reports on the long-term sustainability of Finland's public finances to assist stakeholders in tackling Finland's challenges from population ageing; explore important new reforms to the fiscal rules; develop their analysis on public finances and debt evolution to match the same level of detail as the Ministry of Finance and Bank of Finland; develop their analysis of elasticities central to assessments of fiscal rules; and do more granular evaluations of specific policy measures and how these contribute to wider fiscal objectives.

The IFI Team has the flexibility in its mandate to develop this analysis at its own initiative. The constraint has been having staff available consistently for IFI-related work rather than other NAOF (non-IFI) work. If more staff are devoted full-time to the IFI responsibilities, they will have the capacity to support these ambitions, which have merit on their own but were also supported by stakeholder feedback. The expanded work programme could also be supported by co-operating with the Bank of Finland and other research institutions in Finland to build and maintain tools.

The IFI Team's plan to deepen its long-term fiscal sustainability reporting is well-supported by international precedent. Many peer IFIs – such as those in Canada, Denmark, the UK, Ireland, Portugal, and Slovakia – publish detailed long-term sustainability reports using the IFI's own in-house projections. The IFI Team could usefully contribute to the domestic debate by developing its own long-term fiscal sustainability analysis and reports.

Long-term sustainability assessments by nature do not change significantly on an annual basis, unless there are drastic structural policy changes. Many IFIs therefore publish long-term sustainability reports at less frequent intervals, for example, every two to three years. Given the IFI Team's small size, it would be sensible to publish a sustainability report at a similar frequency – every two to three years – while making annual incremental assessments on an as-needed basis if there are significant policy changes announced during interim years.

As in other IFIs, the capacity to report on long-term fiscal sustainability may require considerable time to develop. The work also overlaps to a degree with the mandate of the Economic Policy Council and analysis already published by the Bank of Finland. When expanding the coverage of its reports, the IFI Team must not compromise its core responsibilities and it should consider whether it would be appropriate to co-ordinate aspects of the analysis with other institutions like the EPC and the Bank of Finland to avoid encroaching on other mandates and duplicating effort.

### *Content*

The focus of the IFI Team's main product, its *Fiscal Policy Monitoring Report*, is appropriately on the key parts of its mandate: monitoring fiscal rules, assessing the realism and reliability of official Ministry of Finance forecasts, and monitoring the government's fiscal plans.

Recent fiscal policy monitoring reports have expanded their focus to offer richer insights in addition to meeting core aspects of the NAOF's mandate. For example, the latest report included an assessment of the impacts of employment measures the government implemented to achieve its employment targets. The IFI Team also recently introduced its own heatmap and composite index of the cyclical position of the economy as alternative benchmarks to help gauge the reasonableness of the output gap estimated under the EU methodology. Stakeholders reported that the IFI Team is the only institution in Finland that provides an alternative to the EU's estimates.

Despite the richer breadth of analysis in recent reports, stakeholders reported a tendency for the IFI Team's reports to focus on *ex post* rather than *ex ante* assessments of the EU fiscal rules. The focus on *ex post* assessments of EU rules has not gained a lot of traction, as most stakeholders place greater weight on the domestic implementation of rules in the General Government Fiscal Plan. This focus also poses a risk to the IFI Team, should the EU fiscal rules change drastically in coming years following an expected review. Recognising this, the IFI Team has signalled its intention to broaden its analysis on medium-term objectives in future years. That plan is welcome but achieving it would require an appropriately sized staff with more time dedicated to IFI work rather than other NAOF work.

### *Accessibility*

The IFI Team's reports are widely perceived to be highly readable, something which the IFI Team has worked on over time. As shown in Box 4, this view is also supported by a text analysis that compares its reports with peer institutions internationally.

The length of the IFI Team's Fiscal Policy Monitoring Report is appropriate, with few stakeholders reporting this as a concern. Further, the word count compares favourably in brevity with the main reports of other IFIs with similar resources and mandates (Figure 9). The *Fiscal Policy Monitoring Report* averages about 14 000 words with no clear increasing or decreasing trend over time. If additional areas of analysis are developed in future years, the IFI Team should be mindful to avoid an excessive lengthening of its reports.

## Box 4. Readability of major reports

The readability of the IFI Team's main report – the Fiscal Policy Monitoring Report – fares relatively well in comparison to similar reports of peer institutions. An analysis of the summary texts of reports finds that the IFI Team's reports score well when assessed across a range of readability measures. It ranks closer to institutions such as the Portuguese Public Finance Council (CFP) and the Irish Fiscal Advisory Council than compared to the Slovak Council for Budget Responsibility (CBR), the UK Office for Budget Responsibility (OBR), or the Swedish Fiscal Policy Council, which are found to have relatively less readable reports.

Though difficult to define, a variety of readability measures have emerged as standards in the literature. These have been used to assess financial disclosures (Loughran and McDonald, 2014[8]) introductions to economics papers (McCannon, 2019[9]), and annual reports (Lo, Ramos and Rogo, 2017[10]). As McCannon (2019[9]) shows, there is an important relationship between a paper's readability and its citations, with the most unreadable papers experiencing relatively fewer citations.

To assess readability, we used text analysis software on approximately 1 000 words from the executive summaries or their equivalent sections in a variety of reports from the IFI Team's peer institutions. We focused on those reports that are similar to the IFI Team's flagship *Fiscal Policy Monitoring Report*. Care needs to be taken with these measures, particularly if analysing large texts as identifying sentence endings can be problematic. This is especially important in texts that contain lots of numbers. Focusing on executive summaries or their equivalents, as done here, avoids these complications.

The measures considered are:

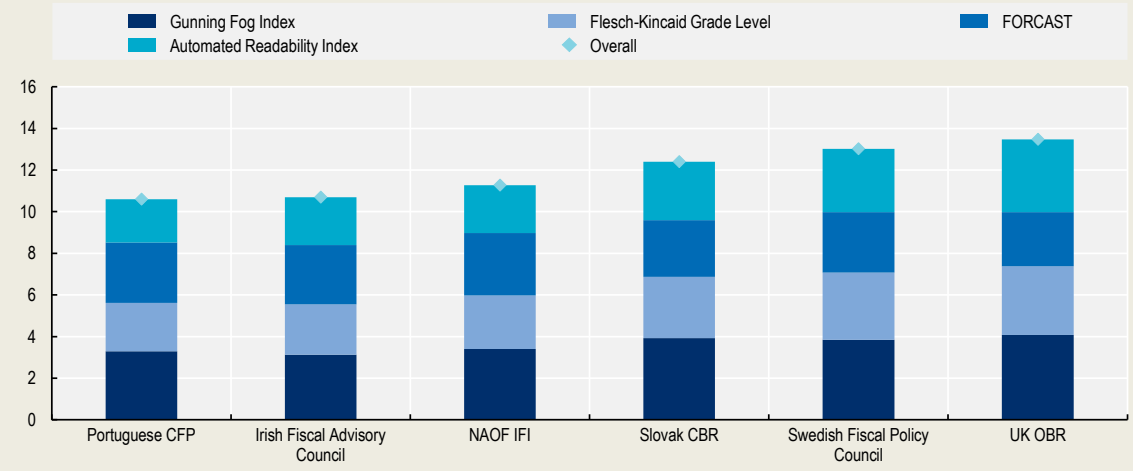
1. The Gunning-Fog Index is a popular measure, first published in Gunning (1952[11]) and is marked by its ease of calculation. It is a function of average sentence length in words and complex words, defined as the share of words with more than two syllables. Mathematically, it can be expressed as: $0.4 \times \left(\left(\frac{total\ words}{total\ sentences}\right) + 100 \times \left(\frac{complex\ words}{total\ words}\right)\right)$
2. The Flesch Kincaid Grade Level is another long-established readability measure. It attempts to approximate reading grade levels of texts, again based on sentence length and word complexity as measured by average syllables per word: $0.39 \times \left(\frac{total\ words}{total\ sentences}\right) + 11.8 \times \left(\frac{total\ syllables}{total\ words}\right) - 15.59$
3. The FORCAST readability formula is designed to analyse more technical documents and is given as: $20 - (N/10)$ where $N$ is the number of single-syllable words in 150-word samples. Unlike other formulas, it does not rely on complete sentences, but instead focuses on vocabulary.
4. The Automated Readability Index differs slightly from other measures in that it counts characters as opposed to syllables, with more characters implying harder-to-read words. This makes it suitable for technical writing. It is given as: $4.71 \times \left(\frac{characters}{words}\right) + 0.5 \times \left(\frac{words}{sentences}\right) - 21.43$

In each case, a *higher* index score indicates report summaries that are *more difficult* to understand. By standardising the scores, we can combine the readability scores. Giving the four measures equal (1/4) weightings to derive an "Overall" readability score, Figure 8 shows the results for each of the IFIs' executive summaries considered.

The results indicate that the Finnish IFI Team fares relatively well for readability. It ranks close to institutions such as the Portuguese CFP and the Irish Fiscal Advisory Council, which both have moderately low scores (good readability), while other IFI's texts had higher scores (relatively less-readable reports). Institutions assessed that tend to fare worse on readability scores as measured here typically do so because they tend to use more difficult language – using more multi-syllable words – or because they tend to be more verbose, with lengthier sentences on average.

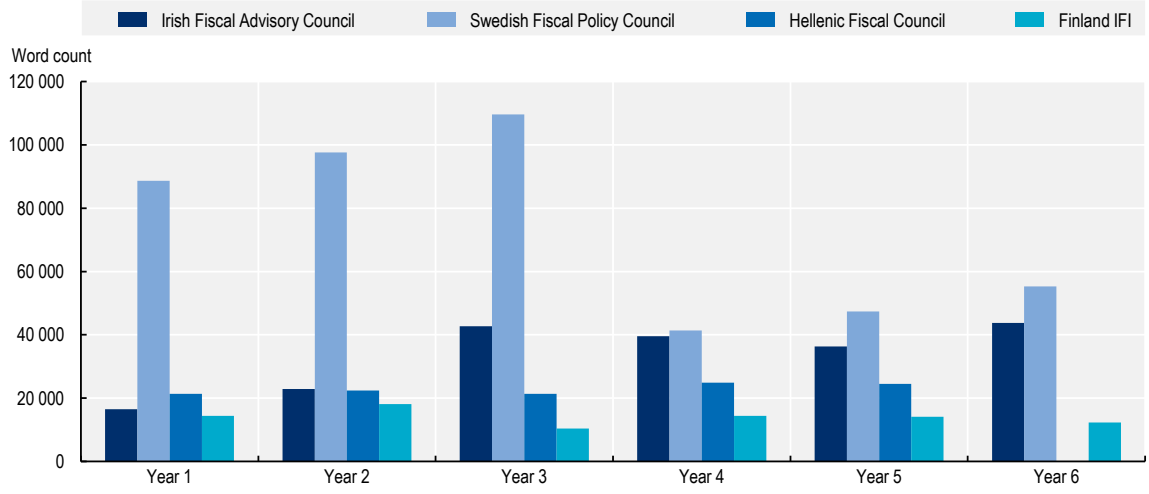
## Figure 8. The NAOF IFI Team fares well in terms of the relative readability of major reports

Measure of readability (higher = less readable)




Note: This assesses the "Main Content" section of the IFI Team's *Fiscal Policy Monitoring Report,* 2020, in terms of four readability measures that are given equal weighting so as to derive an overall readability score. It also assesses the Executive Summary of the OBR's *Economic and Fiscal Outlook,* March 2021; the Overall Review of the Portuguese Public Finance Council's *Analysis of the State Budget Proposal for 2020*; the Non-Technical Summary of the Irish Fiscal Advisory Council's December 2020 *Fiscal Assessment Report*; the Slovak CBR's *Summary of the Evaluation of the General Government Budget Proposal for 2021-2023*; and the Summary of the Swedish Policy Council's *Swedish Fiscal Policy 2020* report.

## Figure 9. The main reports of Finland's IFI Team are more concise than peers and have resisted expansion over comparable institutional maturity (years since establishment)




Note: The Hellenic Fiscal Council publishes in Greek; differences in average word count per language were controlled for using European Commission document translation averages.
Source: Main annual analytical reports of each IFI in the comparison.

### *Influence on the public debate*

#### *Engagement with parliament*

Perhaps the most important channel through which an IFI can strengthen fiscal outcomes is by directly supporting the legislature's ability to hold the government to account – that is, by empowering the representatives of the public who have been elected for the full-time job of scrutinising the executive with quality information to do so. This can be accomplished by submitting reports to the legislature, participating in committee hearings, and providing background briefings to parliamentarians and their staff.

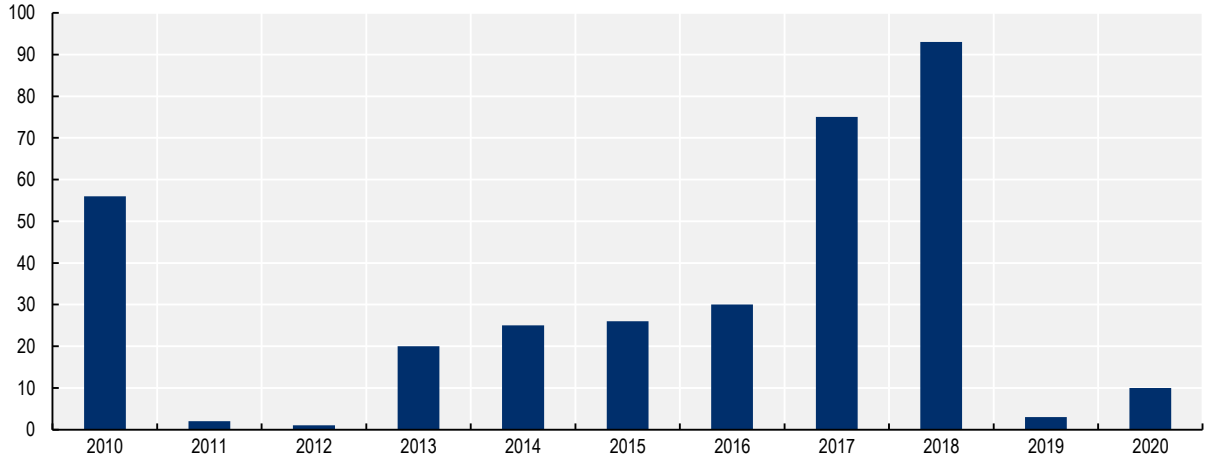
The IFI Team's reports are officially introduced to the plenary agenda by Members of Parliament. While there are no mandatory reports (it is up to the NAOF to decide how findings are reported), the IFI Team's annual *Fiscal Policy Monitoring Report* is submitted officially to Parliament once a year and there are two debates on it – one for its introduction and one for adopting its conclusions. Sometimes the debates in the plenary session are long and comprehensive and other times they are short. The mentions of the IFI Team in Parliament are difficult to track separately from the rest of the NAOF's activities, but mentions of the NAOF in the context of fiscal policy debates grew following the IFI Team's creation in 2013 and peaked in 2018 when the government's reforms of health and social services were hotly debated (Figure 10). Mentions have fallen in recent years, but are on pace to more than double in 2021 compared to 2020.

The IFI Team's leadership appears an average of three times a year before parliamentary committees (Table 8). This is in-line with most OECD IFIs. Reports are submitted and discussed in the Audit Committee, which occasionally sends the report to the Finance Committee as well. The reports and conclusions of the committees have generally concurred with the IFI Team's views. The transcripts of committee sessions are not public (only very short minutes are published). The IFI Team could support transparency by themselves disclosing their attendances and the topics covered (to the extent permitted).

The IFI Team has not provided briefings to individual parliamentarians; however, fiscal policy issues are often discussed when the NAOF has informal meetings with Audit Committee members. In addition, the NAOF has started a regular practice of meeting with the secretariat of the Audit Committee, Finance Committee, and Commerce Committee to discuss topical issues, often related to the IFI Team's research.

An important forum for parliamentary engagement is the Advisory Board of the NAOF, which has representatives from all parliamentary parties. The IFI Team's work is often on the agenda of the Advisory Board meetings.

**Figure 10. Mentions of the NAOF in relation to fiscal policy debates grew since the IFI Team's creation in 2013 but have fallen in recent years**



Note: keywords “fiscal policy” and “VTV or Tarkastusvirasto” in Finnish.
Source: Scan of debate transcripts provided by the Eduskunta research service.

### Table 8. Committee appearances

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|
| Finance Committee | 1 | 1 | | 1 | 1 | 1 | 1 | 2 |
| Audit Committee | 1 | 2 | 2 | 2 | 2 | 3 | 2 | 1 |
| Grand Committee | | | | 1 | | | | |
| **Total (average = 2.75)** | **2** | **3** | **2** | **4** | **3** | **4** | **3** | **3** |

Note: Cases of multiple committee hearings on the same issue in the same committee have been counted as one and appearances of the IFI Team in connection with other audit activities have been excluded.

#### *Engagement with government: comply or explain*

As a participant in the EU surveillance framework, Finland is also encouraged to put in place comply or explain elements to increase the IFI Team’s influence on the deliberations of fiscal policy makers. Comply or explain provisions in a fiscal framework create an obligation for a country’s government to either immediately enact the advice of an IFI or publicly explain the reasons for deviating from it. Although the principle was not ultimately recognised in the EU’s Two Pack (Regulation (EU) 473/2013), it is a core tenet of the common principles for fiscal councils that the Commission developed under the authorisation of the Fiscal Compact. The comply or explain principle was endorsed by finance ministers and incorporated into some domestic legal frameworks. In Finland, comply or explain elements are in place requiring the Ministry of Finance to respond to the IFI Team’s reports.

In the view of the IFI Team’s leadership, the IFI Team’s recommendations have not fully tested the comply or explain provisions, having only indicated small shortcomings in adhering to the *Fiscal Policy Act*. The government has not objected to the findings, and the shortcomings were addressed in the subsequent Fiscal Plan.

Once established and accepted, the comply or explain principle ideally plays a pre-emptive role discouraging non-compliance, as decision makers internalise the potential confrontation with the IFI in their proposals. Several stakeholders, including the government, suggested that the lack of real confrontations is a sign that the IFI Team’s mere existence encourages rule adherence.

#### *Engagement with media*

OECD Principle 8.1 states that IFIs should develop effective communication channels from the outset, especially with the media. While the Finnish IFI Team does not have its own communications strategy, it follows the NAOF’s general guidelines and relies largely on the NAOF’s communications team. The IFI Team is continuing to work with the communications team to develop its strategy.

The IFI Team’s reliance on the NAOF’s communications policy is appropriate given the institutional relationship, the small staff devoted to IFI work, and the NAOF’s experience wading into policy issues. However, communicating financial audits and fiscal policy monitoring require very different approaches. NAOF staff reported that this is recognised and largely accommodated in the working arrangements, with considerable flexibility given to the IFI Team members; however, the NAOF’s communications team ultimately controls the process.

Journalists either contact the IFI Team leadership and analysts directly about their work or go through the communications team, with staff estimating about 70% of contact is direct and 30% is through the communications team. This informal relationship works but contributes to the lack of a distinct identity for

IFI activities. In addition, there is a risk that the NAOF could tighten its external communications policies, preventing the IFI Team from having an independent voice separate from the NAOF's overall messaging.

The IFI Team's outreach to the media is largely confined to publishing press releases on the day of the publication of a report. Press releases are sent to a mailing list which has approximately 1 100 stakeholders for Finnish-language recipients. The mailing list is adjusted depending on the topic. Reports are sometimes released to journalists early under embargo. In the past, this was on an informal basis relying on personal relationships with no general announcement – possibly to the unintentional exclusion of some outlets. However, beginning in December 2020 the offer for an advanced copy of the report was announced equally to all journalists.

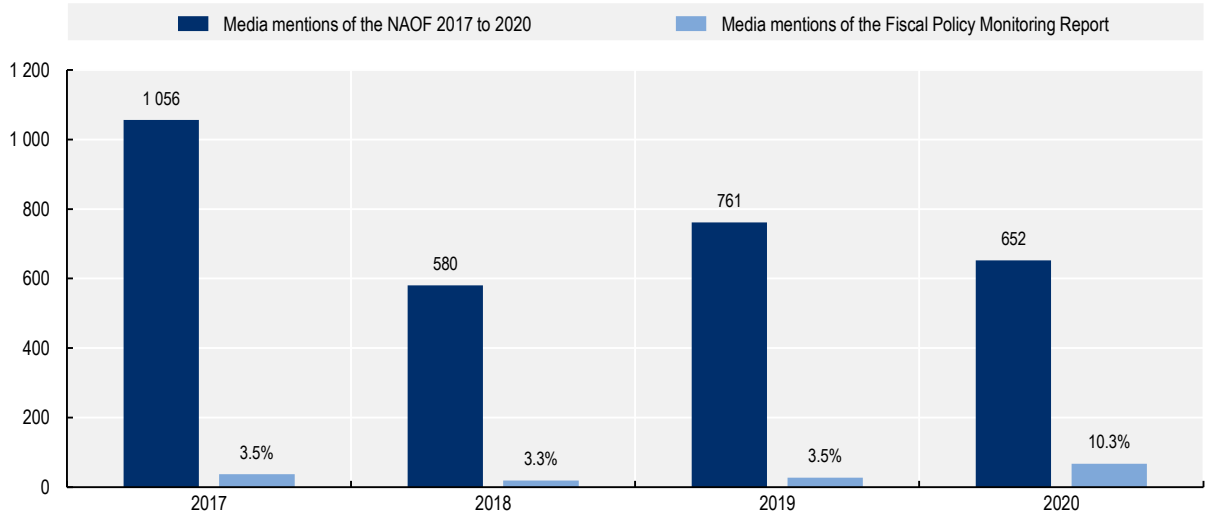
The IFI Team holds press conferences on occasion, but they are generally poorly attended and the IFI Team will continue to decide on their merit on a case-by-case basis. Of potentially more benefit to those in the media, the NAOF has organised briefings for individual outlets on topical issues including fiscal policy (not limited to reports), with experts visiting media outlets and providing a short briefing of issues with an opportunity to discuss the topics in depth.

The IFI Team rarely does TV or radio interviews. When it does, the person representing the IFI Team varies depending on the subject and the audience. It is typically the director in charge of the function or the fiscal policy team leader (Principal Fiscal Policy Auditor). In some cases, the author of a report has responded to media requests. For example, a senior economist was interviewed for an extensive article in the online media *Mustread* in May 2020 following a blog post on the economic impact of the COVID-19 pandemic on municipalities.

Mentions of the NAOF's distinct impact areas are not typically identified in media coverage, making it difficult to assess coverage of the IFI Team separately; however, the communications team does monitor mentions of specific reports. For example, the autumn 2017 report on the *Assessment on the Management of the General Government Finances* sparked a great deal of interest and was mentioned in approximately 50 different media articles. In addition, the Finance Minister and the Minister of Family Affairs and Social Services responded to the report and the IFI Team's director (the director of the broader Sustainable General Government Finances impact area) was interviewed for the main Finnish TV news programme.

Coverage of the NAOF overall has been roughly stable over the past three years at between 600 and 700 mentions (2017 was an exceptional year, owing to several national strategic reforms for which the NAOF played a prominent role). The spring 2020 *Fiscal policy monitoring assessment on the management of general government finances* was mentioned by six different online press outlets. Interest in the *Fiscal Policy Monitoring Report* was roughly stable as a share of total NAOF mentions in the media but tripled in 2020 with interest in the IFI Team's COVID-19 analysis and its assessment of the government's employment measures (Figure 11).

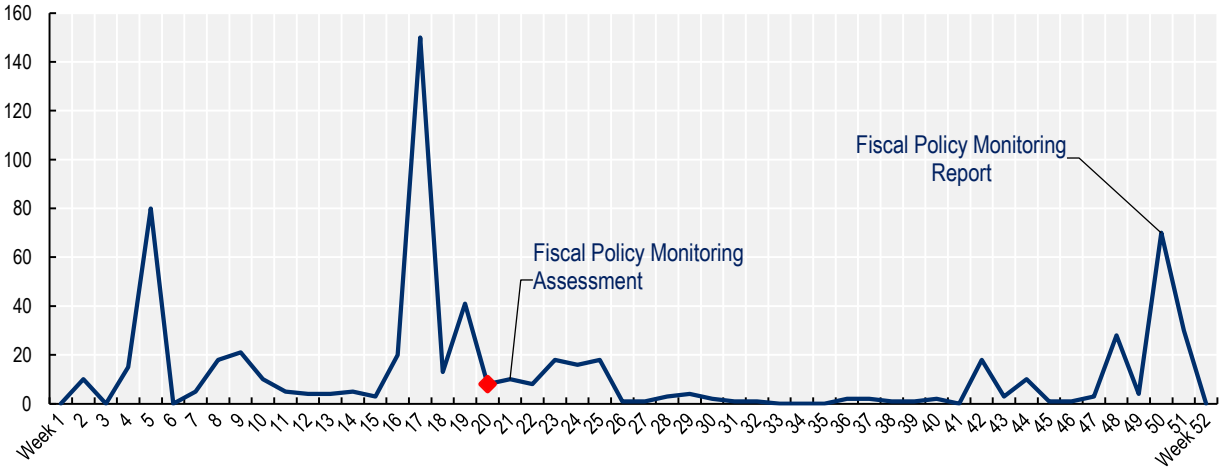
## Figure 11. Trends in media mentions of the NAOF versus the Fiscal Policy Monitoring Report




Source: NAOF media monitoring.

The *Fiscal Policy Monitoring Report* receives some of the most attention of any NAOF reports, with coverage in the press for the NAOF as a whole peaking during its release (Figure 12). The spring *Fiscal Policy Monitoring Assessment* is not widely covered. The attention in week 5 was related to NAOF audit reports on a basic income reform and the funding of EU parliamentary election campaigns. The attention in weeks 17-19 was related to the NAOF's research on COVID-19 issues such as business subsidies.

## Figure 12. Weekly media coverage, 2020




Source: NAOF media monitoring.

### *Online presence, web traffic and social media*

The IFI Team does not have its own website, but rather has an overview page under the NAOF's website, which is managed and monitored by the NAOF's communications team but not actively developed or promoted. The new NAOF website (VTV.fi) was launched in the summer of 2018. The communications team uses Google Analytics for monitoring web traffic on the site. In 2020, the overall NAOF website

received around 200 000 page views, while the overview page for the IFI Team received just over 500 page views (Table 9).

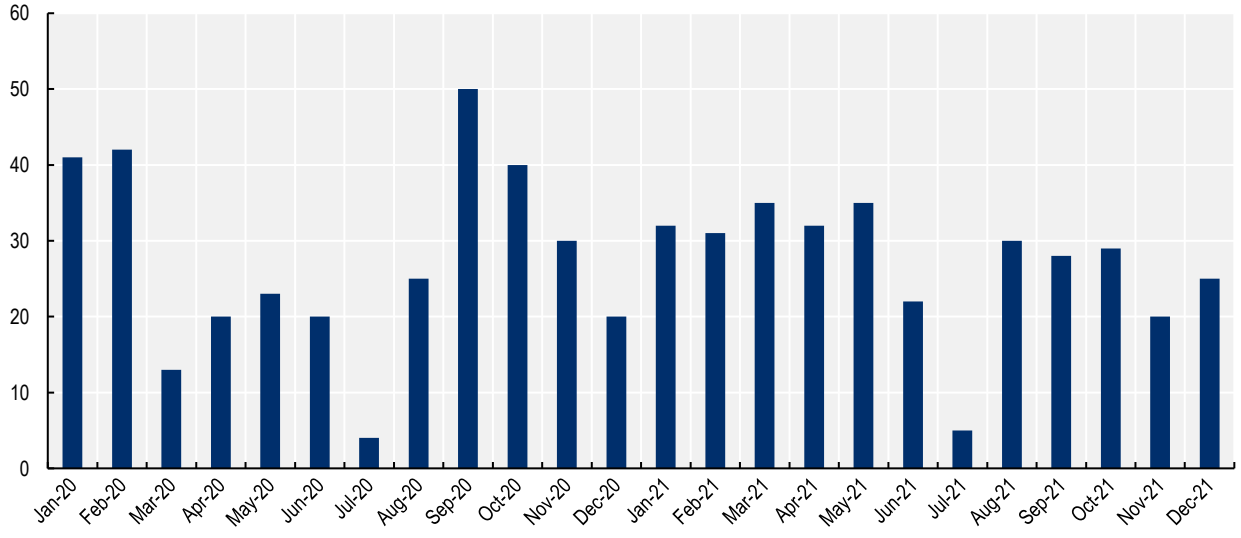
There were no obvious peaks in monthly traffic to the IFI Team's overview page with the release of the *Fiscal Policy Monitoring Report* or the spring 2020 *Fiscal policy monitoring assessment* (Figure 13). The NOAF's communications team reported that it is normal to have no observable peaks when other NAOF teams publish reports on the website, speculating that it is because the NAOF publishes reports so frequently that page views maintain a stable level. Overall, traffic is primarily to the IFI Team's Finnish language website.

### Table 9. The IFI Team receives few views of its overview page

| | 2019 | 2020 | Change |
|---|---|---|---|
| NAOF | | | |
| Page views | 200 067 | 197 973 | -1% |
| Visitors | 43 306 | 55 104 | 27% |
| | | | |
| IFI Team | | | |
| Page views | 533 | 464 | -13% |
| of which: | | | |
| Finnish | 364 | 309 | -15% |
| English | 148 | 122 | -18% |
| Swedish | 21 | 33 | 57% |

Source: NAOF media monitoring and Google analytics.

### Figure 13. Monthly visits to the IFI Team overview page

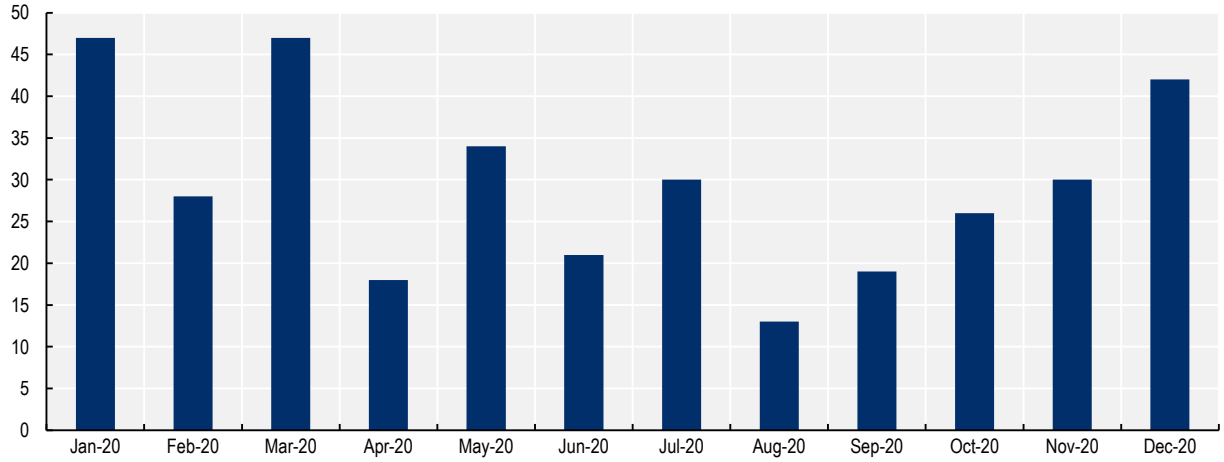



Source: NAOF media monitoring and Google analytics.

The NAOF also has a Twitter presence, where the communications team tweets on fiscal policy and auditing issues. The account highlights the IFI Team's reports when relevant. The communications team monitors mentions, likes, and retweets. As in the case of the website, it is difficult to measure engagement with tweets concerning the IFI Team versus other audit activities, and the two are not tracked separately.

In Finland there are only about 150 000 active Twitter users and the NAOF account has about 2 100 followers. The account sees an average of 30 new followers a month (Figure 14).

### Figure 14. Number of new NAOF Twitter followers in 2020, by month




Source: NAOF social media monitoring.

The IFI Team's staff frequently tweet on fiscal policy issues in their personal capacity. In general, the tweets made by staff in their personal capacity receive more engagement than the NAOF's tweets. For example, in 2019, the NAOF's most popular tweets were on the Building Trust seminar, which received around 25 total engagements on average. Given the low engagement with the NAOF's official account, the IFI Team should continue engaging in social media communications from staff accounts instead of establishing its own social media accounts separate from the NAOF. However, the NAOF's accounts should support and reinforce the IFI Team's independent branding when promoting the IFI Team's work.

## 4. Methods

# Key findings

The IFI Team's methods and workflows are appropriate for delivering its mandate. That said, stakeholders would like to see the IFI Team deepen its analytical work. There are several key areas for future development:

- The IFI Team should deepen its assessment of the Ministry of Finance's macroeconomic and fiscal forecasts and its understanding of the current macroeconomic environment by developing its own models to produce in-house benchmark projections.
- Stakeholders would like to see more work being done to assess the appropriateness of EU methodologies for applying fiscal rules, particularly to test whether they sufficiently consider domestic factors. The IFI Team could make large gains in informing the policy debate by testing refinements to the EU's methodologies, such as by independently estimating revenue elasticities and output gap budget balance semi-elasticities that adjust for historical policy changes and other domestic considerations. The IFI Team's fiscal rules analysis would also benefit from more detailed analysis of the finances of general government and its subsectors (state, local government, and social security funds).

### *Introduction*

This section reviews the tools the IFI uses to carry out its mandate. The team's mandated tasks outlined in Section 2. Mandate and governance include monitoring compliance with EU and domestic fiscal rules, assessing whether the macroeconomic forecasts underlying fiscal plans are realistic, assessing whether macroeconomic and fiscal forecasts were accurate after the fact, and monitoring the preparation and implementation of the General Government Fiscal Plan.

### *Assessing the IFI Team's overall approach and workflow*

Overall, the NAOF has put in place a simple and comprehensive framework for carrying out its mandated tasks. To assess the preparation and implementation of the General Government Fiscal Plan, including the reasonableness of the macroeconomic forecasts and compliance with central government spending limits, the IFI Team scrutinises and replicates the government's calculations and compares results against external benchmark forecasts from commercial banks, research institutions, and international organisations – that is, it does not produce its own benchmark forecasts with in-house models.

This approach allows the IFI Team to assess whether the Ministry of Finance's forecasts are in line with general sentiment and helps pinpoint areas that the IFI team should discuss with the Ministry and explore further. This approach is appropriate for the IFI Team's level of resources and its access to Ministry data and methodologies and is comparable to approaches of the similarly resourced Swedish Fiscal Policy Council (Table 10).

That said, some stakeholders would like to see the IFI Team go further and produce in-house macroeconomic and fiscal forecasts of its own. The models to do so would not have to be sophisticated. Even relatively simple internal benchmarks for some parts of the economy could help to paint a more complete picture of official forecasts and the uncertainty associated with those forecasts.

There would be several advantages to the IFI Team producing its own fiscal and macroeconomic forecasts:

- First, if forecast comparisons remain the only means of assessing the official forecasts, there is a risk that Ministry of Finance forecasters could be encouraged to "herd" their forecasts. That is, the Ministry might be encouraged to set their forecasts in line with other forecasters even if they have strong reasons to doubt the validity of other forecasts.
- Second, the existing approach might be problematic if like-for-like forecasts are not readily available from other institutions. For instance, in times of economic shocks, timing issues may mean that multiple forecasts are produced on a different basis, recognising very different states of the economy. This would limit the availability of forecasts that can be usefully compared to the Ministry's forecasts.
- Third, in developing its own forecasts, the IFI Team would have a useful starting point for thinking through key issues that might arise when it assesses the Ministry's forecasts (preferably, these would only be viewed after the benchmarks are prepared).
- Fourth, producing internal forecasts can force analysts to think through some of the key underlying aspects of how the economy is performing that might otherwise not be considered, including exploring the uncertainty over macroeconomic variables. Insights gained from this work can then help with assessing fiscal policy, contingent on the state of the economy.

To assess Finland's compliance with the domestic implementation of the EU fiscal rules and the fiscal stance, the IFI Team primarily uses the EU's official surveillance framework and commonly agreed methodology (Vade Mecum on the Stability and Growth Pact).[3] These methods are, by definition, comprehensive and appropriate.

That said, many EU IFIs such as the Irish Fiscal Advisory Council, Portuguese Public Finance Council and the Slovak Republic Council for Budget Responsibility have determined that the EU's generalised methodology does not fully capture domestic conditions. Such IFIs have developed their own tools for assessing the government's compliance with the Stability and Growth Pact that are more geared to domestic considerations than the EU's centralised methodology. These tools include most commonly independent estimates of fiscal semi-elasticities for determining the structural balance and alternate approaches to estimating and forecasting potential GDP.

Developing such novel tools from scratch, rather than simply double-checking the government's math or using pre-built tools developed by the European Commission, is resource-intensive. The IFI Team has few full-time analysts with spare time to devote to building model capacity. However, the team has increasingly automated some of the formerly labour-intensive tasks of retrieving and transforming data from Statistics Finland and government publications and performing the calculations required to fulfil the basic requirements of forecast scrutiny. In doing so, the IFI Team has freed time to explore alternative modelling options. In the first phase of such model development, the IFI Team has developed a business cycle heatmap and composite indicator that already shows signs of greater stability and less sensitivity to data revisions than the EU's output gap calculation for assessing the fiscal stance.

## Table 10. Comparison of methods to peer institutions

| | Endorsing or assessing official macroeconomic forecasts | Assessing the government's fiscal forecasts | Assessing compliance with fiscal rules and fiscal stance | Assessing long-run sustainability |
|---|---|---|---|---|
| NAOF IFI Team | Largely qualitative, compares against external forecasts from other institutions and monitors of recent outturn data. | Mostly monitors recent outturn data and compares with external forecasts from other institutions. | Scrutinises government calculations and uses analysis from other institutions. Replicates EU methodologies and domestic calculations. Compares to an in-house heat map and composite indicator. | Not currently in work plan. |
| Swedish Fiscal Policy Council | Largely qualitative, compares to benchmark external forecasts from other institutions and monitors recent data. | Mostly monitors recent data and compares to benchmark external forecasts from other institutions. | Scrutinises government calculations and analysis from other institutions. | Relies on work of other research agencies such as the National Institute of Economic Research (NIER) and European Commission's scenarios and analysis. |
| Irish Fiscal Advisory Council | Produces in-house benchmarks with a suite of supply-side macro forecasting models and output gap models. | Produces in-house benchmark fiscal forecasts using high-level error-correction models for short- and long-run elasticities applied to tax bases. Fiscal and economic interaction (fiscal feedback) model. Suite of output gap models. | Replicates EU and methodology and domestic calculations and also using its own in-house "Principles-based approach" which uses alternative estimates of potential output rather than the commonly agree methodology potential output and budget elasticities used for EU fiscal surveillance. | In-house long-run projections (30 years), alternative scenarios, sensitivity analyses. |
| Portuguese Public Finance Council | Large-scale structural econometric model, error-correction equations with detailed fiscal block for interactions to produce in-house forecast benchmarks. Nowcasting model with MIDAS model. | Uses in-house forecast models, mostly bottom-up ordinary least squares estimated structural econometric equations for tax revenue components. | Replicates EU methodology and domestic calculations. Some in-house benchmarks for reasonableness. | In-house long-run projections, published every two years, assessing five areas: macroeconomic performance, public revenue and public expenditure, contingent liabilities, and public debt. |
| Slovak Republic Council for Budget Responsibility | Mandate only for *ex post* forecast evaluations. However, prepares own macro forecasts. Large-scale structural macro model, error-correction equations. Nowcasting models for short-term. Dynamic stochastic general equilibrium model for simulations. | Produces in-house benchmarks with a mix of elasticity and structural econometric models, microsimulation bottom-up public finance revenue and expenditure projections for longer run. In-year estimates using seasonality. Traffic light system of risks. | Replicates EU methodology. Produces in-house output gap estimations, careful identification of one-offs, Expenditure Benchmark analysis. | In-house long-run projections, fiscal gap calculation over 50 years. Detailed scenarios. Published annually. |

Following the pandemic, fiscal adjustment programmes to return to Finland's medium-term budgetary objectives may feature more prominently in the IFI Team's work than in the past. To that end, staff have begun working with Statistics Finland's *SISU* microsimulation model, which will help fulfil the office's role in assessing and recommending whether the government's measures are sufficient to support the adjustment path. A natural extension of the microsimulation work would be for the IFI Team to also invest in additional in-house fiscal forecasting capacity. In fact, it may be necessary to do so, both for supplying the microsimulation model with alternative assumptions and for incorporating the results of the model back into the fiscal outlook.

It is appropriate for the NAOF to continue its efforts to develop more in-house tools and analytical capacity for independent benchmark forecasts in parallel with its current approach; however, it should be mindful of its resources and aim to supplement rather than replace current practices. Moving immediately toward in-house modelling would be a considerable investment and without an increase in full-time staff could disrupt the quality of the NAOF's work should there be staff turnover.

### *Individual model assessments*

The OECD also assessed the appropriateness of each of the IFI Team's individual tools along six academic and practical considerations (Table 11). The framework provides a structure for assessing whether a tool would hold up to both scholarly peer review and whether it is fit to serve the practical considerations of an IFI's mandate and stakeholders. A detailed technical assessment was provided to the IFI Team.

Some criteria are complementary, while others conflict. When choosing a model, analysts must weigh the trade-offs between the criteria. For this reason, the assessment does not offer a total score or pronouncement on whether a model is the best tool for the analysis. Instead, it provides an opinion on whether the chosen tool is appropriate or inappropriate for delivering an IFI's mandate in the country's context.

**Table 11. Summary of OECD model assessment criteria**

| | |
|---|---|
| **Theory** | Does peer-reviewed literature support (or not provide a strong argument against) this tool for the analysis, given the context and available data? |
| **Accuracy** | Is this tool likely to give the most accurate results (or avoid the most systematic bias) if applied to this problem? |
| **Communication** | Can the tool's outputs provide a coherent and intuitive narrative to stakeholders? |
| **Transparency** | Can the tool's methodology and assumptions be provided to the IFI's stakeholders in a manner that will satisfy its requirements for transparency and accountability? |
| **Resources and business continuity** | Does the tool require a level of resources and expertise that is appropriate to expect from the IFI's analysts to avoid analytical disruptions from staff turnover? |
| **Precedent** | Is the approach used widely at other IFIs and public finance institutions? |

The technical assessment concluded that each of the IFI Team's tools that were reviewed in detail by the OECD are appropriate for its analysis (Table 12).

On **theoretical merit**, the EU's Vade Mecum and the CAM that the IFI Team uses to assess compliance with fiscal rules, specifically Program GAP 5.0, is grounded in peer-reviewed literature, supported by the experts of the EU's Output Gap Working Group, and uses approaches that have gone through considerable debate and scrutiny (although remain controversial). The IFI Team's detailed fiscal forecast error and bias assessments for *ex post* scrutiny of macroeconomic assumptions includes common statistics such as the root mean squared forecast error and Ljung-Box tests, which are well-supported for this application by peer-reviewed literature. The IFI Team provides ample justification and performance testing in its documentation for the statistical error analysis. The NAOF's techniques to estimate the fiscal stance, such as the change in the structural (primary) balance and change in discretionary fiscal effort, follow recommendations that are the product of considerable research and discussion at the European Commission.

## Table 12. Assessment of individual models: Summary results

| Model | Description | Opinion |
|---|---|---|
| **Program GAP 5.0** | Program GAP 5.0 implements the EU's Commonly Agreed Methodology (CAM) with a production function approach to derive the output gap from the cyclical deviations of labour and total factor productivity from their potential. | Appropriate |
| **Heatmap and business cycle composite indicator** | Used as second-opinion benchmark against the output gap calculations and for fiscal space. Time series economic data is detrended, seasonality is removed, and indices are calculated to form the heatmap. A business cycle composite indicator is calculated based on the heatmap. | Appropriate |
| **Fiscal stance model suite** | Micro accounting model using the output of other models including output-gap, composite indicator, structural primary balance and discretionary fiscal effort. The calculation of the latter two follows recommendations of the Commission as does the calculation of the output gap. The fiscal stance model uses a large variety of macro time series data. | Appropriate |
| **Forecast assessment for realism (*ex ante*)** | Collection of different statistical and econometric models (mainly OLS) for calculating key figures (forecast trend, prediction interval, etc.) to perform the assessment. Check of internal consistency based on key macro equations of national accounting, debt dynamics, etc. Data is collected from forecasters for the Finnish economy, at present partly via Macrobond. | Appropriate |
| **Forecast assessment for reliability (*ex post*)** | Forecast error calculation and testing, forecast encompassing test, information efficiency test, regression analysis. Data covers the main forecasters for the Finnish economy from which forecast data is available over a long span (from 1 976 onwards). | Appropriate |
| **Policy costing microsimulation model** | Large-scale microsimulation model covering the vast majority of benefit and tax regulation of individuals. | Appropriate |

Note: The scope of the assessment covers the IFI Team's main tools it identified for delivering its mandate but is not an exhaustive review of the IFI Team's complete analytical capacity.

On **accuracy**, the IFI Team's current models are not generally used to make predictions, but those that do have demonstrated greater accuracy than official models, according to the IFI Team's error assessments. For example, the IFI Team demonstrated that the EU's CAM estimate for the output gap missed the economic upturn from 2017 to 2019 (that is, actual GDP overshot potential output) and that its in-house composite indicator captured a more accurate picture in real time. The EU's CAM estimate was revised over time and eventually converged with the earlier estimate provided by the IFI Team's composite indicator.

On **communication**, the IFI Team's in-house business-cycle heatmap and cyclical indicators provide an intuitive story of economic sectors that are departing from their long run mean and warn policy makers of industries that are potentially overheating or facing a downturn. The IFI Team's fiscal forecast reliability assessments tool provides intuitive and useful descriptive statistics and visuals to easily communicate the government's forecast performance The EU's commonly agreed methodology has communications challenges related to its complexity and legal foundation; however, these challenges are common across all IFIs in the EU IFI community.

On **transparency**, the IFI Team's approach relies on replicating the government's approach and the EU's methods, most of which have working papers or descriptions that are publicly available to stakeholders. The IFI Team relies on spreadsheets and R software, making its tools mostly open-source and readily accessible to the public, on occasions when they are provided. The workflow uses some licensed software but license fees are not restrictive if members of the public were to request the analysis to recreate the results at home. The fiscal stance model suite uses simple equations and spreadsheets, and all equations and parameters could be published for easy replication as the team's documentation and workflows mature. The IFI Team publishes detailed descriptions of methods and evidence for its forecast reliability assessments and for many of its replications and benchmark comparisons in methodology sections of main reports or standalone methodology papers. The judgment applied to EU methodologies, such as for determining the output gap, can be large and opaque; the IFI Team's heatmap and composite index, on the other hand, has little room for judgment.

Despite the IFI Team's efforts to show their work, other IFI peers tend to proactively publish more detailed methodological working papers and underlying data and calculations to accompany analysis. There is therefore scope for the IFI Team to further develop the transparency of its work, such as:

- Publishing background data and spreadsheets of the IFI Team's analysis alongside the relevant reports to allow the public to use the data and review the calculations for themselves. This is something that is done regularly by the UK OBR, the Irish Fiscal Advisory Council, the Portuguese Public Finance Council, the Slovak CBR, and others. Importantly, these often include open-access spreadsheets of assessments of budgetary rules, with the formulas preserved.
- Providing model code for more detailed analytical work. This is a step that few IFIs undertake, but many are pursuing in the future as a best-practice transparency initiative.

On **resources and continuity**, the IFI Team has done well to match its models with its analytical capacity, ensuring that its core approaches are simple and straightforward to fulfil its mandate, even if shorthanded or with staff turnover. The IFI Team's management has also provided opportunities for staff to pursue sophisticated and intellectually rewarding model development on the side, which helps attract and retain PhD-trained analysts. Several of these side projects will soon be coming online to support the team's work in the coming years.

On **precedent**, all EU IFIs rely on the Vade Mecum at least in part for assessing their government's legal fulfilment of the fiscal rules. The NAOF's in-house heatmap and composite indicator is also widely used by other IFIs such as Ireland, Latvia, and Estonia. That said, many other EU IFIs have gone further in exploring in-house alternative elasticity estimates and output gap methodologies after finding that they could improve upon the Commission's general approaches with domestic expertise.

## 5. Financial and human resources

# Key findings

Since 2013, resources and staff assigned to the IFI Team have increased steadily and are currently sufficient to fulfil the minimum activities to deliver the NAOF's legal mandate. However, the IFI Team's reliance on the Auditor General for its budget allocation poses some uncertainty for its future resources. Also, the division of the IFI Team's time between IFI activities and other audit projects means IFI activities do not receive the same full-time attention for continuous monitoring and model improvements as they do within international peer institutions.

The office should consider the following measures to give the IFI Team more financial certainty and full-time resources to devote to IFI work:

- The NAOF should publish a multi-year budget plan and public commitment to the IFI Team's funding.
- Most IFI Team members should devote their full attention to the IFI Team's work. By bringing certain fiscal policy audit projects into the IFI's scope (see recommendations in Section 2. Mandate and governance), two to three staff under the Sustainable General Government Finances impact area who are currently working part-time for the IFI Team can be redirected to more full-time positions under the standalone IFI Team. Some flexibility for part-time assignments within the NAOF could be retained for professional development, morale and retention.

### *Introduction*

This section examines the financial and human resources of the IFI Team within the NAOF, assessing their independence, sufficiency, and sustainability. The OECD Principles state that an IFI must have sufficient financial resources to fulfil its mandate and successfully perform its tasks (Principle 4.1) and that its leaders and staff must be independently selected based on merit and must be independent in their operations (Principles 2.1 to 2.6).

### *Financial resources*

There are no distinct resources for the IFI Team included in the national budget. Instead, the funding allocated to the team is included in the NAOF's global budget, which the NAOF proposes each year to Parliament and then receives from the general appropriation for Parliament.

The NAOF sets the IFI Team's budget annually, based on expected staff needs and other costs. However, the NAOF has an internal strategic medium-term plan to provide some forward guidance and certainty for the IFI Team's continuing operations.

Table 13 shows that the annual expenditures of the IFI Team have increased steadily, with one exception in 2015. For direct personnel expenses, the IFI Team received an allocation of EUR 257 000 in 2020. The remaining expenditures are mostly for general overhead costs of the NAOF that are allocated to IFI activities. The NAOF covers all in-house functions related to human resources, planning, budgeting, general IT support, and communications services. Excluding one-time special funding for the OECD review, the IFI Team's budget reached EUR 552 000 in 2020 – an average annual increase of 13.3% since 2013.

### Table 13. NAOF IFI Team expenditure 2013-2020

In EUR thousand

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|
| Personnel expenditure | 117 | 130 | 113 | 209 | 216 | 225 | 191 | 257 |
| Overhead and other expenses | 113 | 119 | 102 | 187 | 201 | 237 | 217 | 295 |
| Total | 230 | 249 | 215 | 396 | 417 | 462 | 408 | 552* |

Note: asterisk (*) excludes one-time funding for the OECD review.

Although the IFI Team's expenditures are planned and monitored as a distinct team within the NAOF, the IFI Team does not have budget autonomy and cannot independently prioritise its resources. If the IFI Team needs more resources or additional staff, the director in charge of the IFI Team is entitled to make proposals but the final decision is up to the Auditor General.

In general, the IFI Team reports that it receives the resource support it needs and resources appear to be secure going forward; however, it does not have the certainty it would have if it were a distinct appropriations unit within the national budget. The IFI Team's budgetary independence is a consequence of the NAOF's budgetary independence and depends on the NAOF's ongoing goodwill. Although some internal medium-term planning is undertaken, the IFI Team's financing could be given greater security if the NAOF were to publish a multi-year budget plan for IFI activities in which it publicly commits to funding levels.

### *Human resources*

The OECD Principles state that the leadership of the IFI should have full freedom to hire and dismiss staff in accordance with applicable labour laws. The director in charge of the IFI Team (that is, the director of the broader Sustainable General Government Finances impact area) has considerable influence over the number of staff allocated to IFI activities within the NAOF; however, the Auditor General makes the final decision. In filling the positions, analysts are selected by the IFI team's director and team leader, either from internal NAOF candidates or new hires. New hires are recruited under the ordinary open competition procedures of the NAOF.

Many IFI Team members are currently working on both IFI activities and non-IFI activities within the Sustainable General Government Finances impact area. This ability to assign staff to different projects based on their competencies and work load provides the NAOF with flexibility in managing its resources. However, the split hinders the overall productivity of the IFI Team by limiting its ability to develop models and deepen its analysis during the time between reports.

As some staff members only work part-time on the IFI Team, the number of staff counted on the IFI Team is greater than the actual number of staff resources fully available for IFI work. Table 14 shows the number of working days attributed to IFI activity and converts those days to full-time equivalents (FTEs). The bottom half of the table shows the absolute number of staff allocated to the IFI Team since 2016.

The IFI Team started with a small team of two permanent full-time economists. The NAOF initially struggled to find qualified people for IFI work. Staff turnover was an issue for the IFI Team through the years, as analysts left to continue their careers in related institutions. This led to some loss of institutional memory within the IFI Team.

## Table 14. IFI Team staff 2013-2020

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|
| Days of IFI working time | 326 | 361 | 314 | 581 | 599 | 624 | 530 | 716 |
| Full-time equivalent (FTEs) | 1.6 | 1.7 | 1.5 | 2.8 | 2.9 | 3.0 | 2.5 | 3.4 |
| Direct personnel expenditure (EUR 1 000) | 117 | 130 | 113 | 209 | 216 | 225 | 191 | 257 |
| Absolute number of IFI Team staff (approximation) | | | | | | | | |
| Full-time | | | | 3 | 3 | 4 | 3 | 4 |
| Part-time | | | | 2 | 2 | 2 | 2 | 3 |
| Director | | | | 1 | 1 | 1 | 1 | 1 |
| On leave of absence | | | | | | | 1 | 2 |

Note: Assuming 8 weeks on holiday, training, and sick leave leads to 210 effective working days for 1 FTE. Figures for 2013 and 2014 reflect the combined total of the fiscal policy audit and the IFI Team. In the bottom part of the table, numbers for full-time and part-time personnel are approximations provided by the IFI Team and reflect the fact that some staff contribute very different shares of their time to IFI activities. Staff on leaves of absence are not reflected in FTEs shown in the upper part of the table. The working days of the director are not included in the working days or FTEs.

More recently, turnover has decreased. Staff on secondment are returning and the two senior economists that started in 2019 have remained. The current eight staff members who contribute to the IFI Team come from a range of academic backgrounds and bring professional experience from the Ministry of Finance, Bank of Finland and the European Commission. There is roughly equal gender balance (Table 15).

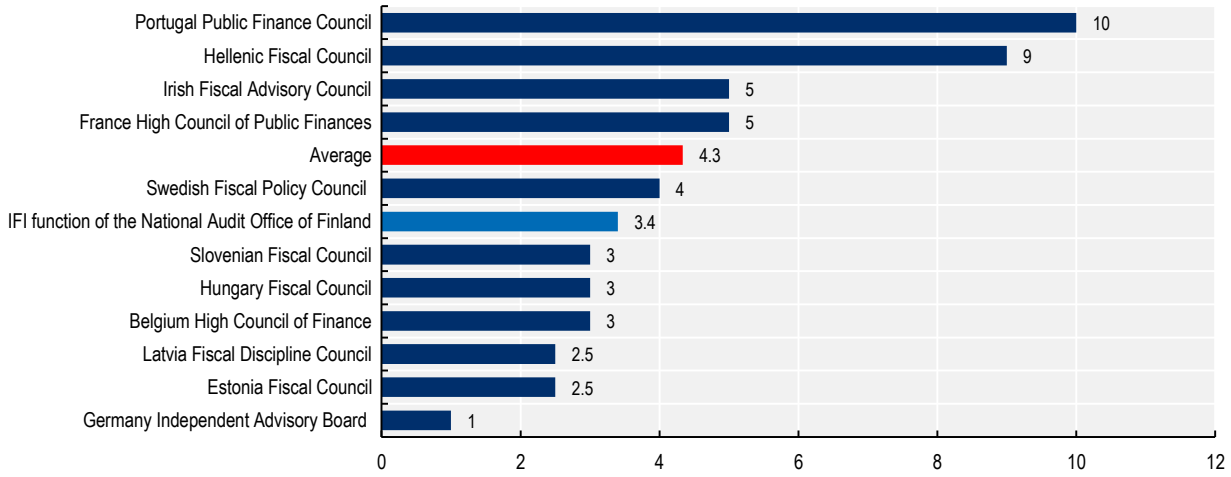
## Table 15. IFI Team staff positions and gender balance

| | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|
| Director | 1 | 1 | 1 | 1 | 1 |
| Economist | 2 | 2 | 3 | 2 | 3 |
| Senior Auditor | 1 | 1 | 1 | 1 | 1 |
| Senior economist | 1 | 1 | 1 | 1 | 2 |
| Team leader | 1 | 1 | 1 | 1 | 1 |
| **Total** | **6** | **6** | **7** | **6** | **8** |
| Female | 4 | 3 | 4 | 3 | 5 |
| Male | 2 | 3 | 3 | 3 | 3 |
| **Total** | **6** | **6** | **7** | **6** | **8** |

Note: Staff on leave of absence are not reflected in the position counts shown in the table.
Source: NAOF, IFI Team.

Compared to other EU IFIs with similar mandates, the number of staff that work for the IFI Team on a full-time equivalent basis is not far from the average (Figure 15). However, analysts at other IFIs generally do not divide their attention between mandated activities and other workstreams. IFI Team members reported that switching between IFI and audit activities can be cumbersome, and the hours worked in different roles must be carefully planned, recorded, and monitored. On occasion, working days planned for IFI activity have been reallocated from the IFI Team to other audit projects. Further, management roles are burdened by the multiplication of responsibilities that come with separate workstreams, such as co-ordinating staff time, organising team meetings, contacting stakeholders inside and outside of the NAOF, chairing working groups, and attending other organisational meetings.

## Figure 15. Analytical staff in other similarly mandated EU IFIs (full-time equivalent)




Source: OECD Database 2021 (forthcoming).

Consistent with recommendations in Section 2. Mandate and governance, the IFI Team should have stronger walls to define its independence and some staff working part time on fiscal policy audits that overlap with the monitoring mandate should be brought into the IFI Team under a more clearly branded IFI Team with a concrete pool of IFI-dedicated resources. This expanded IFI Team would merit a full-time director who can dedicate all of their attention to those combined efforts. With the full-time attention of between five to seven staff, the IFI Team will be better placed to develop more in-house modelling capacity and perform continuous monitoring to deliver the NAOF's legal mandate. Some flexibility for part-time assignments within the NAOF could be retained for professional development, morale and retention.

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## Notes

[1] The full name of the *Fiscal Policy Act* is the *Act on the implementation of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union and on multi-annual budgetary frameworks (869/2012)*. The NAOF's responsibility to monitor compliance with the Act is stated in Subsection 7.

[2] The assessment of compliance is based on Articles 5 and 9 of Regulation (EC) 1466/97 requiring an *ex post* assessment for year *t-1*, an in-year assessment for year *t*, an *ex ante* assessment of plans in year *t+1*, and qualitative assessments for years t+2 and t+3.

[3] The Vade Mecum is effectively the European Commission's playbook on the fiscal rules. The latest edition (European Commission, 2019) is available at: https://ec.europa.eu/info/publications/vade-mecum-stability-and-growth-pact-2019-edition_en.

# Annex 1.A. Acknowledgements

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  - Director for Sustainable General Government Finances
  - Team for fiscal policy monitoring
  - Other teams for fiscal policy audits
  - Communications team
- Ministry of Finance
  - State Secretary to Minister of Finance
  - Budget Department
  - Economics Department
  - EU Secretariat
- Bank of Finland
- Statistics Finland
- Economic Policy Council
- European Commission
- Academic and Research Institutions
  - ETLA Research Institute
  - Labour Institute for Independent Research
  - University of Helsinki
  - VATT Institute of Economic Research
- Commercial bank forecasters
- Media

# OECD Review of Latvia's Fiscal Discipline Council

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## Abbreviations and acronyms

| | |
|---|---|
| EU | European Union |
| FDC | Fiscal Discipline Council |
| GDP | Gross Domestic Product |
| IFI | Independent Fiscal Institution |
| IMF | International Monetary Fund |

## Executive summary and recommendations

Latvia's Fiscal Discipline Council (FDC) was established in 2013 by the *Fiscal Discipline Law* and began operating on 1 January 2014. Its mandate is to monitor the government's compliance with fiscal rules, endorse the macroeconomic forecasts that are used to prepare the budget, assess the adequacy of the fiscal security reserve and assess the sustainability of national fiscal policy, among other responsibilities.

The OECD's review concluded that the FDC is an effective fiscal monitoring body for Latvia and adheres closely to the OECD Principles for Independent Fiscal Institutions (IFIs). It can achieve even greater alignment to the OECD Principles and increase its impact by addressing the following areas with the associated recommendations:

1. **Analytical underpinning of Council opinions.** Stakeholders perceive the FDC's opinions as being driven in large part by the expertise of the highly engaged and well-respected Chair. This contrasts with many of the FDC's European peers, whose formal opinions are viewed primarily as grounded in the analytical work of their secretariat.

   *Recommendation:* Given that the FDC's secretariat does not currently have staff resources available to develop sophisticated internal models, the Council should seek external technical assistance to help build the capacity to support Council opinions with a clear and consistent analytical base that endures beyond the tenure of any specific Chair or Council members. The secretariat should focus first on developing modelling capabilities for fiscal analysis, which would most quickly align the FDC with its European peers. Since the start of this review and the provision of draft recommendations, the FDC has begun receiving such assistance through the European Commission's Directorate-General for Structural Reform Support.

2. **Long-term fiscal sustainability analysis**. Stakeholders appreciated the FDC's Sustainability Report in 2017 and would like to see the report updated to reflect developments following the COVID-19 pandemic. Such a report would be best supported by internal tools developed by the secretariat, rather than those of temporary external consultants, to ensure consistency over time.

   *Recommendation:* The FDC should commit to a regular schedule for publishing long-term fiscal sustainability analysis, with the goal of releasing an updated report within the next two years, when the economy and public finances have stabilised. The sustainability report should be made a regular publication every three years to ensure that at least one major update will occur within the terms of the Presidency and Saeima and under each Chair.

3. **Resources devoted to economic and fiscal monitoring.** During the COVID-19 crisis, the FDC has justifiably focused its effort on monitoring monthly economic and fiscal developments, rather than more strategic analysis of Latvia's fiscal objectives. Its monthly monitoring reports during the crisis have been popular but have required much of the FDC's capacity.

   *Recommendation:* As the immediate pandemic crisis subsides, the FDC should reduce the frequency of monitoring reports, for example to quarterly or twice annually. This will free staff resources to support a greater focus on strategic medium- and long-term fiscal issues and the development of the analytical underpinning of Council opinions.

4. **Parliamentary engagement.** The frequency of the FDC's appearances before parliamentary committees has varied over its history, and there are no legislated requirements for engagement. Under current practice, the FDC participates in meetings of the Budget and Finance (Taxation) Committee and the European Affairs Committee when the annual budget law is reviewed, but has little direct interaction with the Saeima outside of those occasions. Both the FDC and parliamentarians would like to see the FDC's research feature more prominently and routinely in committee hearings during the budget cycle.

   *Recommendation:* The FDC should strengthen engagement with parliament, specifically with the Budget and Finance (Taxation) Committee and the European Affairs Committee. Engagement

could be increased through formal channels, such as through a committee standing motion requiring the FDC to appear twice each year at fixed times in the fiscal year to share its views of the economy and public finances. Engagement could also be increased through informal channels, such as through one-on-one background briefings to committee members and committee analysts, provided the briefings are conducted transparently and with efforts to provide equal opportunities to members.

5. **Legal authority to hire secretariat staff and the balance between inside and outside expertise**. The *Fiscal Discipline Law* provided legal authority for only Council members and a Secretary. The drafters of the law intended that Council members would do the majority of the analysis themselves with the support of outside consultants. However, the FDC's funding agreement sets an upper limit of 72 hours per year of direct remuneration for Council members. Further, as the FDC's mandate has expanded, stakeholders now view the use of outside consultants as suboptimal for responding quickly to emerging issues with evidence-based opinions that are consistent over time.

   In recognition of these challenges, the government has granted the FDC the authority to hire analysts each year in the state budget. However, there is no permanent legislation authorising secretariat staff. The current secretariat of 2.5 analysts on a full-time equivalent basis is smaller than the average of four analysts in European Union (EU) IFIs with similar responsibilities. Further, the FDC's capacity-building programme to expand its internal modelling with the support of the European Commission's Directorate-General for Structural Reform will require additional permanent analytical capacity to implement and maintain for an enduring legacy.

   *Recommendation:* The *Fiscal Discipline Law* should be amended at the next opportunity to explicitly authorise the FDC to be supported by "a Secretary and staff" instead of only a Secretary. The legislation should specify a minimum baseline level of funding for secretariat staff that provides greater flexibility to increase staff numbers toward the average analytical staff levels of EU IFIs with similar mandates. The secretariat's funding should be given multi-year protection in real terms in a similar manner as the existing remuneration of Council members and the Secretary. The limit on hours for which the Chair and Council members can be compensated should be raised to more closely reflect expectations for their analytical commitment.

6. **Communication.** The FDC's reports are well-written and concise, but many stakeholders view them as too technical. This contrasts with the media appearances and public statements of the Chair and Council members, which are widely considered to be accessible. The FDC also does not currently monitor in detail its public engagement statistics and media mentions to track the effectiveness of its reports and communications over time.

   *Recommendation:* To an extent, this stakeholder feedback is expected, as a role of Council members is to communicate technical reports to the public. However, the FDC should nonetheless strive to increase the engagement of non-technical stakeholders through short summaries in plain language, infographics, and visuals with a distinct and consistent branding across reports and on social media. The FDC should also improve its monitoring of media mentions and public engagement so that it can track changes in engagement over time and adjust its approach to reports and communications accordingly.

## 1. Adherence to OECD Principles

### *Introduction*

This review of Latvia's Fiscal Discipline Council (FDC) uses an evaluation framework anchored in the OECD Recommendation on Principles for Independent Fiscal Institutions, adopted by the OECD Council on 13 February 2014 (OECD, 2014[1]).[1]

The OECD Recommendation provides a set of Principles to assist Member countries in designing independent fiscal institution (IFIs) that are effective and viable over the long run. There are 22 Principles across nine headings:

1. Local ownership
2. Independence and non-partisanship
3. Mandate
4. Resources
5. Relationship with the legislature  Access to information
6. Transparency
7. Communications
8. External evaluation

### *Results*

Overall, the FDC's design, operations, and analysis satisfy all OECD Principles at least partially. On **local ownership**, the FDC was established largely in the context of requirements of the euro area surveillance framework; however, the reforms were also motivated by a domestic appetite for improving the management of the public finances and the *Fiscal Discipline Law* was designed with the Latvian context foremost in mind.

On **independence and non-partisanship**, the appointment process and term structure of Council members and the staffing procedures for the Secretary and outside consultants are protected from executive government influence; however, legal authority to hire analysts as a permanent secretariat is provided each year in the state budget through annual discussions with the Ministry of Finance and therefore relies on the goodwill of the government. The FDC's physical placement within the Ministry of Finance is a potential area of concern for its independence; however, it is not without precedent. A small number of IFIs such as the German Independent Advisory Board to the Stability Council and the Belgian High Council of Finance also use the facilities of their finance ministries. Further, stakeholders felt that the FDC is able to keep an arm's length relationship to the Ministry of Finance while benefiting from close proximity that grants the FDC easy access to information to complete its mandated tasks.

On **mandate**, the FDC's responsibilities are prescribed in detail in legislation. The FDC's initial focus on monitoring compliance with fiscal rules was decided by considering the institutional environment, specifically that the Bank of Latvia was already doing considerable fiscal analysis. Section 26 of the *Fiscal Discipline Law* grants the Chair the authority to produce reports and analysis at their own initiative and to represent the FDC without external authorisation. The mandate clearly links the FDC to the budget process by requiring the FDC's fiscal discipline surveillance report to be appended to the draft framework law before its submission to the Saeima. The FDC's role of endorsing the government's macroeconomic forecast was added after creation of the *Fiscal Discipline Law* and its timing is defined by memorandums and other unlegislated arrangements.

On **resources**, drafters of the *Fiscal Discipline Law* initially envisioned that Council members would do the majority of the analysis themselves, supported by only one staff member – the Secretary – for help with administration. Any additional support was to be provided from a budget for consultants on a project basis. Stakeholders, including some who played a lead role in drafting the original legislation, now see that this balance toward outside experts and away from permanent staff was ultimately suboptimal in ensuring that Council opinions had a strong evidence base and consistency over time. The FDC, legislators and the Ministry of Finance are working together to improve upon the status quo; however, the number of staff positions remains below the average of IFI peers with a similar mandate and presents challenges to delivering the IFI's mandate on long-term sustainability analysis and maintaining its programme to expand its modelling capacity.

On **relationship with the legislature**, the FDC's duties toward engaging with committees and legislators are not directly referenced in law. Under current practice, the FDC meets the Budget and Finance (Taxation) Committee when the annual budget law is reviewed but has little direct interaction with the Saeima outside of that.

On **access to information**, the *Fiscal Discipline Law* has a general catch-all clause prescribing that the FDC is entitled to the information that it requires to fulfil its mandate. The Law also has a clause granting the FDC the right to co-operate with government bodies, foreign institutions, and independent specialists to inform Council meetings.

On **transparency**, the FDC publishes all of its reports on its website and provides explanations of the underlying assumptions, including spreadsheets with fiscal rule calculations. It is transparent in its operations, publishing its procurement transactions and details of its contracts online. Detailed council meeting minutes are published on the FDC's website.

On **communications**, the FDC engages an external media consultant to prepare press releases, post to social media, and organise press conferences for its reports. The decision to outsource many aspects of press releases and distribution is uncommon, but has proven to be effective.

On **external evaluation**, the FDC initiated this external OECD review. It also created an expert panel in March 2020 to provide feedback on its technical work. The panel includes the former FDC Chair and Secretary, an economist in the field of international finance, a director of a marketing and public opinion research centre, and an expert with a background in auditing.

A detailed assessment of the FDC's adherence to the OECD Principles is given in Table 7. The remainder of this report expands on these discussions and provides recommendations for bringing the FDC into greater alignment with the OECD Principles and the best practices of peers. The recommendations are grouped into four areas:

- **Mandate and governance**: The FDC's responsibilities, organisation and rights to information.
- **Reports and influence:** The FDC's research products and how it communicates them to engage stakeholders and influence fiscal management practices.
- **Methods**: The FDC's technical approaches, workflows and models for producing its reports.
- **Financial and human resources**: How the FDC has been empowered with a budget and staff to achieve its mandate.

## Table 16. Does the Fiscal Discipline Council adhere to the OECD Principles for Independent Fiscal Institutions?

| | |
|---|---|
| **1. LOCAL OWNERSHIP** | |
| **1.1 Broad national ownership, commitment, and consensus across the political spectrum. Models from abroad should not be artificially copied or imposed.**<br>Although partially motivated by euro area entry, the reforms were at Latvia's urging, owing to existing issues with government spending pressure that Latvia's elected officials and public wanted to address. The drafters of the original law reported that they were not inspired by any international model. | ● |
| **1.2 Local needs and the local institutional environment should determine options for the role and structure of the IFI.**<br>The decision to locate the FDC in the Ministry of Finance was guided by its narrow mandate, small staff, and the availability of experts in Latvia. It was felt that an arm's length but physically close relationship with the Ministry would ensure that the FDC would have access to the data that they require to serve in their role. This has been borne out by experience. The FDC's focus on monitoring fiscal rules compliance was determined by considering the institutional environment, specifically that the Bank of Latvia was already doing considerable strategic fiscal analysis. | ● |
| **2. INDEPENDENCE AND NON-PARTISANSHIP** | |
| **2.1 Does not present its analysis from a political perspective; strives to demonstrate objectivity and professional excellence, while serving all parties. IFIs should be precluded from any normative policy-making responsibilities to avoid even the perception of partisanship.**<br>All stakeholders reported that they view the FDC's work as non-partisan. The FDC does not have policy-making responsibilities. It provides recommendations on the broad fiscal stance in line with the activities prescribed in its legislation. | ● |
| **2.2 The leadership of an IFI should be selected on the basis of merit and technical competence, without reference to political affiliation. The qualifications should be made explicit.**<br>The *Fiscal Discipline Law* requires that council members be "specialists of the field of finance and economics from Latvia or other Member State of the EU who have experience in fiscal policy issues." In practice they come from a wide range of skilled backgrounds in academia, central banks, the private sector, and international organisations. Three members are nominated by at least ten deputies of the Saeima and three members are nominated according to a joint proposal of the Minister of Finance and the Governor of the Bank of Latvia. Nominations are approved by parliament. In practice, the nominations are not made based on political association. | ● |
| **2.3 Term lengths and number of terms that the leadership of the IFI may serve should be clearly specified in legislation along with dismissal criteria and process.**<br>Members are appointed for six years, with the exception of three members who were nominated by Members of Parliament when the FDC was first established, in order to set up a staggering of the end of their terms. Conditions for dismissal of Council members are spelled out in legislation, relating to criminal offences or non-fulfilment of duties. | ● |
| **2.3 The leadership's term should optimally be independent of the electoral cycle.**<br>The FDC's leadership is appointed for 6 years (and may hold office for two successive terms) while the lower house political cycle is 4 years. | ● |
| **2.4 The position of head of the IFI should be a remunerated and preferably full-time position. Strict conflict-of-interest standards should be applied.**<br>The Council's Chair is a part time role. Chair and all council members are remunerated for their deliberations; however, the time invested by the Chair and Council members generally exceeds remunerated hours. The FDC has strict transparency requirements for contracts to allay conflict-of-interest concerns for Chairs or other part-time council members with outside employment. As with other part-time fiscal councils, members must be clear when they are speaking on policy matters in a council role and when they are speaking in the role of their other employment. | ◖ |
| **2.5 The leadership of the IFI should have full freedom to hire and dismiss staff in accordance with applicable labour laws.**<br>Section 26 of the *Fiscal Discipline Law* empowers the Chair of the Council with complete control to hire and dismiss the Secretary and external experts invited by the Council. Leadership is somewhat constrained in staffing the secretariat, in that they must seek the Ministry of Finance's approval for adjusting the mix between consultants and secretariat analysts. They also face practical difficulties competing to attract talent against the compensation offered by other employers of economists in Latvia. | ● |
| **2.6 Staff should be selected through open competition based on merit and technical competence, without reference to political affiliation, in line with civil service conditions.**<br>In practice staff are hired by the FDC through open competition based on merit, without political consideration or political influence. This requirement is not specified explicitly in law. | ● |
| **3. MANDATE** | |
| **3.1 The mandate should be defined in legislation, including types of reports and analysis they are to produce, who may request them and timelines for release.**<br>Section 28 (2) of the *Fiscal Discipline Law* defines the FDC's mandate, stating that "the Council shall examine the correctness of application of balance rule and expenditure growth rule, including when performing independent assessment of potential gross domestic product and nominal gross domestic product and structural balance calculation." The macro endorsement role is only prescribed in a memorandum of understanding with the Ministry of Finance. | ● |
| **3.2 IFIs should have the scope to produce reports and analysis at their own initiative and autonomy to determine their own work** | ● |

| | |
|---|---|
| **programme within their mandate.**<br>Section 26 of the *Fiscal Discipline Law* grants the Chair the authority to manage the work of the FDC and to represent the Council without other authorisation. | |
| **3.3. Clear links to the budget process should be established within the mandate.**<br>Legislation clearly links the FDC's surveillance reports to the medium-term budget framework: "The Council shall draw up a fiscal discipline surveillance report before submission of the draft framework law to the Saeima. The report shall be appended to the draft framework law and submitted to the Saeima." Endorsement timing and other budget engagement are clearly defined by memorandums and other arrangements. | ● |
| **4. RESOURCES** | |
| **4.1 The resources allocated to IFIs must be commensurate with their mandate.**<br>Drafters of the *Fiscal Discipline Law* envisioned Council members would do the majority of the analysis themselves and outsource any specific needs to consultants on a project basis. Stakeholders, including some who played a lead role in drafting the original legislation, now see that this balance toward outside experts is suboptimal. The FDC, legislators and the Ministry of Finance have been working together to shift the balance toward permanent staff. | ◖ |
| **4.1 The appropriations for IFIs should be published and treated in the same manner as the budgets of other independent bodies.**<br>Remuneration of Council members and the Secretary and eligible expenses for Council meetings are prescribed with annual indexation in the *Fiscal Discipline Law.* These are paid from the budget of the Ministry of Finance. Since 2016, the Ministry of Finance has provided the FDC with resources to hire additional secretariat staff to fulfil the FDC's additional mandate to endorse macroeconomic forecasts. This top-up funding for secretariat staff does not have an ongoing legislated guarantee. | ◖ |
| **4.1 Multiannual funding commitments may further enhance the IFI's independence and provide additional protection from political pressure.**<br>The Medium Term Budget Framework Law sets out funding level guidance for the Fiscal Discipline Council over the next three years, but the FDC's budget remains subject to annual approval. | ◖ |
| **5. RELATIONSHIP WITH LEGISLATURE** | |
| **5.1 Mechanisms should be put in place to encourage appropriate accountability to the legislature.**<br>The FDC may be called upon by committees of the Saeima to appear before them and Members of the Council may be terminated by the legislature under several conditions of non-performance. The National Audit Office audits the performance of duties and financial matters of the FDC and reports to the Saeima. The FDC is evaluated against performance indicators related to its Council meetings, reports and opinions under its budget provisions with the Ministry of Finance. | ● |
| **5.1 The budgetary calendar should allow sufficient time for the IFI to carry out analysis necessary for parliamentary work.**<br>The FDC's surveillance reports are appended to the relevant draft laws and submitted to the Saeima. Parliamentarians reported having sufficient time with the surveillance reports to carry out their duties. In producing the reports, the FDC is given little time to assess budget material. | ● |
| **5.2 The role of the IFI vis-a-vis the parliament's budget committee (or equivalent), other committees, and individual members in terms of requests for analysis should be clearly established in legislation.**<br>Specific committee arrangements are not prescribed in legislation. There is some uncertainty over how to handle committee requests and individual requests from parliamentarians. In practice, the surveillance report is submitted to the Budget and Finance (Taxation) Committee every time a new draft budget is reviewed in parliament. | ◖ |
| **6. ACCESS TO INFORMATION** | |
| **6.1 IFIs should have full access to all relevant information in a timely manner.**<br>The *Fiscal Discipline Law* prescribes that "The Council shall have the right to request and receive information from public authorities necessary for discharging the Council's duties." | ● |
| **6.2 Any restrictions on access to government information should be clearly defined in legislation.**<br>The *Fiscal Discipline Law* grants the FDC the right to receive all information to fulfil its mandate and the FDC is not subject to restrictions on access to information. | ● |
| **7. TRANSPARENCY** | |
| **7.1 The IFI should act as transparently as possible, including full transparency in their work and operations.**<br>Relevant expenses, consulting contracts and staffing decisions are disclosed on the web. Detailed council meeting minutes are published on the FDC's website. | ● |
| **7.2 The IFI's reports and analysis (including underlying data and methodology) should be published, made freely available to all and sent to parliament.**<br>All reports are published online. Key reports are submitted to the legislature. The FDC provides spreadsheet files with calculations of the fiscal rules and calculations of the macroeconomic aggregates. | ● |
| **7.3 The release dates of major reports and analysis should be formally established, especially in order to co-ordinate them with the release of relevant government reports and analysis.**<br>The release date of the FDC's Surveillance Report depends on the government's budget calendar and its exact timing is somewhat uncertain; however, it is formally established in that it must be published alongside the draft Medium-term Budget Framework Law and considered with the annual State Budget Law in the Saeima. The FDC's interim report is formally tied to the publication of the government's Stability Programme Update in April. | ● |
| **7.4 IFIs should release their reports and analysis, on matters relating to their core mandate on economic and fiscal issues, in** | ● |

| | |
|---|---|
| **their own name.**<br>All reports are released under the FDC's own name and branding. | |
| **8. COMMUNICATIONS** | |
| **8.1 IFIs should develop effective communication channels from the outset.**<br>The FDC has a strong media presence, driven by the voice of its Chair. It has well-developed research distribution channels, largely through the use of an external media consultant. This outsourcing has been successful but is uncommon. IFIs typically have more direct ownership of press releases and research distribution and invest more in tracking the impact of their communications. | ● |
| **9. EXTERNAL EVALUATION** | |
| **9.1 IFIs should develop a mechanism for external evaluation of their work.**<br>The FDC enlisted the OECD to perform an external review in 2021 and created an expert panel to offer advice on technical matters related to analysis and reports. | ● |
| Key: ● = yes; ◖ = partially; ○ = no | |

## 2. Mandate and governance

# Key findings

The creation of the Fiscal Discipline Council was motivated by domestic calls to improve the management of Latvia's public finances and by requirements of the EU's fiscal governance framework for adopting the euro. The FDC's mandate is clearly defined in legislation and memorandums with clear links to the budget cycle. It fulfils its responsibilities independently and impartially. That said, the following adjustments would bring the FDC closer in line with OECD Principles.

- The FDC currently appears before the Budget and Finance (Taxation) Committee when invited; however, the OECD Principles recommend that an IFI's duties to committees and individual legislators be defined in legislation. Greater certainty could be provided immediately through a motion by the Budget and Finance (Taxation) Committee that the FDC has an ongoing invitation to appear twice a year on a fixed date or date relative to the budget cycle to provide its views. When possible, the *Fiscal Discipline Law* should be revised to clarify the FDC's committee responsibilities and whether they have a defined role in responding to inquiries from individual legislators.
- The FDC has less than two weeks, or at times two days, to review key information to complete its Surveillance Report. The FDC should work with the Ministry of Finance to lengthen the time available to review budget information. This could include, where possible, meetings at intervals leading up to the budget to review draft plans as they are prepared.

### *Introduction*

Latvia's economy suffered severe consequences from the 2008 global financial crises and was the hardest hit of the three Baltic states. The consequences of the crisis left the economy scarred and the public finances in a weakened position, with the 2010 deficit at 8.6% of Gross Domestic Product (GDP), up significantly from 0.6% in 2007. The deterioration of the fiscal position resulted in calls from domestic stakeholders to improve the management of the public finances. The government committed to implementing wide-ranging reforms to stabilise the economy and restore fiscal policy credibility.

The reforms culminated in the *Fiscal Discipline Law*, which Latvia's Saeima (Parliament of the Republic of Latvia) adopted on 31 January 2013. The Law set out fiscal policy principles and fiscal rules for managing the public finances and established the Fiscal Discipline Council, an independent fiscal authority to monitor

fiscal discipline and compliance with the law. The Law and the creation of the FDC also fulfilled Latvia's requirements under the EU's fiscal governance framework for its plans to adopt the euro officially in 2014.

The new fiscal framework, supported by the FDC's voice, has turned around Latvia's public finances. The deficit was brought back down to pre-crisis levels by 2019. The COVID-19 pandemic has created new challenges, but Latvia's fiscal management framework and the FDC are prepared to confront them.

### *The FDC's mandate*

The responsibilities given to the FDC include:

- Verifying whether Latvia's four fiscal rules (three-year spending ceilings, a structural deficit no greater than 0.5% of GDP, and criteria for expenditure growth and general government debt that are in line with or more restrictive than EU surveillance guidelines) have been properly applied, including an independent assessment of the assumptions for potential GDP and nominal GDP;
- Monitoring whether the implementation of the annual state budget law conforms to its plan, for indicators of the consolidated budget of local governments and budgets of public persons;
- Preparing an opinion on whether conditions to suspend the budget balance target have been met during a severe economic downturn;
- Preparing an opinion on whether the Fiscal Stability Reserve (an upward adjustment to planned expenditure as a safety cushion) is set at an appropriate level to counter fiscal risks;
- Preparing a surveillance report on fiscal discipline and, if necessary, a non-conformity report that identifies departures from the *Fiscal Discipline Law*;
- Endorsing the Ministry of Finance's macroeconomic forecasts twice a year – once for preparing the Stability Programme, and once for preparing the annual state budget and the medium-term budget framework (presented simultaneously). This function was added in 2016 and fulfils Latvia's commitments under Regulation (EU) No 473/2013 of the two-pack of reforms to the Stability and Growth Pact requiring independent production or endorsement of forecasts (Box 5);
- Preparing an interim opinion on the Stability Programme; and
- Assessing and analysing the sustainability of fiscal policy.

The *Fiscal Discipline Law* also gives the FDC the freedom to provide self-initiated opinions about any fiscal issue that the Council deems to be important to ensure overall compliance with the *Fiscal Discipline Law*:

> *The Council shall draw up and submit to the Saeima and Cabinet an opinion in other fiscal policy and macroeconomic development issues if it considers them as substantial for the complying with the norms set out in this law (Section 28(7)).*

Under this provision, the FDC has undertaken research such as assessing tax reforms and conducting surveys of political parties on issues related to fiscal discipline. These activities have helped to raise awareness of important issues and the work of the FDC.

The obligations of the FDC and Ministry of Finance to one another were unclear at first. When the FDC's responsibilities were expanded in February 2016 to include endorsing the official macroeconomic forecasts, the FDC and the Ministry of Finance clarified their interactions by signing a memorandum of understanding, which has been updated several times – most recently in 2018 (Fiscal Discipline Council, 2018[2]). The memorandum also improved the information exchange between the two, describing in detail the kind of data needed by the FDC to carry out its evaluation of the macroeconomic forecasts and fiscal policy. After the memorandum was signed, the government formally recognised the FDC's additional endorsement function by including a specific provision in the state budget law each year authorising the FDC to hire additional staff to carry out the responsibility.

The FDC is given less than two weeks, or at times two days, to assess key budget material for its Surveillance Report. The Ministry of Finance and FDC should co-ordinate to lengthen this time by arranging earlier meetings to discuss decisions and planning assumptions in draft form, while recognising that decisions may not be finalised. As a model they can look to the practice in the United Kingdom (UK), where the Office for Budget Responsibility has signed a memorandum with key departments to form a liaison group that meets several times in the run-up to budgets to discuss the evolution of the economic and fiscal forecasts (OBR, 2017[3]).

### Box 5. IFIs in the framework for EU co-ordination and surveillance of budgetary processes for euro area members

The "two-pack" of reforms in 2013 (Regulation 472/2013 and Regulation 473/2013) added a new budget co-ordination and surveillance process to the Stability and Growth Pact to help restore confidence in the fiscal sustainability of Member States in the euro area following sovereign debt crises and contagion effects of the shared currency in the wake of the global financial crisis.

Chapter III Article 4 of Regulation (EU) No 473/2013 gives a Member State the option of either having an IFI produce its macroeconomic forecast or endorse its macroeconomic forecast. Latvia has chosen the latter, in line with most Member States. Formally, the FDC is designated as the independent monitoring body for the purposes of the regulation in a memorandum of understanding between Latvia's Ministry of Finance and the FDC.

Independent fiscal institutions fulfilling the monitoring role in the EU surveillance framework are expected to publish twice-annual endorsement statements corresponding to the Stability Programme Update and the Draft Budgetary Plans of the European Semester.

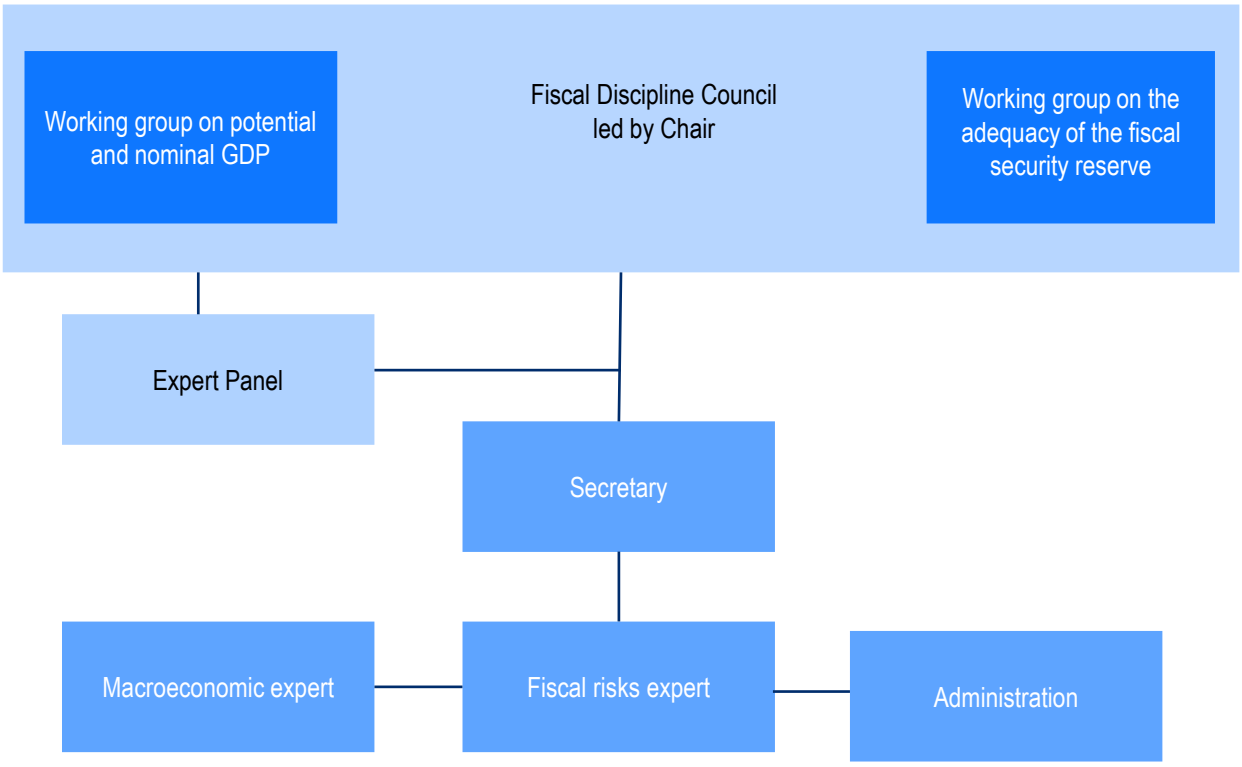
### *The FDC's organisation and governance*

Given the small population of Latvia and its limited fiscal capacity at the time, drafters of the *Fiscal Discipline Law* felt that it would be politically challenging to establish a new public entity for its monitoring. To pre-empt opposition, policymakers designed a small institution that would not require significant funding. The resulting FDC had six appointed council members supported by a sole secretary to handle administration. The Council held its first meeting on 25 February 2014.

When the FDC's mandate was expanded in 2016 to include endorsing the official macroeconomic outlook, the Ministry of Finance re-assessed the Council's analytical support and agreed to approve three staff positions under the FDC's Secretary, filled by two economists and an administrative professional, bringing the secretariat to four.

The organisational structure of the secretariat is lean, with staff reporting directly to the Secretary, who is accountable to the Council for the performance of all support tasks (Figure 16).

**Figure 16. The FDC's current organisational structure**




Note: Working groups are formed by Council members.

### *The Council*

Among the Council's six members, three are nominated by the Saeima, which must be put forward by at least ten Members of Parliament, and three are nominated jointly by the Governor of the Bank of Latvia and the Minister of Finance. All nominations must be approved by a simple majority of the Saeima. Under the *Fiscal Discipline Law*, candidates must be specialists in the field of finance and economics from the EU and cannot be associated with a political party. Members serve for six years and a maximum of two terms. Appointments are staggered (three members were initially appointed for three-year terms) so that tenures do not all expire at the same time.

Although Council members are selected based on their technical competence, without explicit ties to a political party, the selection process should be more transparent. A public hearing in the Saeima with the nominees ahead of their endorsement could bring more clarity about their non-partisanship and professional background.

The law does not specify any time limit within which the nomination of a new Council member must be submitted once a Council member's term expires. The law is also silent about situations in which the FDC is not functional by merely not having enough Council members in place. The Council must have at least four members to have a quorum. It would be appropriate to consider an arrangement whereby Council members remain in office until their replacements have been elected or, alternatively, only when the expiration of a Council member's term of office might render the FDC unable to function. An example may be found in legislation for Slovakia's Council for Budget Responsibility.

Members of the Council elect a Chair among them for the term of three years. The Chair cannot hold the office for more than two such terms (six years) in succession. The Chair appoints a head of secretariat (the Secretary) who then hires additional staff to provide the Council with analytical support.

All reports, decisions, and opinions of the FDC are approved by the Council during its meetings. Council members also approve the FDC's three-year work plan and adjust it as necessary on a year-to-year basis.

Council members generally meet six times a year, but if necessary can schedule additional meetings. Decisions of the Council and meeting minutes are published on the FDC's website. Issues for discussion during FDC meetings can be proposed by any Council member. The secretariat staff generally also attend meetings. Decisions of the Council are made by voting with a majority rule. If the vote on a decision is evenly split, the Chair's vote determines the outcome. Council opinions are usually presented by the Chair. In cases of disagreement, Council members may ask for their opinion to be included in minutes.

#### *Working Groups*

The Council is empowered under the Fiscal *Discipline Act* to establish specific standing or temporary working groups within the Council to carry out specific areas of its mandate. In 2014, the FDC established two such groups:

1. The working group for the evaluation of potential GDP and nominal GDP, and
2. The working group for the assessment of adequacy of the fiscal security reserve.

All six Council members participate in the working groups. Currently, they are divided into two groups of three. Each group is led by a Council member and meets twice a year.

#### *Expert Panel*

In 2020, the FDC established a five-member expert panel of former Council members, employees, and other experts. The expert panel contributes to the Council's analytical accountability by discussing and exchanging views on technical matters. The panel includes the former FDC Chair and Secretary, an economist in the field of international finance, a director of a marketing and public opinion research centre, and an expert with a background in auditing. Panel membership is not remunerated. Thus far, communication between the panel and the FDC has not been routine; however, the FDC Chair has approached panel experts for consultations on several one-off issues.

### *The FDC's accountability*

The FDC is classified as a "budget institution" for purposes of Latvia's *Law on Budget and Financial Management.* This means its funding is allocated under the procedures and supervision of the Cabinet of Ministers (the body exercising executive functions in Latvia's traditional parliamentary system). As a budget institution, the FDC is required to prepare annual financial statements according to procedures set by Cabinet. The procedures require the FDC to undergo an audit by the State Audit Office every five years, which the State Audit Office presents to the Saeima.

Two such audits have been completed thus far. In 2016, the Audit Office raised a concern that the *Fiscal Discipline Law* did not entitle the FDC to be considered a "budget institution" at the time. In addition, the Audit Office highlighted that the law only allowed the FDC to hire experts on a project basis, whereas the FDC secretariat consisted of four full-time employees at the time, through its agreement with the Ministry of Finance. The Audit Office recommended amending legislation to address these issues. Both issues were resolved by introducing provisions on a year-to-year basis in annual budget laws that classify the FDC as a budget institution and authorise it to hire full-time employees. These provisions list performance indicators related to the preparation of Surveillance Reports, the number of Council meetings held and other objective measurements of fulfilling the FDC's mandate.

The FDC is also directly accountable to the Saeima, in that Council members are approved by the Saeima and may be dismissed by the legislature under a set of prescribed conditions of non-performance. The Council's *Surveillance Report* is submitted to the Budget and Finance (Taxation) Committee each year.

Specific committee arrangements are not prescribed in legislation and there is some uncertainty over how the Council should treat requests from committees and individual legislators. Engagement with the Saeima largely depends on the interest of parliamentarians. The FDC has been invited to participate during hearings of the Saeima's Budget and Finance (Taxation) Committee and hearings on the Stability Programme in the European Affairs Committee. For example, the FDC participated in meetings for both of those two committees in 2020, presenting Council opinions on the Stability programme and on the 2021 Budget.

Physically, the FDC sits in the building of the Ministry of Finance and the Ministry is required to support it with general administration activities such as human resources and information technology. While its physical location and shared services could be perceived as a risk to its independence, its legal status as a separate and independent body is well understood and recognised by stakeholders, who view the office as operating separately and independently from the Ministry.

### *Access to information*

Timely access to comprehensive and reliable information is the most important prerequisite for an IFI's ability to deliver its mandate to a high standard. Information an IFI requires includes financial data and forecasts and the underlying methods and models used to produce them. The importance of access to information is highlighted in Principle 6.1 of the OECD Principles for IFIs, which recommends explicit legal guarantees to access information, supplemented by protocols or memoranda of understanding.

According to Section 28 of the Council's enabling legislation, the FDC has the right to request and receive information from public institutions as necessary for the performance of its tasks. Public entities are expected to provide advice and necessary assistance upon request.

To manage the expectations regarding the processing of information requests, timeframes, and treatment of confidential data, the Council's access to information is supported by a memorandum of understanding signed between the Ministry of Finance and the FDC in 2016. It lists a detailed set of tables with macroeconomic and fiscal indicators which are the subject of information exchange. The memorandum was amended in the course of 2016 and again in 2018 as needs evolved. The FDC's use of both legislation and a memorandum of understanding is in-line with OECD Principles and the most common practice of OECD IFIs, 42% of which use both.

The Ministry of Finance is the main source of information for the FDC but the secretariat can also approach other relevant institutions such as the State Treasury and the Central Statistical Bureau. On 1 January 2021 the State Revenue Service introduced a unified account for reporting tax data that has made it more difficult for the FDC to obtain timely information on revenues collected by the type of tax assessed; however, this is expected to improve with time.

In general, the FDC and other stakeholders confirmed that there have been no major issues for gathering information in recent years, other than the difficulties in 2021 securing tax data noted above. The Ministry of Finance and other institutions have been supportive and have provided all the information requested by the Council.

In addition to the legal framework underpinning the FDC's access to information, good personal relations between the secretariat and government staff have played a key role in ensuring smooth access to information. The secretariat estimates that around 80% of the information is gathered via informal protocols or analyst-to-analyst contacts. The FDC should nevertheless be cautious about over-relying on good personal relations and should ensure that formal memoranda are maintained to ensure that access to information from all key actors is secured over the longer term.

Unlike some of its peers, the FDC does not publish statistics on the number of its information requests, nor on whether the responses were complete and received on time. The FDC may wish to consider tracking

such metrics in the future. For example, the Slovak Council for Budget Responsibility attaches an annex to its main reports listing information requests used in its preparation and the responses received. This approach provides transparency and an opportunity to communicate any cases where information was withheld.

## 3. Reports and influence

### Key findings

The FDC has achieved a high level of positive influence on fiscal policy since its inception. This is owed in large part to the adaptability of its reports in response to developing issues, for example, the new monthly monitoring reports that staff developed to inform decision makers during the COVID-19 crisis. To increase its influence further and have greater alignment to the OECD Principles, the FDC should make the following adjustments:

- The FDC should commit to a regular schedule for publishing long-term fiscal sustainability analysis. A frequency of every three years would be roughly in line with the average practices of other OECD IFIs that publish long-term sustainability analysis and would ensure that at least one major update is likely to occur within each Chair's term (3 years) and each term of the presidency and Saeima (four years).
- As the immediate pandemic crisis subsides, the FDC should reduce the frequency of its monitoring reports. This will free staff resources to support a greater focus on strategic medium- and long-term fiscal sustainability issues.
- The FDC should improve the accessibility of its reports for non-technical stakeholders. This may include developing one-page summaries, infographics and visuals with an easily recognisable FDC branding to be used across the FDC's reports and on social media. As the secretariat builds modelling capacity and experience, it should aim to keep its reports concise.
- The FDC should strengthen its engagement with the Saeima, specifically with the Budget and Finance (Taxation) Committee and the European Affairs Committee. More engagement could be both formal, such as with scheduled appearances at committees after publishing major reports, and informal, such as through briefings to individual parliamentarians and parliamentary analysts.
- The FDC should improve the tracking of its web and media presence, along with other communications-related performance indicators to monitor the effectiveness of its communications approach. The FDC should also monitor its impact in parliament and how often its work is mentioned in parliamentary debate.

### *Introduction*

The Latvian FDC has established itself as a credible and effective voice in the fiscal landscape in Latvia. It has developed influential reports and stakeholders reported that it has had an impact on several key fiscal issues (Box 6).

The FDC has fulfilled its statutory role while also responding in an agile way to emerging issues. For example, the FDC's commentary on the government's tax reforms in 2020 were noted by stakeholders as a significant contribution to the public debate at the time, and more recently the FDC introduced monthly

COVID-19 crisis monitoring reports, which have been well-received by parliamentarians, journalists, academics and civil servants.

This section assesses the FDC's reports and the impact on the public debate that they achieve through different communication channels.

### Box 6. The FDC has made a positive impact on fiscal issues

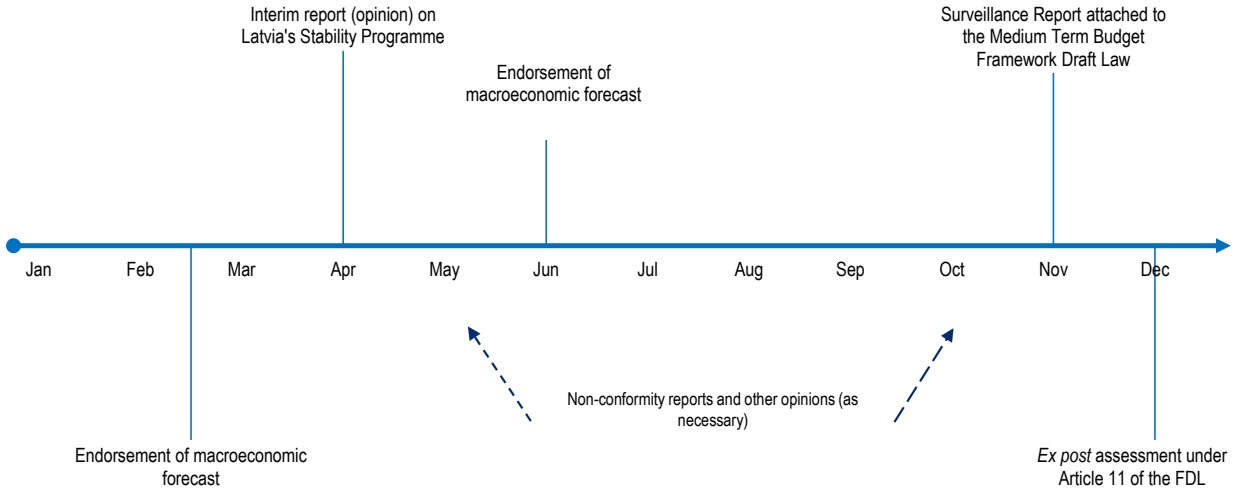
Stakeholders noted several specific areas where the FDC has raised the level of debate on fiscal policy through its work:

- The FDC's scrutiny of macroeconomic forecasts produced by the government of Latvia has improved the analytical rigour of the forecasts internally and the credibility of the forecasts externally.
- In 2017, the FDC contributed to debates on planned corporate tax and personal income tax reforms with an influential commentary on broader aspects of the distributional and economic effects of the reforms.
- In 2020, the FDC published a commentary on the progress of tax reforms along with recommendations for criteria that observers should use to assess the reforms (thereby avoiding specific policy recommendations). Stakeholders appreciated that approach and viewed the FDC as filling a gap in Latvia where few think tanks comment on public finance topics.
- The Ministry of Finance uses the FDC's commentary on fiscal space to challenge proposals from departments across government that might risk violating the *Fiscal Discipline Law*.
- The Council's views are sought by rating agencies and the EU bodies as an impartial opinion on the state of the government's fiscal plans.

### *The FDC's publications and their timing*

The FDC's core publications are anchored to the main tasks in their mandate. Endorsements of the macroeconomic projections used by the Ministry of Finance typically take the form of Council Opinion letters ahead of the Stability Update in mid-February and again at the end of the second quarter of the calendar year (Figure 17).

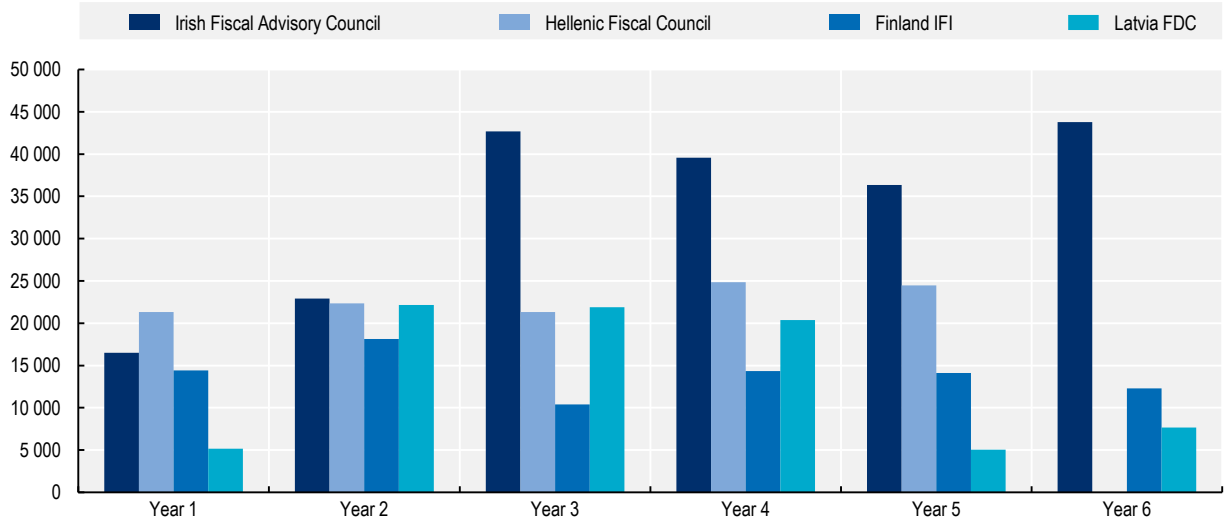
### Figure 17. Core publication calendar



The FDC's assessment of the government's compliance with the *Fiscal Discipline Law* is laid out in Surveillance Reports typically in the fourth quarter and, if necessary, in non-conformity reports as issues arise. The *Fiscal Discipline Law* explicitly requires Surveillance Reports in the context of the draft Medium-term Budget Framework Law (which is considered at the same time as the annual State Budget Law in the Saeima). The FDC also prepares an interim report on the Stability Programme Update in April. The FDC's reports are appended to the relevant draft laws and submitted to the Saeima. The timing of reports depends on the government's budget calendar and is therefore somewhat uncertain. In total, six Surveillance Reports and six interim reports have been prepared by the FDC since its creation.

The FDC's Surveillance Report is currently brief compared to its past reports and to peers with a similar institutional maturity (Figure 18). The report has averaged around 6 000 words in recent years, but contained as many as 20 000 words in earlier years. That partly reflects the recent turnover of staff and resetting of analytical capacity. Brevity is a positive attribute to which IFIs should aspire. As the FDC deepens its analytical capacity, it should aim to preserve the brevity of its reports. Further, it should monitor the readability of its reports using objective criteria based on sentence length, average syllables per word, and average characters per word. A useful discussion of these criteria and a cross-IFI comparison of the readability of reports may be found in Box 3.2 of OECD (2021[4]). The discussion concludes that the reports of the Portuguese Public Finance Council and the Irish Fiscal Advisory Council are good-practice examples.

## Figure 18. Word count of main annual analytical report compared to peers




Note: The Hellenic Fiscal Council publishes in Greek; differences in average word count per language were controlled for using European Commission document translation averages.
Source: Main annual analytical reports of each IFI in the comparison.

The Council's Opinion letters on the Ministry of Finance's macroeconomic forecasts are even more concise documents, typically consisting of fewer than 2 000 words. They are drawn up whenever the Ministry of Finance releases new macroeconomic projections for budgetary planning. This typically happens twice a year, at the time of the Medium Term Budget Framework Law and the Stability Programme. In 2020, the FDC produced three opinions, as the Ministry of Finance had to substantially revise its macroeconomic forecasts to reflect the impact of the COVID-19 pandemic.

Non-conformity reports are prepared by the FDC if it observes violations of the *Fiscal Discipline Law*. The reports are to be drawn up immediately after the detection of an infringement and are to be submitted to the Cabinet and the Saeima. Non-conformity reports contain recommendations for the government to

rectify the observed infringement. The FDC prepared 17 such non-conformity reports over 2014 to 2020. The reports typically pointed to expenditure ceilings being breached without adequate measures to compensate with additional revenue or spending cuts elsewhere.

In addition to the above regular publications, the FDC has published other documents under its broader mandate to assess compliance with the domestic fiscal framework. These range from comments on specific measures or reforms (for example, issues related to corporate or personal income tax reforms) to discussions on the appropriate use of certain windfall revenues. Taken together, these reports promote the role of the FDC as a fiscal watchdog that advocates prudent budgetary policies. Three reports merit a specific mention:

- In 2017, the FDC published a report on fiscal sustainability. In this highly insightful *Fiscal Sustainability Report,* the FDC reviewed long-term macroeconomic and budgetary trends up to 2037 and warned against a rapid increase in government debt, taking into account the ambitions of policymakers to bring health care and social protection standards better in line with the EU average (Fiscal Discipline Council, 2017[5]). The FDC also called for productivity-enhancing labour market reforms to improve potential growth.
- In the run-up to the October 2018 national election, the FDC provided a service estimating the impact of political party platforms on fiscal rule compliance and produced a report summarising the results. To carry out the work, the FDC surveyed interested political parties on their priority revenue and expenditure intentions. The FDC then aggregated the self-reported measures into broad public finance projections and determined whether they were likely to be at odds with the *Fiscal Discipline Law*. This increased the transparency of the budgetary impact of the different electoral promises to the public.
- Since the onset of the COVID-19 pandemic, the FDC has published a monthly monitoring report that provides an update of the economic and fiscal situation using short-term indicators. These reports have been well-received by stakeholders as they cater to the need for detailed information on macroeconomic and budgetary developments in highly uncertain times. While the reports are in principle mostly descriptive, the Council also uses them to present its views on budgetary policy against the backdrop of the pandemic.

Finally, the FDC regularly monitors infra-annual fiscal and macroeconomic developments and publishes useful tabulations and summaries on their website. For example, the FDC publishes monthly statistics of government revenue and expenditure (based on data from the State Revenue Service and the Treasury). Economic monitoring on the Council's website includes an overview of quarterly statistics as well as a heatmap of a broad range of macroeconomic indicators.

## *The FDC's influence on decisions and the public debate*

### *Influence on Cabinet decisions*

The FDC is invited on an ad hoc basis to participate in Cabinet meetings during budget discussions, where it provides opinions on fiscal discipline issues. In particular, the Chair is usually invited to be an observer of the meetings and is sometimes given the opportunity to present opinions of the Council about fiscal policies being considered by the Cabinet.

Prior to a Cabinet meeting, the FDC receives the agenda for an upcoming discussion and has a chance to consider whether any proposed fiscal actions might violate the rules under the *Fiscal Discipline Law*, which would trigger a non-conformity report by the FDC. The FDC can also simply provide its expert opinion about whether Cabinet plans constitute sound fiscal policy or not.

The Chair of the Council has been asked to provide input into Cabinet discussions on responses to the COVID-19 crisis and the FDC has been a key player in arguing for a more nuanced view of fiscal prudency

– one that recognises the importance of public spending in propping up households and firms to avoid greater damage to the public finances over the longer term. Stakeholders reported that the message encouraged the government to be bolder in its emergency response. The FDC has also urged the Cabinet to be more transparent on pandemic expenditures.

### *Influence on parliamentary debate*

Perhaps the most important channel through which an IFI can strengthen fiscal outcomes is by directly supporting the legislature's ability to hold the government to account – that is, by empowering the representatives of the public who have been elected for the full-time job of scrutinising the executive with quality information to do so. This can be accomplished by submitting reports to the legislature, participating in committee hearings, and providing background briefings to parliamentarians and their staff.

The FDC's appearances before parliamentary committees have varied over its history. Recent practice is to appear at the Budget and Finance (Taxation) Committee in the Saeima twice a year, once for the interim report on the stability programme in the spring and once for the Surveillance Report for the budget law in the autumn. The Council also occasionally appears before the European Affairs Committee (which directly considers the interim report). There are no formal requirements to appear in committee hearings.

Stakeholders reported that the Saeima recognises the independence of the FDC and that the FDC has had an influence over committee deliberations, albeit limited. A key challenge at the Saeima is a lack of capacity and support for budget analysis. In part, these challenges arise because a high turnover of members of parliament during elections means that the economic and fiscal expertise accumulated by members is lost. Moreover, there is limited analytical support available within the parliament. For the FDC to maximise its impact with the Saeima, its reports must be accessible and well-presented so that members without economics or financial backgrounds can understand and make use of the reports.

No statistics are available on how often the FDC is mentioned in parliamentary debate or how many times the FDC has appeared before the Budget and Finance (Taxation) Committee. A search of the Saeima website shows several recent references included in discussions on the budget and policy changes with fiscal costs. That said, the FDC and other stakeholders would like to see engagement with the parliament increased.

There is scope for increasing the interactions of the FDC with the Saeima by formalising them. For example, the Budget and Finance (Taxation) Committee could consent to a motion to have the FDC appear at a fixed time twice a year to present its views of the economy and public finances, either related to its main surveillance reports or not. This is the practice at the Parliament of Canada's Finance Committee, which adopted a standing motion for the Parliamentary Budget Officer to appear twice a year (Box 7). The FDC should also consider engaging more with other committees in the Parliament and parliamentary committee research support staff. These improvements may take time. Importantly, there may be an opportunity for the FDC to establish new terms of engagement with the Saeima after the next election in 2022 introduces a new cohort of representatives. To facilitate these discussions, the FDC could provide an induction programme to new Members of Parliament to explain Latvia's fiscal policy framework and the FDC's role in supporting it.

### Box 7. The Finance Committee of Canada's motion for the Parliamentary Budget Officer to appear twice a year

The Canadian Parliamentary Budget Officer's duties to respond to committee requests are prescribed clearly in the *Parliament of Canada Act*; however, regular annual appearances before the committee are not. After early years of providing evidence to the Finance Committee on an ad-hoc basis, the committee formalised the relationship by adopting a standing motion for the Parliamentary Budget Officer to appear twice a year at fixed points annually going forward:

> Consistent with the Parliamentary Budget Office (PBO) mandate to provide independent analysis about the state of Canada's finances and trends in the national economy (as outlined in section 79.2 of the Parliament of Canada Act), that the PBO provide an economic and fiscal outlook to the Committee the fourth week of October and April of every calendar year and be available to appear before the Committee to discuss its findings shortly thereafter.

Source: Minutes of Meeting No. 11 of the 1st Session of the 41st Parliament for the Standing Committee of Finance on 29 September 2011. Available at: https://www.ourcommons.ca/DocumentViewer/en/41-1/FINA/meeting-11/minutes.

#### *Influence with other public-sector stakeholders*

The FDC has developed effective two-way working relationships with several key partners, including the Treasury (a distinct entity subordinate to the Ministry of Finance that is responsible for Latvia's cash and debt management and other public finance administration functions), the Bank of Latvia, and the State Audit Office. For example, the FDC relies on high-frequency spending data from the Treasury, while the Treasury considers the monitoring notes and commentary of the FDC for its cash and liquidity reserve management.

The FDC holds meetings with the Bank of Latvia at least twice a year and collaborates on specific policy analysis issues. For example, a Bank of Latvia expert was recently brought in for the FDC's discussions on output gap modelling, and that effort subsequently helped the FDC to form an objection to the Ministry of Finance's macroeconomic forecast resulting in changes to the estimated output gap underlying the official budget.

The FDC also enjoys good relationships with the State Audit Office, and the two assist each other in overlapping areas of interest. For example, in 2018, the Audit Office awarded a record of commendation to the FDC for its co-operation in the audit of the budget planning system in Latvia.

#### *Influence through the "comply-or-explain" principle*

Comply or explain provisions in the EU surveillance framework create an obligation for a country's government to either immediately enact the advice of an IFI or publicly explain the reasons for deviating from it. Although the principle of comply or explain was not ultimately recognised in the EU's two pack of reforms on budget surveillance in 2013, it is a core tenet of the common principles for fiscal councils that the Commission developed under the authorisation of the Fiscal Compact.

Latvia's national structural balance rule is currently more stringent than the European rules. Therefore, when the FDC draws attention to the risk of a rule being violated, it is usually the case that the European rules will still be met. Therefore, the comply-or-explain principle has not been properly tested in the context of the EU fiscal framework. For compliance with the *Fiscal Discipline Act*, the government has chosen to "explain" when replying to the FDC's non-conformity reports. That said, stakeholders noted how the FDC's non-conformity reports have nonetheless been an incentive for the government to avoid non-compliance with domestic requirements and an eventual non-compliance with the EU fiscal governance framework.

### *Influence through traditional media*

For many reports, the FDC uses an outside communications consultant to prepare press releases that are sent to mass media. The FDC also tweets and holds press conferences for reports. In a typical year, the FDC will hold four regular press conferences: two conferences covering its opinion on the Ministry of Finance's macroeconomic forecasts, and two conferences covering its Surveillance Report and interim report. These press conferences are typically attended by between 10 and 15 representatives from print, TV and radio.

In general, the FDC has strong interest from media outlets and most of its public impact is achieved through these traditional channels. Journalists typically approach Council members and the Chair directly for follow-up questions.

The FDC commissioned a documentary film on Latvia's fiscal policy and the history of the FDC which is nearing completion. Having such a documentary will help with further outreach, providing more people with a better understanding of the FDC's role in the consideration of Latvia's fiscal policy.

Although the FDC does not track the level of press coverage, it was noted by several stakeholders that they had received significantly increased media coverage since the beginning of the COVID-19 pandemic, with the Chair appearing on TV, radio, internet news portals and in print. Google searches of news stories referring to the FDC in 2020 and 2021 show regular news coverage of the FDC's monthly monitoring, its opinion on the Ministry of Finance's macroeconomic forecasts and its regular Surveillance Reports and interim reports.

### *Influence through social media*

The FDC has increasingly used Twitter as a channel to disseminate the FDC's work. Although the FDC does not have a formal policy for social media, it uses tweets mainly to promote new reports and circulate media mentions of the Chair and other Council members in the news. Compared to other IFIs, the FDC has a large number of followers relative to the size of Latvia's population, in line with the Irish Fiscal Advisory Council, which is an active Twitter user (Table 17). The FDC's followers on Twitter have increased from 480 in June 2019 to 577 in April 2021.

**Table 17. Twitter followers of selected IFIs, by country**

| Institution | Numbers of followers on Twitter | Followers per million population |
|---|---|---|
| PFC (Portugal) | 646 | 63 |
| CBO (USA) | 30 600 | 94 |
| OBR (United Kingdom) | 13 200 | 199 |
| UNRR (Czech Republic) | 2 473 | 233 |
| SFC (Scotland) | 1 403 | 258 |
| IFAC (Ireland) | 1 452 | 299 |
| FDC (Latvia) | 577 | 299 |
| CPB (Netherlands) | 10 300 | 598 |

Note: Comparisons are total number of Twitter followers and may include some international followers.
Source: Authors' calculations based on Twitter followers in April 2021 and 2018 population data from OECD and National Records of Scotland.

### *Influence through the web*

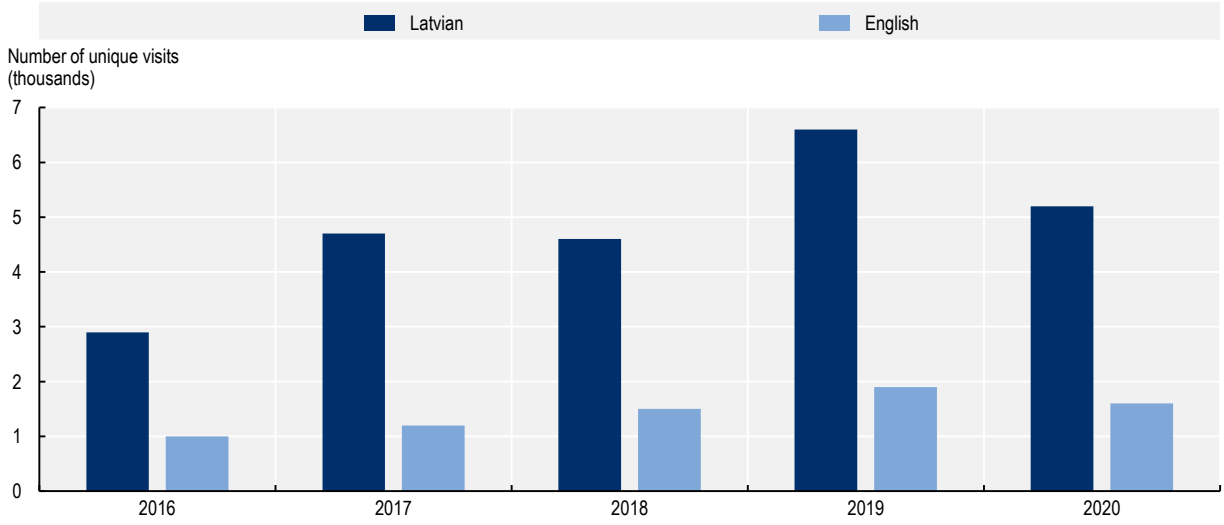
The FDC publishes all opinions and reports on its website. The website is straightforward in its design and available in both Latvian and English. The FDC aims to act transparently and publishes a wide range of information on its activities including minutes of all FDC meetings, minutes of meetings of the fiscal risks

and GDP working groups, and information on procurement activities. The FDC is currently redeveloping its website to improve accessibility and functionality, as well as the ability to monitor usage by visitors to the site, such as identifying which reports are downloaded the most and which parts of the website are accessed most frequently.

The number of visits to the FDC's website has increased since 2016 (the first year for which data are available). Despite media coverage and stakeholder take-up of monthly crisis monitoring reports, website usage fell between 2019 and 2020 (Figure 19).

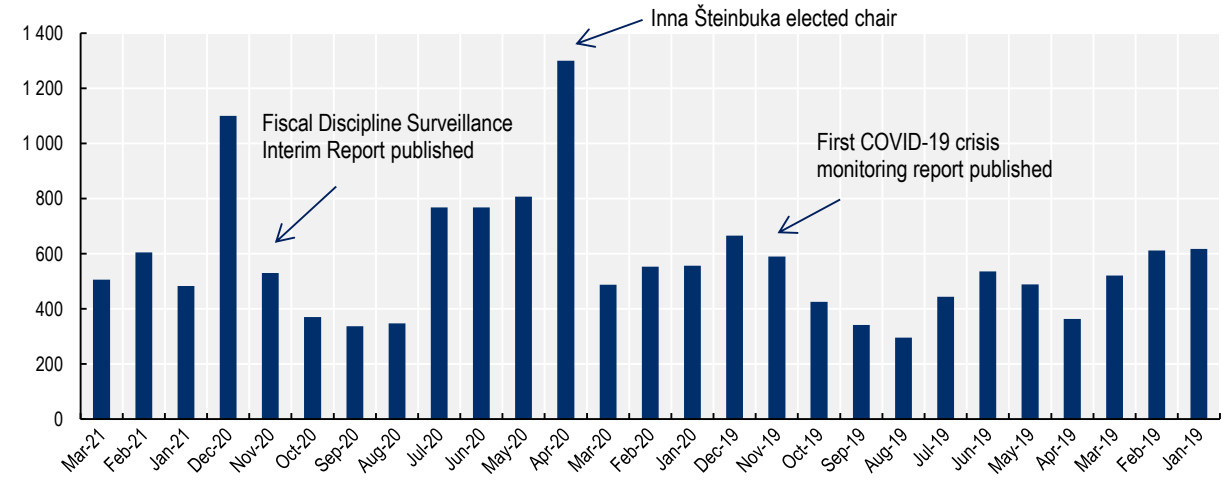
Information on monthly website usage is available since January 2019 and during this period only two months experienced more than 1 000 hits per month. The first was in April, when the Fiscal Discipline Surveillance Interim Report was published, and the second coincided with the appointment of Inna Šteinbuka as Chair of the Council in December 2019 (Figure 20). The publication of the FDC's first monthly crisis monitoring report in April 2020 coincided with the largest number of monthly hits in 2020.

## Figure 19. Visits to the Fiscal Discipline Council's website have grown, but peaked in 2019




Source: Statistics provided by the FDC.

## Figure 20. Visits to the FDC website in 2019 and 2020 (site hits per month)




Source: Statistics provided by the FDC.

## 4. Methods

# Key findings

The FDC's small staff and high turnover have prevented it from building and maintaining significant internal modelling capacity. It has instead pursued an approach of scrutinising official forecasts and comparing them to forecasts produced by other institutions. While this approach has met the requirements of the FDC's mandate, as it matures as an IFI it should strive to find staffing solutions that allow it to move to an approach where it does more independent modelling of its own. The following changes would bring the FDC's methods more in line with the practices of peers.

- The FDC should add more capacity for in-house forecasting. It has an agenda to do so and has begun receiving technical assistance through the European Commission's Directorate-General for Structural Reform Support.
- For macroeconomic assessments, any expansion should focus on simple output gap scrutiny tools, such as creating a composite index from its heatmap, as peers in Finland's National Audit Office have done. The FDC's macroeconomic assessment should also expand to cover demand and income components and subcomponents of GDP such as personal consumption expenditure and corporate profits.
- For fiscal assessments, expansion should focus on internal modelling capacity for the main tax and spending aggregates using simple spreadsheet-based revenue elasticity models, effective rates models, structural econometric models and univariate time-series models. More sophisticated techniques may be contingent on analytical capacity.
- Until that capacity is built, the FDC's current practice of scrutinising assumptions and comparing official forecasts to external GDP forecasts could be improved by including a wider source of think tanks and private banks, testing the performance of different procedures to combine them, and using that average as the basis for determining the government's probability of complying with fiscal rules, including confidence intervals based on past forecast errors and visualisations of the amount of uncertainty.

### *Introduction*

This section assesses the tools that the FDC uses to carry out its mandate. It includes a technical assessment of the tools in comparison to the ones used by peer institutions, and also highlights key issues for the FDC's research, such as addressing the question of how the FDC's effectiveness can be further strengthened taking into account its analytical constraints.

### *Assessing the IFI Team's overall approach and workflow*

For its *ex post* surveillance activities and monitoring, the FDC secretariat uses an annual monitoring model built in R software that conveniently compiles statistics from the Central Statistical Bureau of Latvia. Staff also use a fiscal rules assessment spreadsheet that is updated in co-ordination with the Ministry of Finance to independently confirm the calculations of the fiscal rules with outturn data.

For its *ex ante* functions, FDC staff do not produce macroeconomic and fiscal projections of their own. Instead, staff use an audit and external benchmarking approach. That is, they scrutinise the Ministry of Finance's forecasts for unreasonable assumptions and compare them to benchmark forecasts of other institutions such as the Bank of Latvia, European Commission, the OECD and the International Monetary

Fund (IMF). The audit and benchmarking approach was largely a necessity for the FDC, as most staff (other than the FDC's first Secretary) did not have direct experience modelling Latvia's economy and public finances.

Aside from the *Fiscal Sustainability Report* produced in 2017 with the assistance of consultants, the audit approach is also used for long-term fiscal sustainability analysis, which currently involves requesting the government's analysis of new policy measures that affect long-term sustainability and ensuring that the analysis has been prepared under prudent assumptions.

As a step toward producing independent benchmarks, the FDC has developed a heatmap indicator of the business cycle, which it uses to assess the reasonableness of the EU's commonly agreed methodology for the output gap. Stakeholders find this product to be a useful check on the EU's methodology.

Table 18 compares the FDC's methodology to EU peers with similar mandates. The FDC's reliance on scrutiny and external benchmarks is in-line with its peers in Finland and Sweden; however, Finland's IFI plans to implement in-house forecasting in the near future and many of the forecasts underlying Sweden's budget are supplied directly by independent agencies. The Irish Fiscal Advisory Council and Slovak Republic Council for Budget Responsibility produce in-house economic and fiscal forecasts.

### Table 18. Comparison of methods to peer institutions

| | Endorsing or assessing official macroeconomic forecasts | Assessing the government's fiscal forecasts | Assessing compliance with fiscal rules and fiscal stance | Assessing long-term sustainability |
|---|---|---|---|---|
| **Latvia FDC** | Largely qualitative, compares against external forecasts from other institutions and monitors recent outturn data. | Mostly monitors recent outturn data and compares with external forecasts from other institutions. | Scrutiny of government calculations in fiscal rules spreadsheets with largely replicate EU calculations. Compares to an in-house heat map. | Scrutinising government analysis of impact. Commissioned a report prepared by consultants in 2017. |
| **IFI Team of the National Audit Office of Finland** | Largely qualitative, compares against external forecasts from other institutions and monitors recent outturn data. | Mostly monitors recent outturn data and compares with external forecasts from other institutions. | Scrutinises government calculations and uses analysis from other institutions. Replicates EU methodologies and domestic calculations. Compares to an in-house heat map and composite indicator. | Not currently in work plan. |
| **Swedish Fiscal Policy Council** | Largely qualitative, compares to benchmark external forecasts from other institutions and monitors recent data. | Mostly monitors recent data and compares to benchmark external forecasts from other institutions. | Scrutinises government calculations and analysis from other institutions. | Relies on work of other research agencies such as the National Institute of Economic Research and European Commission's scenarios and analysis. |
| **Irish Fiscal Advisory Council** | Produces in-house benchmarks with a suite of supply-side macro forecasting models and output gap models. | Produces in-house benchmark fiscal forecasts using high-level error-correction models for short- and long-run elasticities applied to tax bases. Fiscal and economic interaction (fiscal feedback) model. Suite of output gap models. | Replicates EU and methodology and domestic calculations and also using its own in-house "Principles-based approach" which uses alternative estimates of potential output rather than the commonly agree methodology potential output and budget elasticities used for EU fiscal surveillance. | In-house long-run projections (30 years), alternative scenarios, sensitivity analyses. |
| **Slovak Republic Council for** | Mandate only for ex-post forecast evaluations. However, prepares own | Produces in-house benchmarks with a mix of elasticity and structural | Replicates EU methodology. Produces in-house output gap estimations, careful | In-house long-run projections, fiscal gap calculation over 50 years. |

| | | | | |
|---|---|---|---|---|
| **Budget Responsibility** | macro forecasts. Large-scale structural macro model, error-correction equations. Nowcasting models for short-term. Dynamic stochastic general equilibrium model for simulations. | econometric models, microsimulation bottom-up public finance revenue and expenditure projections for longer run. In-year estimates using seasonality. Traffic light system of risks. | identification of one-offs, Expenditure Benchmark analysis. | Detailed scenarios. Published annually. |

### *Individual model assessments*

The OECD also assessed the appropriateness of each of the FDC's individual tools along six academic and practical criteria (Table 19). Some criteria are complementary, while others conflict. For example, a structural model grounded in economic theory may score highly in its ability to provide an intuitive narrative to stakeholders but may have higher forecast errors than a simple univariate time series model that relies only on its own history. Analysts at IFIs must consider these trade-offs and strike a balance when choosing models. For this reason, the review cannot provide a total score or pronouncement on whether a model is the best tool for the analysis. Instead, reviewers weighed the assessment criteria to form an opinion on whether the FDC chose a tool that is appropriate or inappropriate for delivering the FDC's mandate in Latvia's context.

### Table 19. Summary of OECD model assessment criteria

| | |
|---|---|
| **Theory** | Does peer-reviewed literature support (or not provide a strong argument against) this tool for the analysis, given the context and available data? |
| **Accuracy** | Is this tool likely to give the most accurate results (or avoid the most systematic bias) if applied to this problem? |
| **Communication** | Can the tool's outputs provide a coherent and intuitive narrative to stakeholders? |
| **Transparency** | Can the tool's methodology and assumptions be provided to the IFI's stakeholders in a manner that will satisfy its requirements for transparency and accountability? |
| **Resources and business continuity** | Does the tool require a level of resources and expertise that is appropriate to expect from the IFI's analysts to avoid analytical disruptions from staff turnover? |
| **Precedent** | Is the approach used widely at other IFIs and public finance institutions? |

The technical assessment concluded that, although the FDC has few formal models to produce in-house research and needs to build capacity, the tools it currently has are appropriate for their specific use in the FDC's audit approach workflow. A summary list of the FDC's tools and the review team's assessment is provided in Table 20.

### Table 20. The FDC's methodology is appropriate but could be improved to meet best practices

| Model | Description | Opinion |
|---|---|---|
| Annual R model | Economic monitoring tool, with some time series statistical forecasting for consumer prices. | Appropriate, unqualified |
| Heatmap economic cycle indicator | Heat map for monitoring sectoral imbalances and the business cycle. | Appropriate, unqualified |
| Fiscal rules assessment spreadsheet | Spreadsheet calculations of *ex post* and *ex ante* fiscal rule compliance. | Appropriate, but room for improvement |

The Annual R model is suited to compiling and reshaping historical data and for limited forecasting of consumer prices. The heatmap has widespread adoption among peer IFIs and is an excellent tool for the FDC and other stakeholders to quickly understand the state of the economy relative to its trend and to use it as a sense check against the output gap as measured by the EU commonly agreed methodology.

The FDC's fiscal rules assessment spreadsheet is appropriate for its role in delivering the IFI's mandate to a basic standard. However, the FDC should further develop this approach. The calculations are technically accurate and the exercise has some benefit as an audit approach to oversight; however, the lack of an internally produced benchmark against which to assess the reasonableness of official forecasts should be addressed in the future to bring the practice more in line with peers. The FDC has a workplan to do so.

Overall, the FDC's audit approach has had considerable success in identifying irregularities and breaches of Latvia's fiscal discipline framework. However, without direct access to the Ministry of Finance's models, and with less than two weeks to review the outlook, the audit approach is suboptimal as a long-term solution for independent oversight. The FDC should strive (and is striving) to move to an approach where it prepares more independent forecasts using its own fiscal models, and eventually, to some extent, simple macroeconomic benchmarks for aggregates such as potential GDP.

The FDC has entered into a modelling development project, funded by the Directorate-General for Structural Reform Support at the European Commission to bring its modelling practices in line with peers with similar functions. There are few examples of other IFIs with four staff or fewer that maintain in-house models. If a shift to in-house modelling is to succeed with the FDC's current resources, it is likely to require considerable technical support with an eye toward using simple techniques. To sustain any sophisticated modelling capacity in the absence of regular technical support is likely to require additional financial and staff resources and a strong documentation and training plan to retain institutional memory.

### *Key issues for the FDC's workflows and models*

While the FDC's work was praised by stakeholders as being well-written, balanced and impartial, it is perceived as being driven by the expertise of the Council Members and especially of the highly engaged and well-respected Chair. Even though Council Members indicated that they are well supported by the small secretariat, this Council-driven approach contrasts with many of the FDC's European peers, whose formal opinions are grounded in the evidence and modelling of their staff and voiced under a more concrete institutional identity. It is therefore important for the secretariat to strengthen its analytical capacity to ensure that all Council opinions are underpinned with a concrete and consistent technical base that endures beyond the tenure of any specific Council members. It should do so in the following areas.

#### *Strengthening macroeconomic analysis*

For its macroeconomic analysis, the FDC's key focus should be on potential output or output gap estimates. While uncertainty around these concepts has increased during the pandemic, the output gap remains a crucial indicator for both the domestic and the EU fiscal governance. The FDC can improve its scrutiny by using the EU's tools to replicate potential output under different assumptions and by taking its heat map a step further by calculating composite indices for an alternative measure of the business cycle, as peers in the National Audit Office of Finland have done. Over a longer capacity development horizon, the FDC can build its own simple short-run GDP benchmark forecast using nowcasting libraries in R software to extend its current monitoring tool. This approach is used by peers facing similar data environments such as the Scottish Fiscal Commission.

Given the FDC's current resource constraints, developing an in-house medium-term macroeconometric forecasting model should not be a key priority. Instead, it could develop a more formal approach for its assessment of the official macroeconomic projections, for example, by determining 'tolerance margins' around the median of a set of alternative projections (candidates include the Bank of Latvia, EC, OECD, IMF, and private banks). Such margins can be anchored to past forecast errors and confidence intervals, allowing the FDC to flag cases where the official projections appear to be too optimistic or pessimistic.

The FDC's assessment of the economic outlook should also be expanded beyond real and nominal GDP, inflation and the output gap. An evaluation of the government's revenue projections requires a view of the building blocks of GDP (demand or income components, as proxies for the tax bases for key revenue items). The FDC's opinions on the official macro projections should be broadened to encompass the relevant demand and income components of GDP. In addition, a more detailed view of macro aggregates is necessary if the FDC wants to develop its fiscal forecasting capacity (see below). In the absence of a fully-fledged macroeconometric forecasting model, the FDC can form a view on the key macro aggregates using alternative scenario tests or with simple decomposition models that project GDP components according to an aggregate GDP constraint.

### *Deepening fiscal analysis*

Efforts to strengthen the FDC's analytical tools should mostly focus on fiscal topics. An increased focus on in-depth fiscal analysis could align the FDC to many of its European peers such as the Slovak Republic Council for Budget Responsibility, the Irish Fiscal Advisory Council and the Portuguese Public Finance Council and would add the most value in the Latvian context.

The FDC should develop its own fiscal forecasting platform for the period covered by the EU stability programme. Such a platform could consist of a disaggregated framework covering the most important government revenue and expenditure items. Key revenue categories can be linked to macroeconomic proxy tax bases in spreadsheet models using revenue elasticities, effective rates, structural econometric models, or other simple time series statistical forecasting methods. Expenditure projections can be anchored to the projections in the Stability Programme or by exploring different population and inflation growth scenarios and comparing those to a "no policy change" scenario. Liaising with the Bank of Latvia, which operates a fiscal projection model, would be useful for exchanging views on the appropriate granularity of the model, specific forecasting rules and key parameters.

The key advantage of having such a model is that the FDC could then move beyond its assessment of the aggregate structural budget balance (which is highly uncertain since it is linked to the output gap that tends to be revised frequently) to include assessments of individual fiscal projections. A fiscal projection model could also be used for scenario analysis of fiscal developments under different macroeconomic and policy options.

### *Deepening scrutiny of fiscal risks and the adequacy of the fiscal security reserve*

The FDC's working group for assessing the adequacy of the fiscal security reserve meets several times a year to form its view and draft a chapter on fiscal risks for the Surveillance Report. The working group's discussion consists mostly of qualitative observations of the comprehensiveness of the Ministry of Finance's declaration of fiscal risks, along with recommendations to the Ministry to expand its analysis and quantify risks it has not considered. In the most recent assessment, the working group accepted the planned margin for 2021 but postponed its opinion for the planned margins for 2022 and 2023 given the unusually high degree of unknowns brought about by the COVID-19 crisis.

The Ministry of Finance's declaration of fiscal risks is a detailed, well-produced document. The FDC would be unable to create comparable independent analysis of its own, which requires detailed administrative data and considerable staff resources. The working group's qualitative discussions and application of members' own judgment to determine gaps in the Ministry's quantitative assessments has been appropriate. However, if the FDC secretariat builds internal forecasting capacity, it will open up new potential for expanding the risk assessments – an area that the FDC would like to explore in greater detail.

To refine its risk analysis, the FDC could consider the following list of options for developing its risk assessment capacity. The options are drawn from discussions with peer IFIs that have similar mandates

for risk assessment reports, such as the Office for Budget Responsibility in the UK, and discussion papers and best practices from international organisations.

- **Scenario analysis and sensitivity tables**. The secretariat could support the working group by using its new fiscal forecasting capacity to provide scenario analysis and sensitivity tables that estimate the consequences of specific or general economic and fiscal developments on the budget balance. Of particular use would be scenarios with alternative assumptions for risks that the Ministry's declaration assumes to be symmetric (and thus do not need to be accounted for in the fiscal security reserve). For example, interest rates have a zero (or slightly negative) lower bound but considerable upside risk. The FDC's fiscal forecasting model can be expanded to include a detailed model for public sector debt, capturing outstanding maturity structures and effective interest rates on government bonds to assess the sensitivity of borrowing costs to interest rate developments, or to assess liquidity and refinancing risks with approaching debt rollover events.
- To support the scenario and sensitivity analysis, the FDC can **maintain a database of historical vintages of the Ministry's risk assessments**, including a central registry of estimates of loans and guarantees over their life. Using this database, the FDC can calculate summary statistics of past risk estimates such as the mean and mode and any bias in revisions. These statistics may show that supposedly symmetric risks are in fact evolving over time asymmetrically. The FDC can then apply these statistics at a high level to the Medium Term Framework Law to arrive at alternative projections of how much of the budget balance is at stake to determine a more appropriate fiscal safety margin if necessary.
- The FDC can also use historical forecast errors of the official budget forecasts to apply a probability distribution to the projections in the Medium Term Framework Law to **create fan charts that illustrate confidence intervals for achieving medium-term budget objectives**. These fan charts will give a sense to the adequacy of the fiscal security reserve for guarding against both known and unknown risks. This technique requires little data other than past budgeted and implemented amounts, which are publicly available. Fan charts of this type were used in the early days of the Portuguese Public Finance Council and Canadian PBO before they developed in-house modelling capacity and signed data access agreements.
- The fiscal forecasting capacity the FDC is developing will have demographic-based drivers for social insurance and social benefits that can be used to **simulate unforeseen demographic risks**, including changes to immigration rates, which tend to be the most sensitive driver of demographics. Currently, the government treats demographic risks as symmetric, but it is unlikely that the immigration rate and birth rates are of equal risk of unexpected increases and decreases. Demographically sensitive expenditure categories can be easily extended beyond the three-year framework law for long-term risk analysis and the FDC can eventually complement these projections with detailed cohort models, which are under development at some of the FDC's peer IFIs and could be part of wider capacity development co-operation.
- The secretariat could provide **quantitative assessments of high-level structural risks** that are not currently captured by the declaration, such as the impact of changes in "growth-corrected interest rates" (the difference between the interest rate and the growth rate) on long-term debt sustainability calculations. Such calculations were provided in the UK Office for Budget Responsibility's first Fiscal Risks Report (OBR, 2017[6]).
- The secretariat could **review the annual corporate plans and financial statements of state-owned companies** for any risks that have not been reflected in the fiscal risks declaration.
- If the FDC has a different opinion on the likelihood of a risk crystallising under the Ministry's probability scale, the FDC could **establish an agreement with the Ministry of Finance for the Ministry to provide alternative estimates under the FDC's preferred assumption**. The FDC could then publish the alternative estimate in its Surveillance Report. The OBR in the UK has a long-

standing practice of requesting departments to re-estimate results with their alternative assumptions and then presenting them as scenarios in OBR reports.

- The FDC could **create a public consultation process and put out a request for expert assistance on evaluating risks that it believes are inadequately covered in the declaration**. For example, the OBR in the UK recently put out a public consultation to find experts on assessing the ongoing risks of the pandemic (looking for experts in the nascent field of macroeconomic epidemiology – the study of the interaction between the economy and pandemic control measures like lockdowns) and for assessing the risk of climate change on the public finances (OBR, 2021[7]). Through these requests for expertise, the FDC may be able to form a partnership with a university or policy school and serve as a platform of public influence for that research.
- As part of ongoing discussions about reforms to European fiscal rules, one proposal that could be a lead option is to set standards according to a probability-based risk management approach that uses **stochastic debt sustainability analysis** (Blanchard, Leandro and Zettelmeyer, 2021[8]). These standards are intended to be a more holistic measure of debt sustainability that balances risks for fiscal sustainability against risks to the macro economy if governments withdraw fiscal support too abruptly. The FDC could offer to serve as a contact point for testing risk-based approaches to fiscal rules for the EU surveillance framework and apply the techniques in its risk declaration assessment.

## 5. Financial and human resources

### Key findings

Stakeholders universally reported that they perceive Council members as having few secretariat resources to support them. This is confirmed with cross-country comparisons against peer IFIs. Further, legal authority to hire permanent secretariat analysts is granted each year in the state budget through annual discussions with the Ministry of Finance and therefore relies on the goodwill of the government.

The FDC's sufficiency of resources and its staff funding independence should be reviewed to align closer to the OECD Principles for IFIs. Specifically:

- The *Fiscal Discipline Law* should be amended to explicitly authorise the FDC to be supported by "a secretary and staff" instead of only mentioning the Secretary. This would provide greater certainty and protection for ongoing secretariat support. The secretariat's funding should be protected in real terms in a similar manner as the existing remuneration of Council members and the Secretary.
- The compensation of the Chair and Council members should be reviewed and adjusted to adequately reflect the commitment of the positions.

### *Introduction*

According to the OECD Principles, an IFI must have resources commensurate with its mandate to fulfil it in a credible manner (Principle 4.1). This section assesses the extent to which the Fiscal Discipline Council has sufficient human and financial resources, as well as whether those resources are predictable and sustainable.

### *Financial resources*

The budget for the FDC is determined by the rules laid out in the *Fiscal Discipline Law* that set minimum levels for:

- Remuneration of Council members
- Remuneration for one Secretary
- Expenses for external expert consultants
- Reimbursement of travel expenses incurred by Council members to attend FDC meetings.

To protect the budget across time, the Law also defines automatic indexation of remuneration, tying it to inflation of wages and expenditures in the public sector. Of note, the *Fiscal Discipline Law* does not provide for staffing beyond the sole Secretary in charge of administration.

The minimum funding for the FDC prescribed by the *Fiscal Discipline Law* is paid from the budget of the Ministry of Finance, which separates and protects the expenditure of the FDC as a separate line, or "budget institution". Since 2016, the Ministry of Finance has also provided the FDC with resources for additional staff above the funding prescribed by the Law. This amount is the result of an agreement between the FDC and the Ministry of Finance, initiated by the former Chairman of the Budget and Finance (Taxation) Committee of the Saeima, in response to the need to increase analytical resources of the secretariat to fulfil the broadening of the FDC's mandate to include endorsing macroeconomic forecasts. The agreement is authorised each year in the annual budget law. In total, the agreement with the Ministry of Finance currently provides for four staff members: the Secretary, a macroeconomic expert, a fiscal risks expert, and an administrative professional.

The funding for the FDC is approved on a year-to-year basis, but stems from three-year plans within the Medium Term Budget Framework Law. This multi-year plan provides a form of commitment to the FDC's budget. That said, as the authorisation for any staff beyond the Secretary does not have a permanent legislated basis, the secretariat's existence ultimately relies on the goodwill of the government to provide for it in the annual budget law. The State Audit Office flagged this risk as part of its 2016 audit of the FDC and recommended that a more permanent solution for funding the FDC's secretariat be found. To achieve a more permanent solution, the *Fiscal Discipline Law* should be amended to specify that the Council is to be supported by an adequate secretariat with a minimum baseline of funding that is indexed to inflation. For example, the legislation of the Irish Fiscal Advisory Council sets a baseline level of funding that provides for several secretariat analysts (with the exact number left for the Council to manage within the budget) and a growth factor to ensure that the baseline is preserved in real terms (Box 8).

### Box 8. The Irish Fiscal Advisory Council is given funding for a robust secretariat in legislation

The Irish Fiscal Advisory Council's budget is set in legislation under the *Fiscal Responsibility Act 2012* and paid directly out of the state's central fund. Section 6 of the Act specifies that the Council's budget is capped at a maximum of EUR 800 000 per year in 2013 prices, which is then indexed to increase each year with inflation (specifically the Harmonised Index of Consumer Prices). The Act prescribes that the Council may "appoint such and so many persons to be members of staff of the Fiscal Council, and on such terms, as may be determined by the Fiscal Council" and that staff "shall be paid out of the moneys at the disposal of the Fiscal Council."

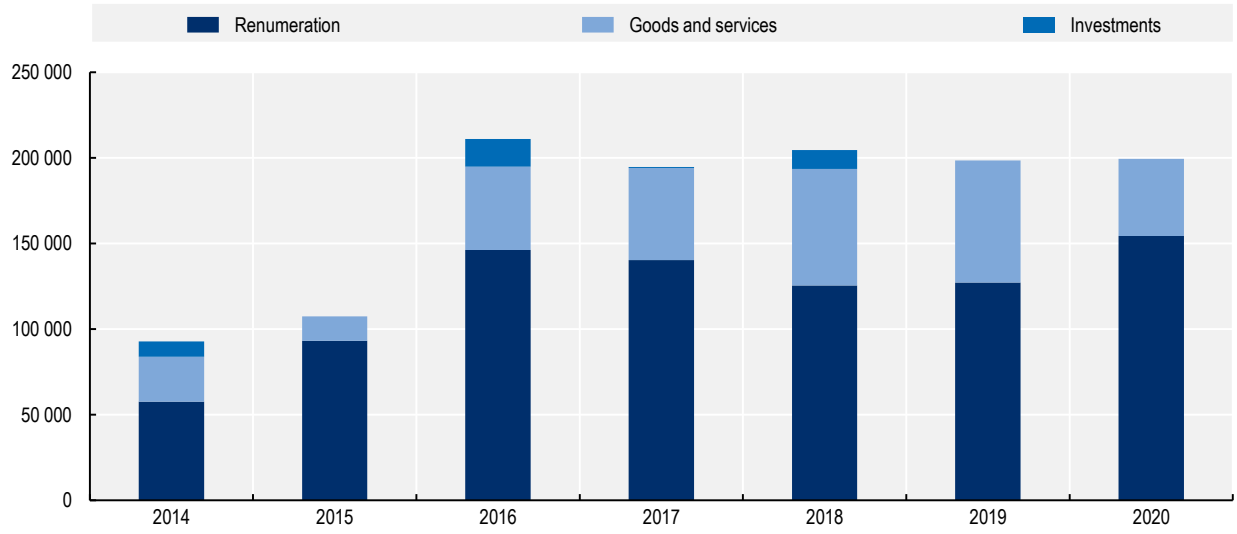
This arrangement protects the Council's independence, as it is not subject to annual decisions by either the government or Oireachtas (national parliament of Ireland), and it guarantees multi-annual stability of funding in line with the OECD Principles.

Since the mandate to endorse the official macroeconomic forecast was added in 2016, the FDC's annual budget has totalled approximately EUR 200 000 (Figure 21). The budget is regularly set in three main categories: salaries, goods and services, and investments such as computers and office equipment. Within these categories, the FDC has flexibility to determine how the funding is used, provided the rules of remuneration in the *Fiscal Discipline Law* are followed.

In 2020, remuneration accounted for approximately 80% of total expenses, of which around 16% (EUR 25 500) was for compensating Council members to attend meetings. During periods of understaffing, spending on consulting services rose and remuneration fell. If needed, the FDC may ask the Ministry of Finance to reallocate resources and use potential savings in services to increase remuneration, or vice versa. As an example, an expert consultant for a tax report was payed out of the remuneration category instead of the services category in 2020. The Ministry of Finance has generally accommodated the FDC's requests for resource reallocations in the past. To preserve the FDC's operating independence, the Ministry of Finance should continue to accommodate the FDC's internal resource management decisions in line with Principle 2.5 of the OECD Principles for IFIs, which says that leadership should have full freedom to hire and dismiss staff in accordance with applicable labour laws.

## Figure 21. The FDC's budget was increased in 2016 to endorse the macroeconomic forecast

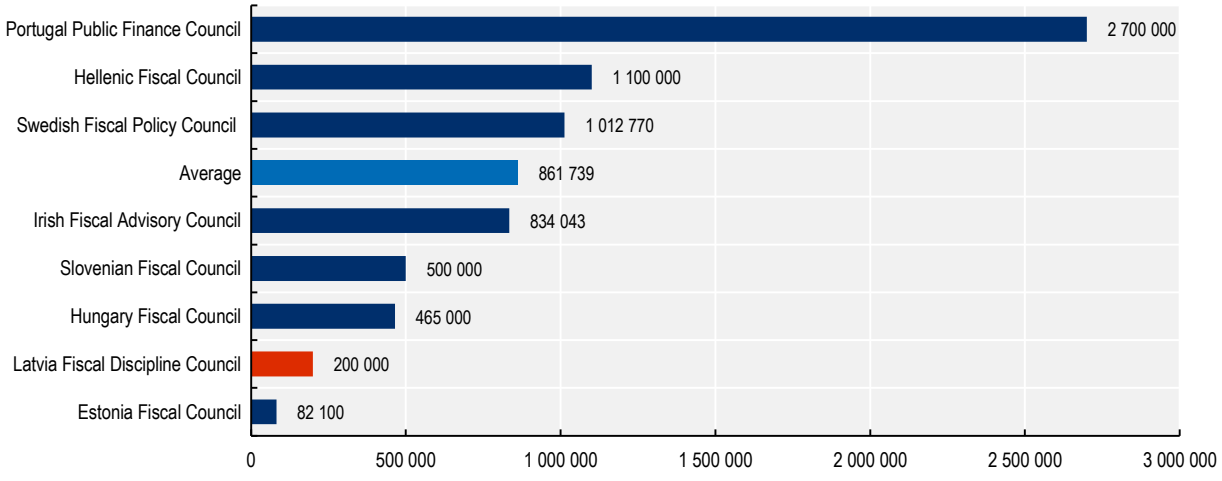
In euros




Compared to other fiscal councils with similar makeups and mandates, the FDC's financial resources are among the lowest (Figure 22). Only the Estonian Fiscal Council has a smaller budget; however, the Estonian Fiscal Council receives considerable support from the Bank of Estonia in which it sits and this assistance is not included in its budget total. This cross-country comparison is limited, as it does not adjust for country-specific differences in salaries and the cost of living.

## Figure 22. Financial resources of EU IFIs with similar functions to the FDC

In euros




Note: Exchange rate conversion: one Swedish Krona is EUR 0.099.
Source: OECD IFI Database 2021 (Forthcoming).

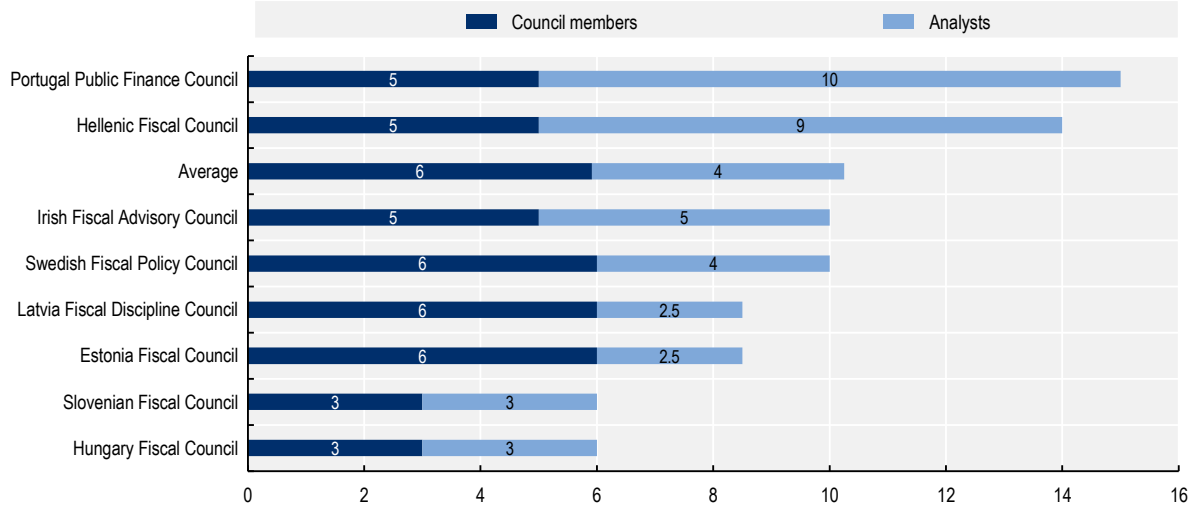
### *Human resources*

When the FDC was established, the designers of the *Fiscal Discipline Law* had in mind that the analytical work and drafting of reports would be carried out by Council members themselves without the need for analytical staff (only one Secretary for handling general administration was envisioned). At the same time, compensation for Council members was capped at low levels, for example 72 hours per year under recent practice. The lack of research staff or incentives for Council members to invest a significant amount of their own time meant that initially the FDC was unable to maintain a strong analytical underpinning for the Council's opinions to ensure that they were consistent and applied under a well-documented framework across time.

That shortfall was partially addressed by increasing the number of approved staff by three in 2016 and increasing the FDC's budget to remunerate them. In total, the FDC now has the Secretary, two analysts, and an administrative position within the secretariat to support the Council. With the Secretary devoting roughly half of their time to administration tasks this leaves roughly 2.5 full-time equivalent employees responsible for analysis at the FDC. This places the FDC's secretariat staff resources among the lowest of EU IFI's with similar mandates (Figure 23).

The secretariat has gender balance amongst employees: half are women and half are men. The Council, on the other hand, has only one female member out of the six, the Chair. The nomination procedure for future Council members should pay special attention to this aspect of the Council's composition.

**Figure 23. Council and analysts compared to peers (full-time equivalent)**




Source: OECD IFI Database 2021 (forthcoming).

### *Key issues for financial and human resources*

#### *Sufficiency of secretariat support and fiscal expertise*

The level of resources provided to the FDC after 2016 are sufficient to deliver its basic mandated tasks of monitoring the government's compliance with the *Fiscal Discipline Law* and endorsing macroeconomic forecasts. However, the FDC's resources are insufficient to support it in pursuing its wider mandate to give "an opinion about any fiscal issue that the Council deems to be important to ensure overall compliance with that law" and the provision requiring that "the Council shall assess and analyse the sustainability of

the State fiscal policy." Conducting the activities that are typical for independent fiscal councils in delivering such responsibilities is likely to require additional permanent staff positions.

Providing greater flexibility for the FDC's leadership to determine their own balance between outside consulting services and permanent staff positions and to increase the number of secretariat analysts closer to the average of its peers would significantly aid the FDC's efforts to build capacity and support the sustainability of its current technical assistance programme.

### *Remuneration of Council members*

The members of the Council receive remuneration in conformity with the *Law on Remuneration of Officials and Employees of State and Local Government Authorities* and in proportion to the length of time worked, subject to a limit. The hourly wage rate of Council members is tied to the national average monthly wage (lagged by two years) published by the Central Statistical Bureau and should not exceed 50% of the monthly average wage in the country.

The hourly remuneration of Council members is relatively competitive (EUR 56.22 in 2020, based on the 2018 average monthly wage of EUR 1 004). However, the hours of work that are compensated are limited and do not reflect the time that Council members invest. The *Fiscal Discipline Law* sets a level of remuneration that assumes only six Council meetings per year, with eight hours of preparation for each meeting. Since 2016, the Ministry of Finance has provided funding for an additional two meeting days for the working groups. In total, the compensated effort related to the preparation of Council meetings, including the work of the working groups, is limited to 72 hours per year. The compensation for Council members in 2020 varied between EUR 3 500 and EUR 4 300. This is below the compensation offered at other peer IFIs. For example, the Chair of the Irish Fiscal Advisory Council is provided with a set rate of EUR 20 520 per year and other Council members are provided with EUR 11 970 (OECD, 2021[9]). Although average wages and the cost of living in Ireland are considerably greater than Latvia, a gap remains. The limit on annual compensated hours for Council members should be raised to better reflect the analytical commitment that is expected of them and the Council should be provided with funding in a manner that allows it to determine its own activities such as working group meetings, without detailed discussions with the Ministry of Finance.

As it stands, the ability of the Fiscal Discipline Council to fulfil its mandate depends on the Chair devoting considerable uncompensated time to Council work. Stakeholders noted that the Chair must be available at all times to communicate the FDC's outputs and that they must be deeply involved in the preparation of material for Council meetings. The OECD Principles recommend that the position of an IFI head should preferably a full-time position. In the case of smaller institutions like the FDC, it is not unusual that, given the overall financial resources available, such an arrangement is impractical. Nevertheless, the total available hours of compensation for the FDC's Chair should be raised to attract a wider range of candidates who will not be discouraged by the considerable voluntary time commitment required of them to keep the FDC operating successfully.

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## Note

[1] Throughout, "FDC" will be used to indicate the institution that includes both council members and secretariat staff collectively. "Council" will be used when it is necessary to distinguish council members themselves, and "secretariat" will be used for the staff that support council members.

# Annex 1.B. Acknowledgements

The review team would like to thank Latvia's Fiscal Discipline Council and all stakeholders who contributed evidence and insights to this review, in particular individuals from the following institutions and groups who met with the review team during its virtual discussions in February 2021:

- Saeima (Parliament of the Republic of Latvia)
  - Chair and members of the Budget and Finance (Taxation) Committee
- Ministry of Finance
  - Adviser to the Minister of Finance
  - Economic forecasting team
  - Fiscal policy team
- Bank of Latvia (Latvijas Banka)
- State Audit Office of the Republic of Latvia
- State Treasury of Latvia
- Academics and think tanks
  - Latvian Institute of International Affairs
  - University of Latvia's Faculty of Business, Management and Economics
- Commercial bank forecasters
- European Commission Latvia desk
- IMF Latvia desk
- Representation of the European Commission in Latvia
- Media
- Fiscal Discipline Council
  - Council members and chair
  - Expert Panel
  - Former council members and staff
  - Secretariat

# OECD Review of the Irish Fiscal Advisory Council

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This review was originally published on 16 February 2021 and reflects the situation at that time. This version has been reformatted and lightly edited from the original to be in line with the OECD Journal on Budgeting guidelines. The EU Structural Reform Support Programme (SRSP) provided funding for the review.

**JEL classification:** E62, H60, H61, H68

**Keywords:** surveillance of public finances, independent fiscal institutions, fiscal council, Irish Fiscal Advisory Council, oversight of fiscal policy, Ireland

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## Abbreviations and acronyms

| | |
|---|---|
| CAM | EU Commonly Agreed Methodology |
| C&AG | Office of the Comptroller and Auditor General |
| COSMO | A new COre Structural MOdel for Ireland |
| CSO | Central Statistics Office |
| DPER | Department of Public Expenditure and Reform |
| EC | European Commission |
| ESRI | The Economic and Social Research Institute |
| EU | European Union |
| EU-IFIs | EU Independent Fiscal Institutions (autonomous network) |
| EUNIFI | EU Network for Independent Fiscal Institutions (initiated by EC) |
| FAR | Fiscal Assessment Report |
| FTE | Full-Time Equivalent |
| FRA | Fiscal Responsibility Act |
| GDI | Gross Domestic Income |
| GDP | Gross Domestic Product |
| GVA | Gross Value Added |
| HICP | Harmonised Index of Consumer Prices |
| IFI | Independent Fiscal Institution |
| IMF | International Monetary Fund |
| NESC | National Economic and Social Council |
| PBO | Parliamentary Budget Office |
| PBO Working Party | OECD Working Party of Parliamentary Budget Officials and Independent Fiscal Institutions |
| SPU | Stability Programme Update |
| VAT | Value Added Tax |

## Executive summary and recommendations

The Irish Fiscal Advisory Council was formally established in 2012 to help strengthen Ireland's fiscal framework after the 2007-08 global financial crisis. In addition to functions, such as assessing and endorsing the government's forecasts and assessing compliance with fiscal rules, the Council also assesses the government's fiscal stance.

The Council performs well relative to international standards, meeting or exceeding the OECD Principles for Independent Fiscal Institutions and EU-IFI Minimum Standards in all areas except those relating to its leadership arrangements and legal underpinning for access to information. Over almost ten years, the Council has helped strengthen fiscal management in Ireland. For example, it has developed new tools, tailor-made for the Irish economy, for assessing compliance with fiscal rules and measuring the output gap; these have also been adopted by other key stakeholders. Furthermore, its reports and outreach activities have improved the awareness of fiscal issues among the wider public. These achievements are noteworthy given the small size of the Council and are facilitated by its skilled and ambitious Secretariat. The Council demonstrates high levels of transparency regarding its methodologies and is perceived as independent and non-partisan.

A summary of key issues and recommendations regarding the future functioning of the Council follows:

- **Budget**: The Council's budget is fixed in legislation and indexed to price inflation to protect its independence. However, the Council's mandate has expanded since the ceiling was set and its main costs - such as public sector salaries - have grown at a faster rate than price inflation. The Council is now approaching its budget ceiling, a situation which is already affecting staffing levels and which could in the future affect its ability to deliver its legal mandate.

  *Recommendation:* An IFI must have a budget commensurate with its mandate to be able to fulfil its functions in a credible manner (OECD Principle 4.1). Indexing the budget ceiling to key expenditure items would help protect the real value of the Council's funding. It would also be prudent to build in periodic review of the budget ceiling and indexing mechanism to ensure sustainability.

- **Leadership**: All Council members are part-time, including the Chair, who is appointed from among Council members. Given the Chair is also the public face and accountable officer for the Council, this role can be particularly challenging to balance with other work commitments. Member vacancies on the Council can also have a significant impact on its ability to function effectively.

  *Recommendation:* The role of accountable officer could be transferred to the Head of the Secretariat, allowing Council members to focus on delivering the core mandate. Advertising the Chair role as up to half-time instead of part-time could also provide greater clarity on the significant time commitment that the post demands. The Deputy Chair role could furthermore be formalised in legislation and be associated with greater responsibilities to strengthen the collective nature of the Council. To protect the Council's ability to function when there are member vacancies, flexibility to extend the terms of existing members until new members are recruited could be introduced, as well as provisions for the Deputy to become Acting Chair if the Chair position is vacant.

- **Governance requirements:** The governance requirements for the Council are quite burdensome given its small size. Existing arrangements for external audit weigh particularly heavily. While good governance helps ensure the integrity and credibility of the Council, it also places demands on the time of key personnel, such as the Chair and Head of Secretariat, which could otherwise be focussed on delivering the Council's core mandate.

  *Recommendation:* Governance requirements for the Council should be alleviated where reasonable. For example, the approach to external audit could be more proportionate to the size of the Council. The Council could also spread management responsibilities more broadly across the institution. As well as greater responsibilities for the Deputy Chair, one of the Economists could

be given a Deputy Head of Secretariat role. This would also provide an opportunity to improve succession planning and alleviate risks related to any change in leadership.

- **Access to information**: Access to information works well in relation to the Council's endorsement function but continues to be a challenge for its broader functions. While the government shows goodwill in relation to the Council's requests, some important data is not systematically published or provided to the Council in a timely manner.

  *Recommendation:* An IFI should have full access to all relevant information in a timely manner (OECD Principle 6.1). It would be useful if the Council set out a statement of data needs and extended its Memorandum of Understanding (MoU) to cover all of its functions.[1] To align with international peers and continue to operate sustainably and effectively, the Council should have a statutory right of access to information.

- **Staffing**: The Council does not have a large staff budget and relies on being able to attract young and highly skilled staff in order to function effectively. However, the staff grading structure can only be changed with prior consent of the Minister for Finance and this can hinder the ability of the Council to attract secondees and retain promising junior staff.

  *Recommendation:* The leadership of an IFI should have full freedom to hire and dismiss staff (OECD Principle 2.5). Greater autonomy over its staff grading structure, together with increased budget flexibility, would better enable the Council to attract and retain highly skilled staff. The Council needs to pay special attention to ensuring gender equality in its staffing.

- **Medium- to longer-term fiscal issues**: The Irish budget process largely has an annual rather than a medium-term focus and this is likely to be exacerbated in coming years, given the immediate pressures that COVID-19 is putting on government finances. Stakeholders have suggested that the Council could help bring greater attention to important medium- to longer-term fiscal issues.

  *Recommendation:* The Council should seek to further strengthen its annual budgetary analysis and work, highlighting medium- and longer-term fiscal issues, including through continued publication of its new Long-term Sustainability Report. This will be particularly useful in the context of the difficult fiscal choices that the COVID-19 crisis is likely to bring in the years ahead. These developments may require more resources or a reallocation of resources.

## Introduction and methodology

This Review is the second independent external review of the Irish Fiscal Advisory Council. It provides a detailed assessment of how the Council is performing against international standards, including the OECD Principles for IFIs and EU-IFI Minimum Standards, and assesses the context, resources and independence, outputs and methodologies and the impact of its work. Based on this assessment, it provides options and recommendations to strengthen the institution in light of national developments and international experience.

**Section 1. Context** outlines the context in which the Irish Fiscal Advisory Council operates. This includes information on why the Council was established, its mandate, governance structure, relations with other institutions and adherence to international standards. **Section 2. Resources and independence** provides an assessment of the resources and independence of the Council. It covers aspects such as the Council's funding, human resources, access to information and independence. **Section 3. Methodology and outputs** provides an assessment of the Council's methodology and outputs. It identifies key issues for the Council's outputs and an assessment of key activities relative to peers. Finally, **Section 4. Impact** highlights the impact of the Council in terms of its influence on the public debate, the parliamentary debate, enhanced fiscal transparency and improved fiscal management.

### *Methodology*

The methodology for this review is anchored in the OECD Principles for Independent Fiscal Institutions (OECD, 2014[1]) and a subsequent evaluation framework elaborated within the OECD Working Party of Parliamentary Budget Officials and Independent Fiscal Institutions (PBO Working Party). Principle 9.1 of the OECD Principles for Independent Fiscal Institutions states that:

> *"IFIs should develop a mechanism for external evaluation of their work – to be conducted by local or international experts. This may take several forms: review of selected pieces of work; annual evaluation of the quality of analysis; a permanent advisory panel or board; or peer review by an IFI in another country."*

The Network of EU Independent Fiscal Institutions (EU-IFIs) reaffirmed this OECD Principle in their document Defining and Enforcing Minimum Standards for Independent Fiscal Institutions (2016).

The evaluation framework takes as a starting point internationally agreed standards (e.g. the OECD Principles). As such, the review assesses the Council against these standards, benchmarks it against peer institutions in OECD countries and, where possible, identifies the difference it has made. The framework covers four main elements:

- **Context**, the institutional setting and mandate of the Council.
- **Inputs**, human and financial resources, access to information and independence.
- **Outputs**, the Council's core products, including effectiveness of the methodology.
- **Impact**, of the Council's work, including effectiveness of communications and stakeholder confidence.

The evaluation framework follows a performance framework approach used by governments globally and leverages conventional evaluation tools such as stakeholder interviews and peer review.

#### The review team

The OECD review team included two members of the OECD Secretariat's Public Management and Budgeting Division in the Directorate for Public Governance, two international experts from Denmark and Sweden, and one local expert (see Annex 1.C for more information). A member of the European Commission's Directorate-General for Structural Reform Support (DG REFORM) also participated. The review was informed by a pre-mission questionnaire issued to the Council. Virtual visits for stakeholder

interviews were undertaken in June/July 2020 (see Annex 1.D for more information). The review also draws upon contributions from other relevant members of the OECD Secretariat and peers within the PBO Working Party.

## 1. Context

### *Introduction*

This section looks at the context in which the Irish Fiscal Advisory Council (hereafter 'the Council') was established as well as its legal mandate and evolutions in its functions over time. It highlights the Council's governance structure and key accountabilities, including the external audit requirements and its relationship with the Irish Parliament (the Oireachtas). It then looks at the relationship that the Council has with other peer institutions in Ireland as well as with the global independent fiscal institution (IFI) community. Finally, the chapter profiles the extent to which the set up and design of the Council adheres to international standards.

### *The establishment of the Council*

The Council was set up on an interim basis in July 2011 as part of the institutional response by the Irish authorities to the 2007/8 global financial crisis, with the goal of improving fiscal sustainability through enhanced budgetary oversight. The costs of the crisis were particularly high in Ireland. Irish fiscal policy had been pro-cyclical for some time, with tax revenue and the budget deficit particularly sensitive to the rapid deterioration in economic conditions. This coincided with the Irish government having to bail out the private banking system following the collapse of a credit bubble. As the country was unable to access international bond markets to fund the government deficit, Ireland requested financial assistance from the European Commission (EC), the European Central Bank and the International Monetary Fund (IMF). The agreement involved Ireland entering into an Economic Adjustment Programme in return for financial assistance. As part of this, Ireland agreed to establish an IFI to provide independent assessment of the government's budgetary position and macroeconomic and budgetary forecasts.

Ireland is a member of the euro-area and subject to its system of fiscal governance, most notably the Stability and Growth Pact and its subsequent reforms and extensions. Because of the timing and circumstances of the Council's establishment, its creation helps the Irish government align with requirements of the European fiscal framework, particularly the interpretation and application of fiscal rules.

The Council was formally established as an independent statutory body through the Fiscal Responsibility Act (FRA) that came into effect in December 2012 (Box 9).

### Box 9. The Fiscal Responsibility Act of 2012

The Fiscal Responsibility Act (FRA) was introduced as part of Ireland's Economic Adjustment Programme after the global financial crisis. It aimed to strengthen Ireland's national fiscal framework and ensure compliance with strengthened EU fiscal governance arrangements.

The FRA has two key components. First, it provides the legal basis for a domestic medium-term budget framework and fiscal rules consistent with EU rules. Specifically, it sets out a budgetary rule, debt rule, medium-term budgetary objective and a correction mechanism.

Second, it provides for the establishment of the Irish Fiscal Advisory Council. The FRA includes provisions relating to its functions, membership, the term of office and appointment process for initial members, provisions for member resignation and termination of office, remuneration, staffing, funding, accounts and audit arrangements, relationship to Oireachtas Committees and annual reporting requirements.

The Council's legal establishment followed a period of consultation. The Joint Committee on Finance and the Public Service of the Oireachtas analysed different options for establishing an IFI. The Joint Committee recommended establishing two independent fiscal oversight bodies. The first was an economic advisory council that, it was theorised, could play a role in identifying the cyclical state of the Irish economy at a given time, and the distribution of macroeconomic risk factors centred on the annual budget. Given the macroeconomic environment, it could make recommendations concerning the overall budgetary stance also. The second body was a separate budgetary review council, focused upon the medium term, which could monitor compliance with the specified and adopted fiscal rules and make recommendations concerning the appropriate adjustment path for the economy in the event of non-compliance with those rules. It was theorised the budgetary review council might make an *ex post* evaluation of the conduct of fiscal policy over the preceding year. However, the Department of Finance instead favoured the creation of a single body to consider fiscal policy more generally.

The model chosen mirrors the Swedish Fiscal Policy Council, with a smaller Council of five rather than the Swedish Council's six members. The Irish Council replicated the principle of including non-national Council members to expand the range and experience of potential members given similar challenges with the small size of the potential pool of candidates in Ireland. Similar to Sweden, it combined this with a highly specialised professional secretariat focused exclusively on fiscal policy. This model was seen as economical with part-time Council members and a part-time Chair, and a leaning towards choosing academics as Council members.

The development of the Council took place over several governments. The original discussions and public debate around forming an independent body, or bodies, tasked with budgetary oversight began during a Fianna Fáil/Green Party coalition, and the Council was established formally by a Fine Gael/Labour Party coalition. The Council continues to enjoy support across the political spectrum in Ireland and benefits from broad national ownership. It is widely perceived as independent in its analysis from the political system, with recommendations of the Council based upon their technical expertise applied to their mandate in law. Stakeholders reported that fiscal management in Ireland has improved since the global financial crisis, and that the establishment of the Council has helped contribute to that.

### *The Council's mandate and ongoing evolutions*

The Council's functions were set out in the FRA. The Act set out that the primary role of the Council is to provide independent assessments of the government's fiscal and economic projections, monitor the government's compliance with fiscal and budgetary rules, and assess whether the government's fiscal

stance is conducive to prudent economic and budgetary management. The Council delivers this core mandate through the publication of Fiscal Assessment Reports in the Spring and Autumn.

In order to comply with new EU regulations, the Council's mandate was further enhanced in 2013 through the Ministers and Secretaries Amendment Act. These changes gave the Council an endorsement function in relation to the official macroeconomic forecasts underlying national medium-term fiscal plans and the draft budget. The Council formally and publicly endorses – where it deems such endorsement appropriate – the forecasts produced by the Department of Finance. The first endorsement letter was issued on 6th October 2014 and endorsement letters have since followed the revised European budgetary cycle. A summary of the Council's functions is provided in Box 10.

### Box 10. The Council's functions

The Council's mandate and its attendant functions are set out in the enabling FRA, and were further enhanced through the 2013 Ministers and Secretaries Amendment Act. The key functions of the Council are:

1. To assess the official forecasts prepared by the Department of Finance. These are the macroeconomic and budgetary forecasts published by the Department twice a year – in the stability programme update (SPU) in the spring and in the budget in the autumn.
2. To endorse, as it considers appropriate, the macroeconomic forecasts prepared by the Department of Finance on which the budget and SPU are based.
3. To assess whether the fiscal stance of the government is conducive to prudent economic and budgetary management, including by reference to the EU Stability and Growth Pact.
4. To monitor and assess compliance with the budgetary rule as set out in the FRA. The budgetary rule requires that the government's budget is in surplus or in balance, or is moving at a satisfactory pace towards that position.
5. In relation to the budgetary rule, to assess whether any non-compliance is a result of "exceptional circumstances". This could mean a severe economic downturn and/or an unusual event outside the control of the government that may have a major impact on the budgetary position.

In addition to its legally mandated functions, the Council publishes outputs on its own initiative. It has made particular efforts to publish work that helps to improve understanding of fiscal policy among the Irish public. Among stakeholders there is a sense that, relative to its size, the Council has been able to exert influence in this area, helping the public realise the importance of, and impact from, economic and fiscal policy in their lives.

The Council tries to raise awareness of weaknesses in the Irish fiscal framework, and highlight concerns relating to major fiscal risks and large budgetary issues. For example, one of the continued weaknesses in Ireland's fiscal framework relates to the annual focus of fiscal planning. The Council aims to encourage greater consideration of the medium-long term through regularly covering issues such as pensions, demography, and climate change in its reports. It also published its first Long-term Sustainability Report in 2020.

Another factor which impedes good fiscal planning in Ireland is the conflicting information that is presented to the public on how much budgetary room the government has within the bounds of the fiscal framework. To help overcome this, the Council started publishing "Stand-Still" Scenarios in 2018 that provide estimates of the cost of maintaining today's level of public services and benefits in real terms over the medium term. The Council has also recently developed a "Fiscal Space Calculator" that will be published in early 2021. This aims to set the parameters of the budget debate more clearly, and will also allow stakeholders to

adjust policy (tax, spending and Rainy Day Fund decisions) to test the fiscal impact of their own preferred policy mix.

An area where there are ongoing demands for the Council to undertake further work is more detailed annual budgetary analysis. The Council's work looking at large annual overspends in health in recent years and how they have been funded through higher than expected corporation tax revenues has been well-received. Stakeholders would like to see the Council undertaking more detailed annual budgetary analysis to help avoid mistakes of the past and inform better decision making. The COVID-19 crisis is likely to give rise to difficult budget policy choices in the years ahead, adding further weight to the Council increasing its work in this area.

Since the Council was established, there have also been ongoing discussions about the need for independent costings of policy proposals from political parties and groups in the Oireachtas. Although some originally looked to the Council to carry out this function, the Oireachtas Parliamentary Budget Office (PBO) was established in 2017[2] with a view to it undertaking this role. The 2020 Programme for Government ("Our Shared Future") specifically allocates this costings function to the PBO.

### *The Council's governance structure and key accountabilities*

The Council is an independent statutory body, governed by its Chair and Council members. While the Chair is appointed by the Minister for Finance, the Council has also decided to informally create a Deputy Chair role. This serves as a backup in case the Chair is unavailable for a specific task or is unable to fulfil their duties due to unforeseen circumstances (e.g., illness).

The Council decides its own procedures. The staff of the Secretariat report to a Head of Secretariat (also the Chief Economist) who in turn reports to the Council. The Council sets its own work programme in accordance with its mandate. Council members and Secretariat staff are subject to the Code of Practice for the Governance of State Bodies and the Council has developed its own Code of Conduct that outlines the agreed standards of principle and practice and includes a section on conflict-of-interest.

The Chair is formally the accountable officer for the Council. Other international peer institutions, such as the Hellenic Fiscal Council, the Portuguese Public Finance Council and the Slovenian Fiscal Council, also have the Chair as the accountable officer. However, these institutions all have full-time Chairs. In other institutions, including the Swedish Fiscal Policy Council, the Danish Economic Council, and the Czech Fiscal Council, the Head of Secretariat is the accountable officer.

The part-time nature of the Chair's role in Ireland could give rise to challenges in handling the governance and administrative requirements associated with being the accountable officer. To help alleviate this, the Chair is supported by key Secretariat staff (the Head of Secretariat and Administrator) and an Audit and Risk Committee (further detailed below). Administrative responsibilities include: developing internal policies, managing the shared services agreement with the Irish Economic and Social Research Institute (ESRI), processing payments, procuring goods and services, undertaking internal audit and control, organising human resources, ensuring legal compliance, handling communications, organising events and complying with reporting and audit requirements.

In relation to reporting requirements, the Council prepares a triannual Strategic Plan and evaluates its progress against it. To ensure oversight and accountability of the Council's work, the FRA sets out that the Council should prepare an Annual Report of its activities during the year. This is provided to the Minister for Finance, with a copy also laid before the Oireachtas. The Council also prepares an annual Chairperson's report to the Minister. Furthermore, the Council pro-actively engages in independent external assessments of its performance in line with OECD Principle 9.1 on external evaluation, most recently a peer review published in 2015, and now this Review.

In terms of audit requirements, the Council has an internal audit process that covers both financial and procedural elements. In addition, as the Council receives non-voted public expenditure, it is subject to an annual external audit by the Office of the Comptroller and Auditor General (C&AG). The nature of this audit is further detailed in Section External audit arrangements.

To help fulfil the Council's governance and audit requirements, it has set up an Audit and Risk Committee, chaired by one of the Council members and normally comprised of a further two members. This Committee meets four times a year and reviews the quarterly Management Accounts, organises and reviews the annual C&AG audit, updates and reviews the Council's Risk Register, and reviews Council policies, such as its Anti-Fraud Policy and its Business Continuity and Disaster Recovery Plan.

The volume of the work related to governing an independent institution places a significant burden on the small Council. Moving the accountable officer role from the part-time Chair to the full-time Head of Secretariat could give the part-time Chair and Council members the ability to focus their more limited time on overseeing the Council's mandated outputs, mirroring arrangements in a number of peer OECD IFIs. The Council could also look at options to spread the governance burden more broadly through increasing the responsibilities of the Deputy Chair and giving one of the Economist's an additional Deputy Head of Secretariat role to help fulfil these tasks. This would also give an opportunity to build greater succession planning and alleviate risks related to any change in leadership.

### *External audit arrangements*

The Council is audited by the C&AG annually in accordance with Section 10 of the FRA. Sections 10 (1) to 10 (3) of the Act require the Council keep accounts of receipts and expenditure, and to submit them for audit by the C&AG. The Council must give a copy of the accounts to the Minister, who in turn must lay the accounts before the Oireachtas. Section 10(4) of the FRA then requires the C&AG to undertake an annual audit in relation to these accounts.

The Council undertakes its internal audit in January and the external audit usually involves the C&AG being on site in the Council's premises for two weeks generally in May and extensive interactions over the following weeks. After several weeks, the Council receives the draft audit for review. The audit comes during one of the peak times for the Council, given that it also publishes its bi-annual Fiscal Assessment Report (FAR) in June.

All regulatory authorities whose audits are conducted by the C&AG are subject to the same audit regime and this oversight mechanism is stringently applied by the C&AG, despite the relatively small size of the Council. The C&AG has certain mechanisms it can use to minimise the regulatory burden of the audit. For example, it can change the materiality threshold. For the 2019 audit, the C&AG used a level of materiality that it is 2% of the Council's total income (EUR 16 000) and 2% of its total assets (EUR 3 800). The C&AG can also introduce cyclical control testing for institutions which it deems to be low risk and where significant issues have not arisen in the past as is the case with the Council.

There are clear benefits from such a rigorous auditing process, in terms of encouraging internal rigour, promoting transparency, bolstering credibility and increasing public trust in the Council. However, there are also costs for the Council, including the administrative burden of the audit on such a small organisation – the Council is the smallest institution in Ireland to be audited by the C&AG. The audit requirements for the Council are greater than those faced by international peers (Box 11).

### Box 11. External annual audit requirements in select IFIs across the OECD

**Danish Economic Council:** The Council's budget for 2020 is EUR 3.84 million. The institution is subject to an annual external audit by the National Audit Office (Rigsrevisionen). The audit takes about one week, although this time is spread out over two to three months due to iterations with the ministry and questions from the Audit Office. The whole audit is done digitally, without the Audit Office coming on site. Once every three or four years the Audit Office make special inquiries in a certain area, such as payroll. The Council does not have any flexibility as to when the audit is undertaken and the auditors usually change from year to year.

**Swedish Fiscal Policy Council:** The Council's budget for 2020 is EUR 1.05 million. The institution is subject to an annual external audit by the Swedish National Audit Office (Riksrevisionen). In general, changes to individual budget items that are larger than 10% are commented on in the audit report. The Audit Office spends around 60 hours on the audit, half in the Autumn, and half in the Spring, and the head of administration at the Council spends around 80 hours on the audit, also divided equally between the Autumn and the Spring. Previously the Audit Office would spend around three days on site, however the whole audit is now conducted digitally. The Council does not have any flexibility as to when the audit is undertaken, but it does not take place at peak times and the auditor is usually the same for three years and then changed, with a well-established protocol to hand over to the next auditor.

**UK Office for Budget Responsibility (OBR):** The OBR's budget was EUR 3.85 million in 2019-20. The OBR annual accounts are subject to annual external audit by the Comptroller and Auditor General at the National Audit Office (NAO). The materiality threshold for the audit is GBP 68 600 (2% of budget expenditure). In total, the audit takes around two months to complete. The OBR schedules one week to cover key elements of the audit, although correspondence is always electronic. The NAO only goes onsite to test payroll and transaction processing systems, a service provided to the OBR by HM Treasury. The timing of the audit is agreed in advance, and usually sits outside periods of peak workload for the OBR.

A fundamental change to the audit requirements placed on the Council would require a change to the FRA. In this instance, audit requirements could be more closely matched with other smaller regulatory bodies in Ireland that are not subject to an audit conducted by the C&AG. However, even within the existing legislative framework, there are some adjustments that could be made to the audit process to help the Council given its small size. For example, at present, the C&AG prioritises its audit procedures around the larger institutions that it audits. Taking into account – and avoiding – the peak work times for the Council would be very helpful. In addition, trying to ensure continuity in the external audit team over consecutive years would reduce help reduce the annual demands of the audit on the Council. Cyclical control testing may also be considered.

#### *Relationship with the Irish Parliament (Oireachtas)*

Under the FRA, the Council is accountable to the Oireachtas. There are several requirements associated with this governance arrangement:

1. Firstly, as mentioned above, the Council is required to produce an Annual Report for the Minister who then forwards a copy to be laid before each House of the Oireachtas (Article 13).
2. Secondly, the Council is also required to submit a copy of its audited accounts before each House of the Oireachtas each year. The C&AG also makes a report to the lower house (Dáil Éireann) with respect to the correctness of the sums brought to account by the Council. Oireachtas Committees can also request that the Chair give evidence on its accounts, and a Committee of either House of

the Oireachtas can request that the Chair account for the performance of the functions of the Council.

3. Thirdly, the Oireachtas also has a role in protecting members of the Council from dismissal by the Minister for Finance without cause. The FRA states that a Council member cannot be removed from office by the Minister unless a resolution for their removal is passed by the Dáil Éireann.
4. Finally, the Council appears before the Oireachtas Committee on Budget Oversight at least bi-annually to give evidence in relation to its FAR, and it may also appear before other Oireachtas Committees as requested.

The Council appears before the Oireachtas Budgetary Oversight Committee in relation to its technical reports on three occasions per annum:

- In June, after the publication of its spring FAR
- In September, after the publication of its Pre-Budget Statement
- In December, after the publication of its autumn FAR

There have been some other occasions when the Council has been asked to appear before an Oireachtas Committee. For example, the Council was asked to appear before a Special Committee on the COVID-19 Response in June 2020. Stakeholders commend the Council for always making itself available to parliamentary stakeholders. All of the Council's appearances before Oireachtas Committees are public and televised.

The impact of the Council's technical reports on the parliamentary debate is presented in Section 4. Impact.

### *Relationship with other institutions in Ireland*

The Council has developed productive working relationships with a number of Irish institutions. In addition to its regular contacts with the Department of Finance and Department of Public Expenditure and Reform (DPER), the Council regularly engages with the Central Statistics Office (CSO), the Revenue Commissioners, National Treasury Management Agency, Irish Government Economic and Evaluation Service, and other departmental teams working on social benefits and health. In general, these exchanges allow helpful clarifications and facilitate the provision of information feeding into the Council's analysis.

There is a small but strong academic and think tank community in Ireland, which features prominently in public debates. Staff at the Council Secretariat frequently engage with academics, often through Council members. Some stakeholders suggested the Council could increase engagement with universities in the interest of business continuity (ensuring both a supply of interested researchers for the Secretariat and Council members).

The Council engages informally peer-to-peer with the think tank community and participates regularly in the Dublin Economics Workshop (DEW) Economic Policy Conference. The Council also hosts an annual "Path for the Public Finances" conference that helps build bridges with interested stakeholders. It is predominantly attended by those on the policy side, including government departments, the Central Bank of Ireland, the ESRI, and other international IFIs.

The Council interacts with private sector organisations such as commercial banks and rating agencies with an interest in the Council's work for its implications for markets, particularly fixed income markets which react to expectations for sovereign interest rates and the stability and reliability of public borrowing and government solvency.

The Council's relationship with three institutions deserves particular attention: the ESRI, the Oireachtas PBO, and the National Economic and Social Council (NESC).

### *Economic and Social Research Institute (ESRI)*

The ESRI is an independent and non-partisan think tank created in 1960 to conduct research that informs economic and social policy in Ireland. The Council is co-located with the ESRI and has a service level agreement under which the ESRI provides it with its offices and support for financial administration, information technology, and human resources. The service level agreement has business benefits for both institutions. However, there is some hesitation by the Council to access services related to financial administration, IT support, and human resources because of the charges incurred for each interaction and the suitability of the advice for the Council's purposes. The ESRI and the Council should continue to periodically revisit this agreement considering value for money and the Council's evolving needs.

Collocation within ESRI provides opportunities for staff interaction and cross-fertilisation. Proximity allows for both informal interaction and more formal professional development opportunities through seminars and conferences. Co-location could also have drawbacks, were groupthink and convergence of views to take hold. However, having a Chair and Council members located outside the ESRI helps counteract that possibility.

### *Oireachtas Parliamentary Budget Office (PBO)*

The Oireachtas PBO was set up in 2017, but was formally created by the Houses of the Oireachtas Commission (Amendment) Act 2018 and put on a statutory basis 1 January 2019. The PBO is a unit within the Houses of the Oireachtas Service and is mandated to provide the Oireachtas and its committees with economic and fiscal information, and independent and impartial analysis and advice. Its functions are in support of parliament, specifically on topics related to: the macro-economic conditions in the State; developments affecting the public finances; the management of the public finances; and the financial implications of policy proposals. The PBO does not have a mandate to evaluate official forecasts or compliance with fiscal rules.

Like the Council, the PBO has the flexibility to undertake self-initiated analysis in the areas covered by its mandate. The PBO must also fulfil requests for analysis it receives from either House of the Oireachtas or its Committees (particularly the Budget Oversight Committee) if the area is related to its mandate. The Council, on the other hand, is not required to respond to requests from the legislature.

The PBO has a statutory obligation to provide independent advice on macroeconomic and fiscal conditions. This means that, while it could and should consider the research of the Council, it would act against the principle of analytical independence to rely on the Council's analysis exclusively – that is, the PBO is free to comment on the Council's analysis, use the analysis of other researchers, and take a view of its own.

Further, the PBO provides rapid analysis of the budget and Stability Programme Update (SPU) to assist members in scrutinising the government's plans in real time. By contrast, the Council's scrutiny of the budget and SPU are more detailed and its reports are often released weeks after the PBO provides its analysis and the Dáil has considered the budget and SPU – that is, the reports fulfil different needs for stakeholders.

Some stakeholders expressed concerns that the PBO and the Council publish analysis on similar topics, with the potential for overlap and mixed messages. As both bodies have analytical independence, it would be inappropriate to co-ordinate messaging to ensure consistency between them. In the past, the Council and the PBO have informally exchanged drafts of their reports that reference each other's work in the past to avoid technical errors or misrepresentations. This process, which has precedents internationally, appears to function well but may benefit from becoming more formalised.

*The National Economic and Social Council (NESC)*

The Prime Minister (Taoiseach) and government receive strategic advice on economic, social, and environmental policy from the NESC, which the Taoiseach appoints for three-year terms. The NESC appointees represent a diverse range of business, trade unions, civil society and government stakeholders. The NESC is supported by a Secretariat of around eight policy analysts that draft reports according to a work programme steered by the NESC and the Department of the Taoiseach.

Table 21 compares the Council with NESC and the Oireachtas PBO. Key differences relate to the general focus of each institution. In addition, there are differences in the autonomy that each institution has over its work programme and the audience for their analysis. The Council has complete autonomy over its work programme, providing it fulfils its statutory reporting and endorsement roles. The PBO, on the other hand, is required to respond to the analytical requests of Parliament, including potentially requests to assess the research of the Council and NESC. NESC must work within the work plan steered by the Department of the Taoiseach and respond to requests from the Taoiseach.

### Table 21. Comparison with similar domestic institutions

| | Irish Fiscal Advisory Council | Oireachtas PBO | NESC |
|---|---|---|---|
| **Year established** | 2011 | 2018 | 1973 |
| **General focus of mandate** | Economic and fiscal oversight, assessing official forecasts, compliance with fiscal rules and fiscal stance. | Economic and budgetary analysis, policy costings. | Research relating to economic and social policy. |
| **Type of analysis** | More in-depth, nuanced research. | More rapid analysis. | More bold analysis and blue sky thinking. |
| **Audience for analysis** | All stakeholders in Ireland's national and EU budgetary architecture. | Mainly parliamentarians and Oireachtas committees. | The Department of the Taoiseach, and the Irish government. |
| **Analytical impartiality** | Yes | Yes | Partially |
| **Autonomy over work programme** | Yes, mandate requires Council to make an endorsement and publish two reports a year, but outside of that can accept or refuse requests for analysis. | Partially, must serve legislative requests for analysis, although legislation also provides for self-initiated reports. | Partially, work programme steered by Department of Taoiseach priorities, although some flexibility for self-initiated reports. |
| **Transparency** | All research published, no confidential reports. | Research published following presentation to the legislature. | Submitted to government before approval for publication. |
| **Budget** | EUR 820 000 | EUR 880 000 (not including central services provided by Parliament) | EUR 1 876 000 (not including central services provided by government) |
| **Analytical staff** | 5 | 12 | 8 |

Source: Institution websites and annual reports.

### *Engagement with the international IFI community*

The Council has been actively involved in the international IFI community. The Chair plays a leadership role as Deputy of the autonomous Network of EU Independent Fiscal Institutions. Members of the Network from younger IFIs have reported that the Council's Secretariat has been a particularly willing and open source of technical expertise assisting their establishment. Moreover, the Council has been a regular and active member of the Commission-organised informal EUNIFI initiative since 2013. The Council is also an active participant in the OECD PBO Working Party.

Peer IFIs have mentioned that Ireland is particularly proactive in promoting co-operation, valuing the Council's contributions to international working groups. The Council has also provided good benchmarks against which to measure their IFI's methodology and outputs.

### *Adherence to international standards*

IFIs have diverse functions and resources guided by country-specific circumstances and, for European IFIs, supranational commitments. Despite this diversity, there is broad agreement on standards to ensure the independence and good functioning of IFIs, such as those defined in the OECD Principles for IFIs (OECD, 2014[1]) and the document on Defining and Enforcing Minimum Standards for Independent Fiscal Institutions (EU Independent Fiscal Institutions, 2016[2]). These standards provide useful benchmarks against which to evaluate the Council.

Annex Table 1.E.1 in Annex 1.E evaluates the Council against the OECD Principles for IFIs. Overall, the Council performs well relative to international standards. This lends the Council credibility among peers and legitimacy as part of the EU framework of economic and fiscal monitoring and stability. The Council meets or exceeds the OECD Principles and EU-IFI Minimum Standards in all areas except those relating to its leadership arrangements and legal underpinning for access to information (these are both discussed further in Section Influence on the parliamentary debate). In addition, when the EU Commission assessed IFAC's adherence to the independence safeguards and mandate requirements stipulated in the Fiscal Compact, it concluded on overall compliance (European Commission, 2017[3]).

### *Conclusions and recommendations*

The Council was set up in July 2011 to help Ireland respond to the fiscal challenges associated with the global financial crisis. The Council helps Ireland to improve fiscal sustainability through enhanced budgetary oversight. It also ensures that Ireland aligns with requirements of the European fiscal framework. Although its establishment was agreed as part of the Economic Adjustment Programme overseen by the EC, European Central Bank and the IMF, the Council is viewed as a national institution and benefits from cross-party political support.

The Council provides independent assessment and endorsement of the government's fiscal and economic projections, monitors the government's compliance with fiscal and budgetary rules, and assesses the government's fiscal stance. The Council also publishes work at its own initiative. As part of this, the Council tries to encourage more of a medium- to longer- term approach to budgeting and recently published its first Long-term Sustainability Report. It is also developing a fiscal space calculator to complement its previous work framing fiscal debates and has focussed attention in recent years on prominent budgetary issues such as health overspends. Continued work in this space is welcomed by stakeholders, particularly since the COVID-19 crisis will give rise to difficult budgetary choices in the years ahead.

The Council is an independent statutory body, governed by its Chair and Council members. A key challenge is the governance and administrative requirements associated with being an independent institution in Ireland. The Chair, Council members, Head of Secretariat and Administrator devote a significant amount of resource to tasks such as developing and updating corporate policies, financial processing, procurement, hiring, and communications. Moving the accountable officer role from the part-time Chair to the full-time Head of Secretariat could give the Chair and Council members the ability to focus their more limited time on overseeing the Council's mandated outputs. The Council could look at options to spread the governance burden more broadly through increasing the responsibilities of the Deputy Chair and giving one of the Economist's an additional Deputy Head of Secretariat role to help fulfil these tasks. This would also give an opportunity to build greater succession planning and alleviate risks related to any change in leadership.

A further challenge for the Council relates to its annual external audit by the C&AG. While the rigorous annual audit is a legal requirement and provides clear benefits in relation to public trust in the Council, the burdensome nature of the audit seems disproportionate to the size of the institution and is greater than that experienced by peers. There are some adjustments that could be made to the audit process to make it less onerous for the Council.

Ireland has a number of institutions that receive public funding to undertake economic and/or budgetary analysis, including the Council, the PBO, NESC, and the ESRI. Stakeholders expressed concerns about overlap between the work of the Council and the PBO, however the work of each institution is found to serve distinct purposes. Nevertheless, to ensure that each institution represents each other's work accurately, there could be merit in establishing more formal arrangements to exchange draft reports that refer to each other's analysis before publication.

## 2. Resources and independence

### *Introduction*

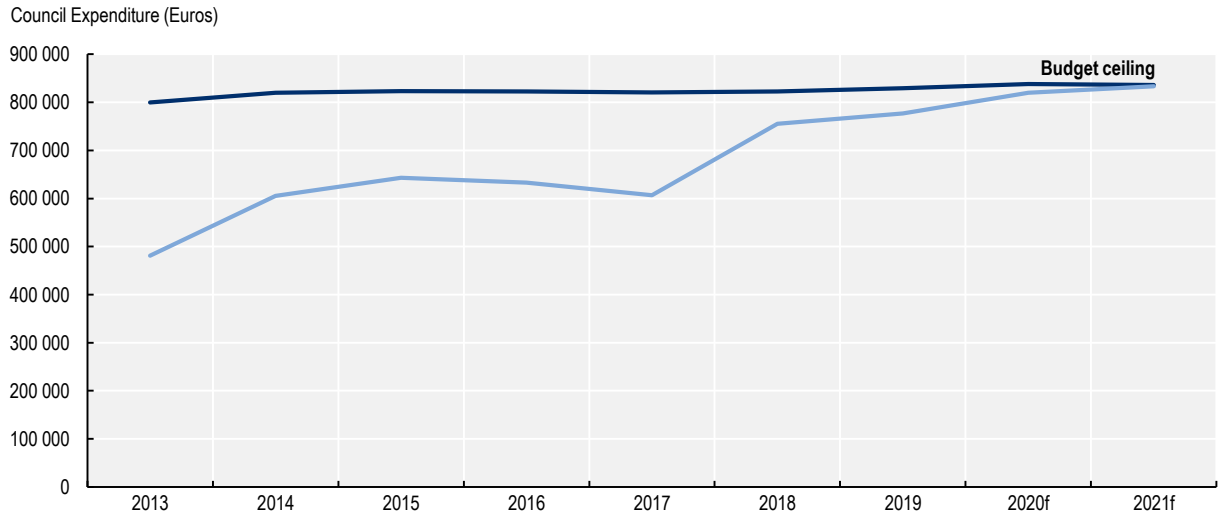
This section examines financial and human resources of the Council, assessing their reasonableness at present, as well as in light of expected requirements in the coming years. The OECD Principles set out that an IFI must have sufficient financial resources to ensure that it can perform its tasks satisfactory (Principle 4.1). The section also provides an assessment of the Council's independence, given that non-partisanship and independence are prerequisites for an IFI to be successful (Principle 2.1). The final part of the section assesses the Council's access to information, which underpins any IFIs ability to undertake robust analysis (Principle 6.1).

### *Funding*

The Council's budget is set in legislation under the FRA and paid directly out of the state's central fund. This arrangement protects the Council's independence, as it is not subject to annual decisions by the Oireachtas. The budget is capped at a maximum of EUR 800 000 per annum (2013 prices) indexed to inflation, specifically the Harmonised Index of Consumer Prices (HICP). This arrangement guarantees multi-annual stability of funding conducive to the independence of the Council, in line with best practice set out in the OECD Principles. However, the sustainability of the arrangement depends on the budgetary cap being sufficient given that changes require amending the Council's enabling legislation.

Since the Council was initially established its mandate has expanded[3], without an increase in its funding. In addition, key costs for the Council – particularly public sector salaries - have risen faster than HICP inflation. As a result, the Council's expenditure levels are now running very close to the budget ceiling, a situation which is already impacting staffing levels and which could impact its ability to deliver its legal mandate (Figure 24).

## Figure 24. Council expenditure vs budget ceiling




Note: Figures for 2020 and 2021 are forecast.
Source: Irish Fiscal Advisory Council, 2020.

If the use of an index was designed to protect the real value of the Council's funding, consideration should be given to using an index more closely linked to the cost of key items that make up the Council's expenditure (especially public sector salaries) rather than solely HICP inflation. This would allow the Council to continue to have sufficient resources to deliver its mandate and function sustainably as an effective and credible institution, in line with OECD Principle 4.1. It would also be prudent to build in a mechanism to allow periodic review of the sufficiency of the Council's budget ceiling and indexing mechanism in the years ahead, e.g., every five years.

### *Human resources*

#### *The Council*

There are five members of the Council including the Chair. The Council's enabling legislation states that members are appointed by the Minister for Finance, and that the Minister should have regard for competence and experience in macroeconomic or fiscal matters and for gender equality on the Council. In practice, when a Council position is set to become available, there is a call for applications. A selection committee is then formed, consisting of four to five members: one or two representatives from the Public Appointments Service, a representative from the Department of Finance, the Council Chair and an external stakeholder. The selection committee reviews the applicants and draws up a shortlist of three candidates. The Minister for Finance then appoints from the shortlisted candidates. The other candidates remain cleared for appointment for up to two years, ensuring that there is a pool of candidates to cover any other vacancy that arises. The use of this selection committee to help with the appointment of Council members helps ensure a tradition of appointing members with a strong technical standing.

The standard term of office for Council members is four years. Members cannot serve more than three consecutive terms[4] but are otherwise eligible for reappointment. The terms of initial Council members were staggered so that their terms did not come up for renewal at the same time. This would normally ensure continuity and an institutional memory within the Council.

The Council was recently facing a short-term issue whereby it may have had to have gone a number of months with just two members who were relatively new to the role. This would have given rise to serious

continuity issues. The situation arose because Council members' terms were finishing at the end of 2020, including the Chair. To avert this situation, the new coalition government took two actions. First, it passed legislative amendments that meant that outgoing Council members (including the Chair) could be appointed for a third term. Second, it advertised for new Council members in late 2020 and appointed two new members with effect from 1 January 2021.

To prevent a similar situation arising in the future, the government should ensure more timely appointment of replacement members. Once a smooth transition between existing and new members is secured, the government may also wish to revisit the ongoing need for allowing members to have a third term. For exceptional circumstances, a solution more aligned with international practice would be to allow the terms of existing members to be extended until the new members are recruited. This has helped where there have been delays in the appointment of new members at IFIs in Sweden, Italy and Slovakia.

Council members are not required to be Irish and the Council has to date always included members based outside of Ireland. An international presence enhances the Council's objectiveness by providing an outside perspective. The greater ability to work virtually coming out of COVID-19 may also facilitate international experts to join the Council. However, some stakeholders expressed a preference for the Chair in future to at least be based in Ireland in order to engender domestic ownership.

The OECD Principles recommend that leadership is remunerated and preferably full-time (Principle 2.4). Being a member of the Irish Council is a part-time commitment. Members of the Council tend to be recruited from academia, and the extent to which their employer reduces their academic responsibilities to enable them to undertake the role varies. It is not unusual for Council members to dedicate significant personal time to the role. This holds in particular for the Chair who is the accountable officer for the Council, and for whom the workload often corresponds up to a half-time position.

In addition to the Chair's role as accountable officer, they are also the face of the Council for key stakeholders including the parliament, the media and the public. In this role, the Chair requires to be available at short notice, and needs the ability to communicate complex issues in simple terms to enable successful messaging. Given the demanding nature of the role, a number of peer IFIs have decided to employ a half or full-time Chair, including a number of similarly sized institutions such as the Slovenian Fiscal Council (where the role is legally at least half-time, currently full-time), the Czech Fiscal Council (where the role is full-time) and the Hellenic Fiscal Council (where the role is full-time).

Despite the unique requirements of the Chair role, there is no separate recruitment process for the Council Chair in Ireland. Instead, the Minister for Finance appoints the Chair among the Council members. Given the significant additional responsibilities associated with this role, and the different skills that are required in order to fulfil it, there could be merit in advertising the Chair as a separate position, as is the case in peer institutions such as the Slovak Council for Budget Responsibility (Box 12). This would allow a more specific job description to be posted, helping attract a pool of candidates with the capacity and skills to undertake the role. If the Chair retains the accountable officer role, the post could also be advertised as a half-time position instead of a part-time position. Although this would have small budgetary consequences, it would ensure that both the Chair and their second employer have a more realistic understanding of the commitment involved.

### Box 12. Separate recruitment of the Chair of the Slovak Council for Budget Responsibility

The Slovak Council for Budget Responsibility is led by a Fiscal Responsibility Board comprising three members, including a full-time Chair and two part-time Board members. The Chair is recruited separately from other Council Members. The job specification details the knowledge and skills required for the leadership role, including expertise in relation to public finance and economic policy, the ability to make decisions and act independently and the ability to communicate effectively to the media, general public and international organisations. Shortlisted candidates are invited for a public hearing before a committee chaired by the parliament's Budget Committee Chairperson. The committee recommends up to three candidates to the Minister for Finance, from which one is selected and nominated for approval by parliament.

Remuneration is currently set at EUR 20 520 per year for the Chair and EUR 11 970 for regular Council members. Because of the "One Person One Salary" principle in Ireland,[5] Council members working in the public sector do not receive any additional compensation for their work at the Council. Instead, their employer receives the board fees, and it is assumed that the primary workload of the Council member is correspondingly reduced. However, as previously indicated, not all employers accommodate a reduced workload in practice. In such cases, Council members' commitment to the role rests on it being an attractive role to undertake personally or professionally.

Although the Council has informally had a Deputy Chair for a number of years, there are no formal provisions for an Acting Chair if the Chair resigns, as occurred at the end of 2019. The Council responded by nominating the longest-serving Council member and Deputy Chair as Acting Chair, and this was subsequently confirmed by the Minister for Finance. However, the period when the Acting Chair had no formal authority exposed a weakness in the Council's legal provisions. It would be helpful if arrangements for this situation are formally set out in legislation, as is the case in peer IFIs such as the Portuguese Public Finance Council (Box 13).

### Box 13. Formal arrangements for an Acting Chair at the Portuguese Public Finance Council

In Portugal, the Public Finance Council (CFP) is governed by a five-person Senior Board. The members of the Senior Board are the President, the Vice-President, one executive member and two non-executive members. The Council's enabling legislation sets out the functions of the Vice President as follows:

- To replace the President of the Senior Board in non-executive functions in the event of absence or impediment.
- To give previous opinion on the calling of the Senior Board and on the issues to be dealt with.
- To take part in the parliamentary hearings and press conferences.

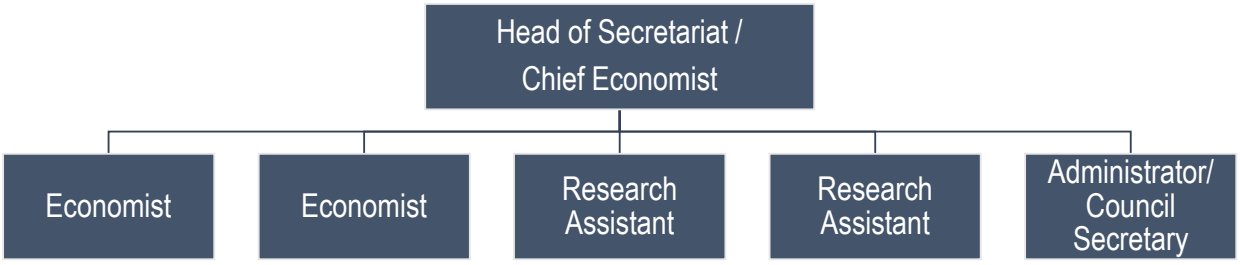
To perform any other functions conferred by the internal regulations.

#### *The Council Secretariat*

The Council's Secretariat has taken a number of years to reach its full complement. In 2013, the first full year of operation for the Council, the Secretariat consisted of three full time staff, hired on secondment from the ESRI and the Central Bank. By 2015, the Secretariat had doubled in size as it built up the capacity

to fully deliver its mandate: one Head of the Secretariat, also serving as the Chief Economist, two Economists, two Research Assistants and one Administrator (Figure 25).

### Figure 25. Organisational chart for the Council Secretariat




Source: Irish Fiscal Advisory Council, 2020

The Council does not have a large budget for staff, and so its staffing model relies on a small group of core economists and young Research Assistants who use their time at the Council to gain valuable experience that can help them further their career elsewhere. The Council has a strong reputation among stakeholders for delivering high-level analysis in a clear and informative way. Co-operation between Secretariat staff and Council members works well, and the work environment is perceived as stimulating and dynamic. For this reason, the Secretariat has been able to achieve a lot relative to its size. There are few examples of IFIs the same size as the Irish Council that have had the capacity to develop in-house macroeconomic and fiscal modelling to the same technical specification.

The grades of staff at the Council are linked to equivalent positions in the government and the number of people that can be hired at each grade within the Council is subject to agreement from the Minister for Finance. Any changes to the existing arrangements also require prior consent of the Minister.

Retaining and continuing to attract highly qualified staff is crucial for the future of the Council. Having staff seconded from other institutions such as the central bank, the government and the ESRI has also proved to be an effective way of attracting experienced staff into the small Secretariat. However, at present the Secretariat has no staff on secondment. In the last recruitment round, the prospective candidates for a secondment were all at government grades that the Council could not accommodate given its existing grade-structure.

The lack of autonomy that the Council has in relation to the grades-structure of its staff has also hindered the Secretariat in retaining fixed-term Research Assistants. The salary increase between a Research Assistant and the next grade of Economist is prohibitive for the Secretariat, and the Council has had to let go of experienced Research Assistants that it would otherwise have liked to have retained through a promotion. Greater autonomy over its staff grading structure, together with increased flexibility in the Council's budget, could help the Council continue to attract and retain the skilled staff it requires in the years ahead.

A small Secretariat can be vulnerable to sudden loss of key individuals and competences. Many Secretariat staff are relatively early in their careers and staff will often move on to more senior positions elsewhere. The Council's small size and budget constraints mean that it hires Research Assistants on two-year fixed term contracts, instead of on permanent contracts. In addition, employees on secondment from other institutions return to their sending institution after their period at the Council Secretariat. To decrease the dependence on specific individuals and ensure institutional memory, Secretariat staff rotate tasks and cover different areas. This approach not only decreases the vulnerability of the Secretariat to staff changes, but also has the added benefit of widening the skills base of existing staff.

Current levels of staffing at the Secretariat are considered by the Council to be the minimum that is reasonable in order for the Council to deliver its mandate. However, given various pressures, there are some changes that the Council might consider to the staffing arrangements.

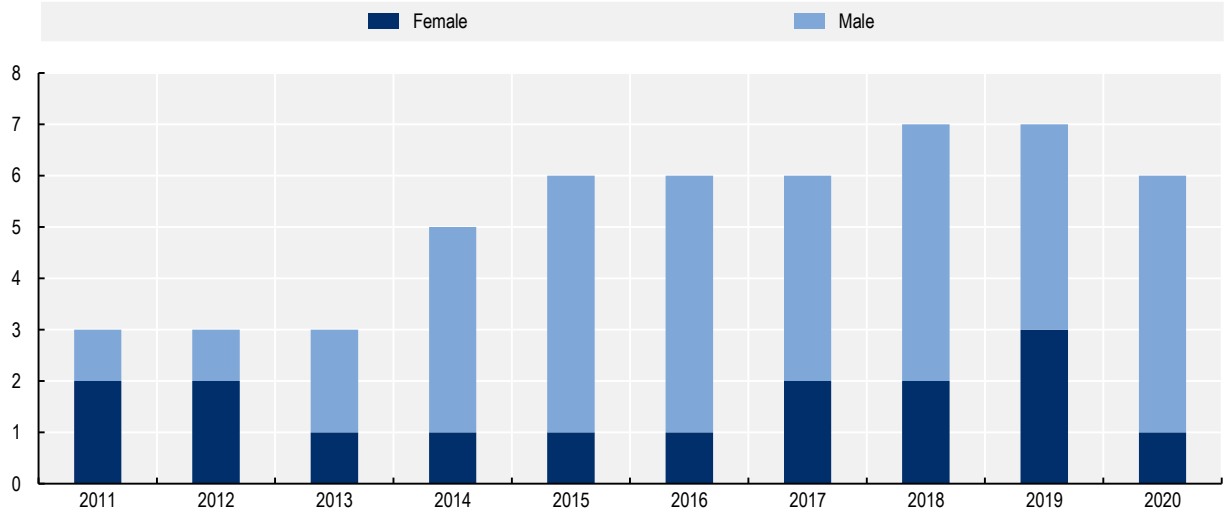
To help further strengthen consideration of medium to longer-term fiscal issues during the Irish budget process, the Council has just published its first Long-term Sustainability Report. Stakeholders broadly welcomed this new report and would like to see the Council augment this work with greater analysis of key budgetary issues, similar to its work on health spending and corporation tax revenues. These developments may require more resources or a reallocation of resources.

#### Gender balance

At present, the Council has a 50-50 gender balance amongst ordinary members. The situation is different for the Secretariat where just one out of six employees are female, and following the ending of contracts of two female Research Assistants, there is currently no women among the five analytical staff (Figure 26). The Council has not yet had a female Economist. The Council needs to pay special attention to this issue. Giving the Council greater autonomy over staff grading, as recommended above, could potentially help to improve on the gender balance by grade, through enhancing general progression opportunities for Research Assistants.

### Figure 26. Secretariat staffing by gender

Number of staff members




Source: Irish Fiscal Advisory Council, 2020

### *Access to information*

Access to relevant and timely information underpins an IFIs ability to deliver its mandate. This applies to relevant data and forecasts, but also to underlying methods and models and the judgements underpinning them. Although the Council's enabling legislation states that it should have "all such powers as are necessary for, or incidental to, the performance of its functions" (Section 8(7)), and it further requires the government to set out in the official forecasts the data required to assess whether the fiscal rules are complied with (Section 2(2)), there is no explicit provision regarding access to information as is recommended in the OECD Principles (Principle 6.1).[6]

Instead, the Council has a Memorandum of Understanding (MoU) with the Department of Finance to cover information needs relating to assessing and endorsing official macroeconomic forecasts. The MoU is updated in the beginning of the year and sets out the Council's informational needs throughout the year. Overall, the arrangement works well. The Council reports that it is usually able to obtain the information it needs to undertake its role. Nevertheless, pursuing information requests can still take a lot of time and this puts strain on the small Secretariat.

Access to information to enable the Council to assess the fiscal stance and compliance with fiscal rules can be more problematic. Although the government provides a lot of information for the Council to perform this function, it often takes the Council a considerable amount of time to get the information, and this is occasionally incomplete. This is not necessarily because of lack of goodwill on the part of the government, rather because the data requested is not always systematically collected or easily prepared.

The Council also experiences challenges in relation to accessing information on corporation tax revenues. Access is hindered because revenues are dominated by a small number of multi-national companies and the Revenue Commissioners have strict obligations in relation to confidentiality. However, the Council and the Revenue Commissioners should explore more directly what could be done to facilitate the Council's analysis in this area. In seeking solutions, it is possible to look at examples from other countries, such as the United Kingdom, where external researchers can request access to non-public statistical results on an aggregated or anonymised basis through HM Revenue & Customs.

The Council could publish a statement of data needs each year to help the preparedness of the government in providing the required information. If challenges persist, the Council and the government should also extend the existing MoU to cover all of the Council's functions[7]. A good practice example is provided by the Scottish Fiscal Commission (Box 14).

### Box 14. Measures taken by the Scottish Fiscal Commission to improve access to information

The Scottish Fiscal Commission's (SFC's) right to access information held by the Scottish government is enshrined in its enabling legislation. Section 10(1) of the legislation states:

> *The Commission –*
>
> *a) Has a right of access at reasonable times to any relevant information that the Commission may reasonably require for the purpose of performing its function,*
>
> *b) May require any person who holds or is accountable for relevant information to provide at reasonable times any assistance or explanation that the Commission may reasonably require for the purpose of –*
>
> *(i) Performing its functions, or*
>
> *(ii) Exercising the right conferred by paragraph (a).*

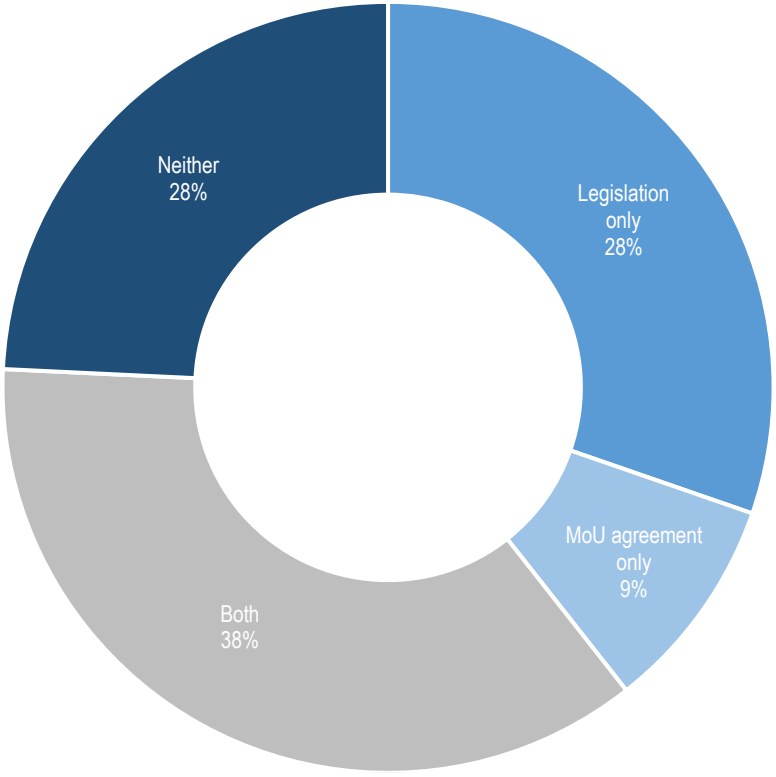
This right of access was reiterated in a Framework Document and the Protocol signed by the Scottish government and the SFC.

Despite these arrangements, the SFC faces many data gaps that can affect the quality and robustness of its economic and fiscal forecasts. In order to help improve the situation, in September 2018 the SFC decided to publish a statement of data needs. This acknowledged progress the Scottish government had made in developing data in Scotland, and identified the areas where new data and improvements in existing data would be necessary. A second statement of data needs in September 2019 showed positive progress made towards filling these data gaps and again laid out priorities for improvement that the SFC believed will have the greatest impact on its ability to forecast.

Together, the legal provisions, signed agreements and statements of data needs have helped ensure continued improvement in the quality of information received by the SFC to undertake its functions effectively.

Even if the Council's MoU was expanded to cover all of its functions, the Council would remain an outlier among peer institutions, two thirds of whom have access to information provisions codified in legislation (Figure 27). This leaves it vulnerable to a change in the willingness of government to engage with the Council and provide it with the information it needs. Rectifying this through putting in place legislative provisions in relation to access to information would elevate the Council to being in the group of OECD IFIs who have access to information underpinned by both legislation and an MoU, putting it in a stronger and more sustainable position to fulfil its functions.

### Figure 27. Formal underpinning of access to information across IFIs



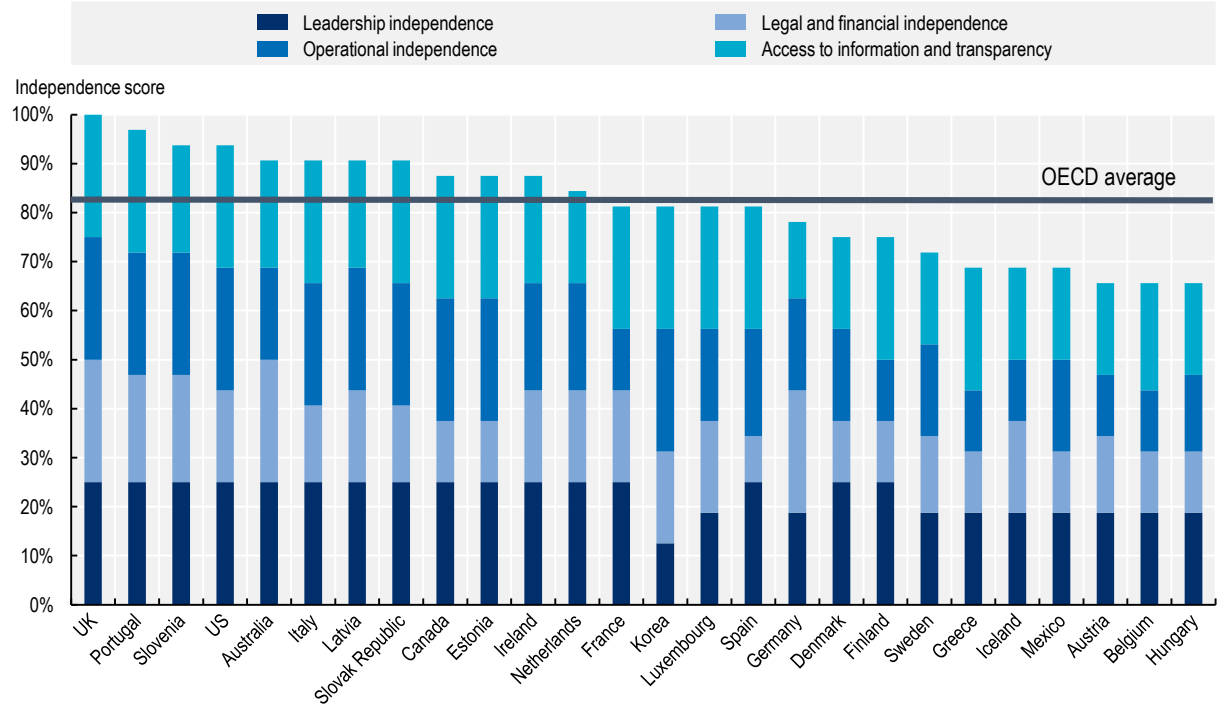

Source: OECD IFI Database (2019)

### *Independence*

Independence and non-partisanship refer to the ability of an IFI to undertake its duties free from political pressure or influence. The Council's enabling legislation states that it shall be independent in the performance of its functions. A number of provisions in the FRA help protect the independence of the Council. For example, although the Minister for Finance appoints Council members, they may only be removed for reasons set out in the FRA and after a resolution providing for the removal and stating the grounds for it is passed by Dáil Éireann. In addition, as previously noted, the Council's funding is set out in legislation and paid directly from the State's Central Fund. This arrangement protects its independence as the budget is not subject to annual decisions by the Oireachtas.

IFIs themselves, through their internal rules and norms can further strengthen their independence. For example, the Council publishes details of the underlying methodology it uses to make its assessments alongside its reports and publishes a range of material on its website to promote transparency in its operations, including minutes of Council meetings and correspondence with the Minister for Finance. Together, these legal provisions and actions give the Council an above average rating compared to IFI's in OECD countries (Figure 28).

## Figure 28. IFI independence




Source: (von Trapp and Nicol, 2018[4])

Stakeholders confirmed that the Council's work is widely viewed as independent and non-partisan. Stakeholders also pointed to incidences where the Council had been critical of the government's fiscal stance as evidence of its independence.

The main area which would further strengthen the Council's administrative independence would be for the Council to be given greater autonomy regarding human resource management, as mentioned in Section Human resources. At present, changes to the number of staff in different positions needs to be approved a priori by the Minister for Finance.

### *Conclusions and recommendations*

The Council enjoys a budget set out in its enabling legislation and paid directly from the state's central fund. Since the budget ceiling was set, the Council's mandate has been expanded without an increase in its funding. In addition, although the budget ceiling is indexed to inflation, this has risen more slowly than the Council's main costs – notably public sector salaries. In order to stay below the ceiling, the Council has already had to reduce its staffing and may have to further streamline its human resources in coming years, which could affect its ability to deliver its legal mandate. If indexing the budget ceiling to HICP inflation was

designed to protect the real value of the Council's funding, consideration should be given to using an index linked also to the key component items that make up the Council's expenditure.

Periodic consideration should also be given to whether or not the resources available to the Council remain appropriate. For example, retaining and continuing to attract highly qualified staff is crucial for the future of the Council. Giving the Council greater autonomy over its staff grading structure, could help it continue to attract and retain the skilled staff it requires in the years ahead. Furthermore, there is demand for the Council to help foster greater consideration of medium to long-term budgetary issues in Ireland. This work is likely to be particularly valuable in the context of the difficult fiscal choices that the COVID-19 crisis is likely to bring in the years ahead. However, these developments may require more resources or a reallocation of resources.

There are five members of the Council including the Chair. There is no separate recruitment process for the Chair, with the Minister for Finance selecting the post-holder from among the Council members. However, as the accountable officer and public face for the Council, the Chair's role can involve significant additional time commitment. Creating a separate recruitment process for the Chair would ensure the Council can attract a pool of candidates who have the necessary capacity and skills for the role. Furthermore, to support transitions between one Chair and the next, it would be helpful to formalise the Deputy Chair role, and arrangements for an Acting Chair when the Chair role is vacant.

Access to information is pivotal for the effectiveness of an IFI. The Council has access to information arrangements for assessing and endorsing the forecasts in the form of a MoU with the Department of Finance. While these arrangements work well, access to information can be more difficult in relation to the Council's broader functions on assessing the fiscal stance and compliance with fiscal rules. This is not because of a lack of goodwill on the part of the government, but because the information may not be published or provided to the Council in a timely manner. It would be useful if the Council set out a statement of data needs and extended its MoU to cover all of its functions. To align with international peers and continue to operate sustainably and effectively, the Council should also have a statutory right to access to information.

The Council scores highly on the OECD Index of IFI Independence, reflecting the strong legislative provisions that protect its budget and leadership arrangements from political interference. Stakeholders also report that the Council's work is viewed as independent and non-partisan, and that it has not been afraid to raise its voice when needed.

## 3. Methodology and outputs

### *Introduction*

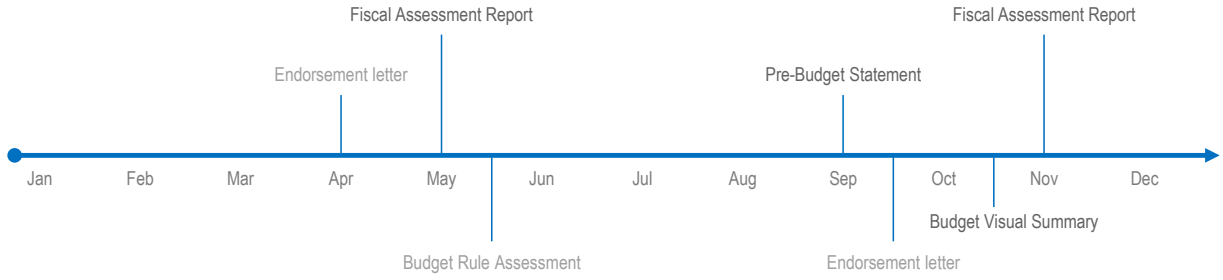
This section reviews the Council's outputs and assesses the tools it uses to produce them. As outlined in Section 1. Context, the Council's annual work programme is based on the four specific tasks outlined in its enabling legislation in support of domestic budget management and the annual Stability Programme drawn up in the European Semester framework of the EU Stability Programme. These are: 1) assessing the official macroeconomic and budget forecasts; 2) assessing the fiscal stance of government; 3) monitoring compliance with fiscal rules; and 4) endorsing the official macroeconomic forecasts.

### *The Council's outputs*

The Council publishes six regular reports or statements throughout the year to fulfil its mandate. The main regular publications are the Fiscal Assessment Report (FAR), published in the Spring and Autumn as per the requirements contained in the EU economic governance legislation of the European Semester, and the annual Pre-Budget Statement. These are complemented by shorter statements and analyses including

the annual Assessment of Compliance with the Domestic Budgetary Rule report and the twice-annual Endorsement letter to the Minister for Finance ahead of the Stability Programme Update (SPU) and the budget. The Council also developed an annual Budget Visual Summary to fulfil demand for rapid post-budget analysis, first released in 2019. The regular publication cycle is outlined in Figure 29.

## Figure 29. The Council's publication cycle




Beginning in September 2020 the Council also released is first Long-term Sustainability Report, the regularity of which is still under discussion. The Council also publishes work at its own initiative, including working papers and analytical notes (as highlighted in Table 22). The methods, models, and results developed in these publications are often used directly or indirectly in the Council's core publications. The topics are diverse but focus on relevant forecasting issues and special topics related to Ireland's public finances, including potential improvements of the fiscal framework.

The range of outputs is impressive for a small Council. The potential downside of having such a broad range of outputs is that it may also be overwhelming for general stakeholders. For example, it may not be clear why products such as the Budgetary Rule Assessment reports and Stand-Still Scenarios are standalone products rather than forming part of the core Fiscal Assessment Reports. There may be scope for reorganising the total portfolio of different publications and their interrelations. Stakeholders may also be confused about the distinction between working papers and analytical notes, and the functions to which they relate. The Council could alleviate this through specifically highlighting its models and linking them to their role in delivering the mandate and associated working papers.

## Table 22. Selected supplementary outputs at the Council's own initiative

| Category | Examples |
|---|---|
| Working papers | • Designing a Rainy Day Fund to Work Within the Fiscal Rules<br>• Estimating Ireland's Output Gap<br>• Nowcasting to Predict Data Revisions |
| Analytical notes | • Tax Forecasting Error Decomposition<br>• House Price Risks<br>• Estimating Ireland's Budgetary Semi-Elasticities<br>• Stand-Still Scenario for Government Spending |
| Conferences and presentations | • Annual "Path for the Public Finances" conference |
| Data sets | • Long-run tax dataset: tax data from 1938 to present at annual frequencies compiled by scanning old texts and combining it with more recent official databases.<br>• Policy-adjusted tax dataset: tax data from 1987 adjusted to remove fiscal impact of discretionary policy changes and one-off factors to arrive at improved counterfactual to estimate revenue elasticities for forecasting. |

### *Technical assessment of the Council's methodologies*

The Council has developed a suite of tools to enable it to effectively deliver its mandate. The output of these tools is combined with the expert judgement of Council members and Secretariat before being communicated to a general audience through its publications.

The Council's main tools that it identified and submitted to the OECD at the beginning of the review have been assessed according to the technical assessment framework for IFIs developed by the OECD. This framework first examines the overall appropriateness of the IFI's workflow and suite of technical tools for delivering its mandate. The framework then examines each model individually, weighing both academic and practical considerations to determine whether the Council's tools are appropriate for the Council's analysis and whether they meet standards practices by other IFIs.

#### *Individual model assessment criteria*

The appropriateness of each tool or methodological decision was assessed along six academic and practical considerations (Table 23). The framework challenges whether a tool would hold up to both scholarly peer review and whether it is fit to serve the practical considerations of an IFI's mandate and stakeholders.

**Table 23. OECD Summary Assessment Criteria**

| | |
|---|---|
| **Theory** | Does peer-reviewed literature support (or not provide a strong argument against) this tool for the analysis, given the context and available data? |
| **Accuracy** | Is this tool likely to give the most accurate results (or avoid the most systematic bias) if applied to this problem? |
| **Communication** | Can the tool's outputs provide a coherent and intuitive narrative to stakeholders? |
| **Transparency** | Can the tool's methodology and assumptions be provided to the IFI's stakeholders in a manner that will satisfy its requirements for transparency and accountability? |
| **Resources and business continuity** | Does the tool require a level of resources and expertise that is appropriate to expect from the IFI's analysts to avoid analytical disruptions from staff turnover? |
| **Precedent** | Is the approach used widely at other IFIs and public finance institutions? |

Some criteria are complementary, while others conflict. When choosing a model, analysts must weigh the trade-offs between the criteria. For this reason, the assessment does not offer a total score or pronouncement on whether a model is the best tool for the analysis. Instead, it provides an opinion on whether the chosen tool is appropriate or inappropriate for delivering the Council's mandate in the country's context.

#### *Summary results of individual model assessment*

The technical assessment concludes that each of the Council's tools that were reviewed in detail by the OECD are appropriate for its analysis (Table 24). The detailed technical assessment is published separately, alongside this review.

**Table 24. OECD Assessment of Individual Models - Summary Results**

| Model | Description | Opinion |
|---|---|---|
| Benchmark economic modelling | Suite of quarterly time series forecasting models, mainly estimated separately as structural error correction models constrained to national accounting identities, for endorsing macroeconomic forecasts. | Appropriate |
| Large Bayesian vector autoregression model. | Statistical time series estimated using a dataset of 47 variables for endorsing macroeconomic forecasts. | Appropriate |

| Model | Description | Opinion |
|---|---|---|
| Suite of output gap models | Range of statistical filters, production function, and cyclical indicators used for the endorsement of macroeconomic forecasts and assessment of compliance with the domestic budgetary rule. | Appropriate |
| Fiscal feedbacks model | Spreadsheet-based macro-fiscal feedback loop tool to capture interaction between macro and fiscal modelling and ensure consistency between the Council's macro and fiscal assessments. | Appropriate |
| "Maq" stress testing | Small-scale macro model (32 equations: 5 behavioural; 27 identities) with calibrated fiscal multipliers for assessing the fiscal stance and applying stress tests (under development for future reports). | Appropriate |
| Nowcasting models | Time series statistical forecasting model with Bayesian features focusing on underlying domestic demand and its components (personal consumption, government consumption, and investment excluding aircraft and intangibles). | Appropriate |
| Heat map for monitoring imbalances | Descriptive statistics, benchmarks, and comparison of trends over time. | Appropriate |
| Fiscal benchmarking | Policy-adjusted elasticity estimates applied to economic tax bases from the Council's forecasting suite. | Appropriate |
| Budgetary rule assessment spreadsheet | Simplified methodology for assessing compliance with the domestic budgetary rule by adjusting the budgetary balance for the business cycle using aggregate budgetary semi-elasticities. | Appropriate |
| Long-term fiscal sustainability modelling | Cohort-component model for demographic projections, production function with capital and labour for long-run steady-state growth (GNI*) projections, prices, and wage growth. Official fiscal medium-term outlook (extended by the Council from 2022 given the unique circumstances of the most recent SPU which only had two years 20201-21) linear convergence from medium-term outlook (which the Council calls short term) to long-term modelling, revenue constant as a share of GNI*, spending varies with demographic-driven beneficiaries. | Appropriate |

Note: The scope of the assessment covers the Council's main tools it identified for delivering its mandate but is not an exhaustive review of the Council's complete analytical capacity.

On **theoretical justification**, the Council's approaches have a firm basis in the economic and forecasting literature and would hold up well to academic peer review given the modelling context. The models are supported by well-developed working papers that detail extensive supporting literature and provide a strong evidence base for their use.

The Council's suite of macroeconomic models and stress tests are appropriate for its mandate and institutional decision to pursue in-house benchmarking as the main path to assessing the official outlooks for reasonableness. Both structured econometric approaches and unstructured statistical approaches such as Bayesian vector autoregression are used. Theory suggests that the partial error correction modelling suite and model combination/averaging is well suited for benchmark forecasting.

The Council's fiscal forecasting benchmarks are prepared using high-level revenue elasticities applied to economic proxy bases. This approach has a firm justification in the literature and international best - practice guidance; however, it is only one approach of many that are typically tried and tested. Other approaches include effective rates models and structural econometric models.

On **accuracy**, the Council's reliance on a suite of models and averaging for its macroeconomic benchmarks has been demonstrated to greatly increase accuracy in Ireland's challenging modelling environment, which is still recovering from severe banking and real economy bubbles and crises and suffers from large distortions from capital flows and activity related to foreign-owned multinational enterprises. To monitor that these approaches continue to add value, the Council has routinised analysis and decompositions of its forecast errors. While these exercises continue to show biases toward positive surprises in the current year and the one- to three-year-ahead forecasts, they compare favourably (of

smaller magnitude) to other forecasting institutions in Ireland trying to navigate the same forecasting challenges.

Often a model's predictive value comes not from its unconstrained output, but from the framework it provides for generating discussion and debate. In this spirit, the suite of many different approaches that the Council uses to produce its macro forecasts are likely to foster productive discussions and challenge meetings and improve overall accuracy. That said, the level of diversity and sophistication in the Council's models could also hinder the challenge process: if models are diverse and complex to the point that only its authors understand the results, it may limit productive debate. Simple approaches, with more eyes and voices involved in the process can act as a check on any one individual's tuning and judgment.

Ireland's fiscal forecasting environment suffers from similar issues related to the activity of multinational enterprises, leading to large swings in corporation tax, as well as significant spending surprises driven by health expenditure, particularly hospitals. The Council's general approach to benchmark fiscal forecasting is to apply high-level elasticities to economic proxy bases approach, which is suited to the Council's mandate as many stakeholders interpret it: high-level aggregate fiscal analysis concerned principally with the interaction of fiscal policy with the macro economy. However, unlike many economic forecasting applications, capturing more structure in public finance models can improve fiscal forecasting accuracy even from a macro lens. The Council has identified considerable bias in the government's forecasts as well as its own (although it has improved upon the government's results). For example, the elasticity approach tends to over-predict then under-predict corporation tax following a recession. While the Council has undertaken a more sophisticated elasticity estimation approach to attempt to improve upon these biases, they may be better addressed by more structural econometric modelling and effective rates approaches that incorporate characteristics of underlying tax law and tax bases.

On **communication**, the Council's focus on benchmarking using suites of models and averaging is likely to make communicating precise drivers of changes between forecasting rounds somewhat difficult, as models could have conflicting narratives. Consistency between macro and fiscal modelling may also suffer by using model averaging as macro inputs. The reliance on high-level tax elasticities applied to macro drivers for tax forecasting makes it more difficult to link forecast revisions to announced future changes in tax policy or developments in compliance or enforcement when communicating the Council's results. However, the Council's main role is not to supply convincing narratives to voters nor provide multiple policy scenarios to executive decision makers, but rather to assess and endorse the reasonableness of assumptions. Its models are well-suited as purely forecast-driven benchmarks for reasonableness against the government's more policy-driven models.

On model **transparency**, the Council leads its international peers in producing polished, journal-quality working papers for each of its main models. The papers include not just stylised equations but also in many cases the parameters and model estimation information that would easily allow outsiders to recreate the results. Further, the Secretariat is willing to engage with interested outside analysts to share code and assist further with replicability. The Council's transparency practices generally exceed those of many other IFIs. However, a clear picture of the Council's modelling workflow in relation to its mandate and each model's link with working papers would be difficult given the organisation of information available. As mentioned earlier, this could be remedied through additional information linking the Council's models to their mandate and working papers. Where publication of assumptions or code is not proactive, the Council could be more explicit in stating its willingness to provide additional information.

On **resources and business continuity**, the Council's diverse and sophisticated approaches could leave it exposed to the loss of any one senior secretariat member. The available pool of experts in Ireland who could step in to maintain the current suite of models is limited to the point of potentially threatening the ongoing viability of the Secretariat's work. The current suite was an appropriate exercise in building the Council's capacity and exploring approaches, and the Council's analysts should be commended for their efforts. Good documentation and efforts to ensure staff can back up each other's modelling work have

limited the risk of turnover. But now, as the Council has reached a level of maturity, it would be appropriate to consolidate approaches, look at simplifications and streamlining where possible, and to focus on business continuity. The Council could even proactively look at building the talent pool by incorporating practical modelling sessions into its annual "Path for the Public Finances" conference or by participating in temporary exchanges with government analysts as a way of both developing capacity in departments and building the talent pool.

On peer **precedent**, an approach using a suite of partial macro models is not widely practiced by other IFIs or central finance ministries (large-scale macroeconometric models with Keynesian short-run dynamics and supply side driven medium-run dynamics are the most common); however, this is largely because many institutions are constrained to structural systems modelling because of requirements for policy analysis and for providing narratives to stakeholders. Although the Council has usefully refined estimates of Ireland's elasticities over history to adjust for policy, the Council's general high-level elasticity approach for forecasting tax revenues is used by institutions in other countries as one approach among many, with other IFIs also relying on bottom-up methodologies using effective tax rates, structural econometric methods, or time series autoregressive integrated moving average methods. The elasticity method is common among Irish institutions such as the Department of Finance, albeit without the Council's policy-adjusted refinements.

## *Key issues for the Council's outputs*

This section assesses key issues for the Council's outputs, including their coverage and scope, accessibility, communication of uncertainty and risk, overall transparency of the production of outputs, and how they compare to international practices among peers with a similar budget and mandate.

### *Coverage*

Overall, the number of core reports is appropriate and their coverage is suited to the Council's resources and mandate. The Council does not feel overburdened meeting the demands of the regular reporting cycle. However, in striving to provide technical background working papers and other special issues notes, the Council is stretched thin for resources. Any further expansion of the Council's activities is unlikely to be achievable without a corresponding increase in resources or reduction in supplementary analysis and transparency.

As mentioned in Section 1. Context, stakeholders would like to see the Council doing more medium- and long-term fiscal analysis. The Council has begun addressing this, recently publishing its first Long-term Sustainability Report. The regularity of the report is still under discussion. Many peer IFIs (such as those in Canada, Denmark, and Slovakia) publish long-term sustainability assessments annually, although increasingly there is a recognition that the assessments do not change significantly on an annual basis and so a number are considering moving to publication every two years. The Portuguese Public Finance Council already publishes its assessment every two years. One option, given the Council's small size would be to publish an in-depth revision of the sustainability report every two to three years, but make annual incremental assessments focusing on the marginal impact of policy changes and the economic context if there is a significant policy announced. The Council may also wish to extend the time horizon beyond 2050 in future reports and provide a greater discussion around summary statistics for fiscal sustainability such as the fiscal gap.

Some stakeholders would like to see the Council publish independent fiscal forecasts in greater detail. While the focus of the Council's analysis has been appropriate, the coming years may require greater capacity for fiscal scrutiny and financial modelling, particularly as the government adopts accrual-based international public accounting standards in its financial reporting as part of a series of reforms based on recommendations from the OECD. For example, under accrual accounting, year-end settlements for

personal income taxes are brought back to the tax year in which they occurred, and certain tax exemptions, deductions, or other reliefs (tax expenditures) may be treated as spending programmes rather than reductions in net revenues. The Council will need sufficient details of such programmes to switch between accruals and cash flows to calculate market borrowing for interest charges and net lending for fiscal sustainability projections. There may also be new capacity requirements as the COVID-19 crisis shifts fiscal policy to balance sheet expansion and loans and guarantees through quasi-government entities.

*Content of reports and length, accessibility*

The Council has made concerted efforts to improve the readability of its reports for stakeholders in recent years (Box 15).

### Box 15. Efforts by the Irish Fiscal Advisory Council to improve accessibility of its reports

The Council recognises the importance of its reports being accessible to stakeholders, particularly since the subject matter can be technically complex. To help overcome this, the Council has implemented a number of reforms to improve the readability of its reports:

- The Council has increased its focus on using "plain English" in its publications. As part of this, staff have undertaken training on writing simply and are provided with recommended reading to help them make their language more readable.
- The Council uses an online tool to measure the readability of its text. Feedback from this tool helps the Council to improve the language it uses in communication. For example, it now uses the terms "jobs" and "prices" instead of "employment" and "inflation" in non-technical summaries.
- The Council has undertaken analysis of the platforms being used to read its reports. It found that half of users were reading their publications on their phone or tablet. In response, the Council changed the format of its briefings, employing wide margins either side of the text so that they read more easily on these devices.

The improvements to the readability of reports is welcomed. However, stakeholders report that the length of the Council's reports remains a key issue in relation to accessibility. They would like to see the main reports become shorter and more focused on the relevant issues at the time of publication. Some pointed to the ESRI's communications as a good example.

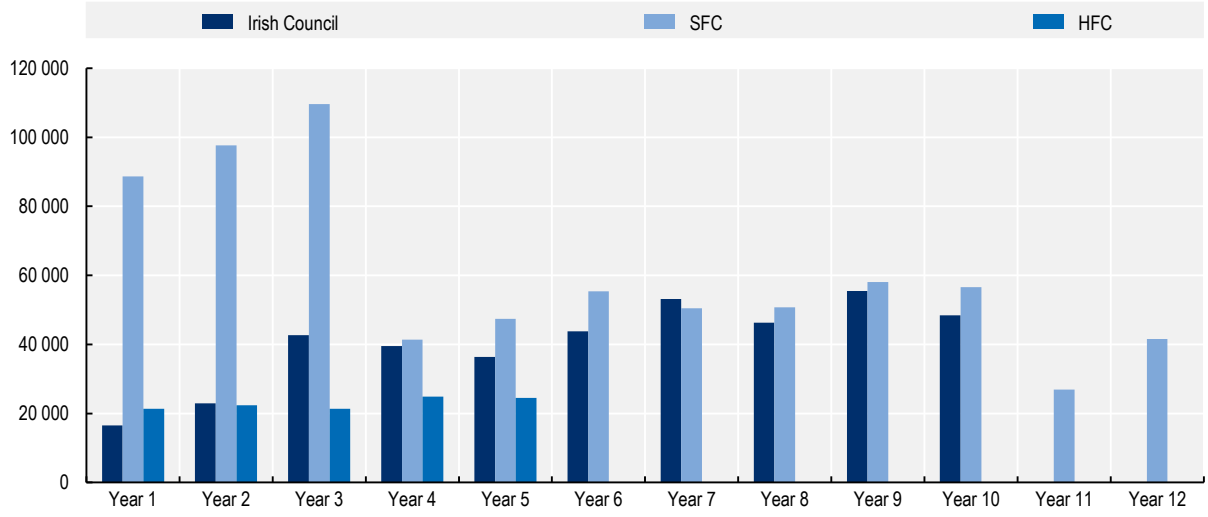
The length of the Council's publications has been a feature of internal debates from the outset among Council members and the Secretariat. In general, the Council would also like to see a shortening of its reports and has made considerable efforts in this regard.

A key positive development has been the addition of short "Summary Assessment" reports alongside the Council's main reports, providing stakeholders with the key messages. However, the main reports repeat the summary assessment, along with key messages and summaries at the lead of each section, with the cumulative effect of adding to the length and acting against the concurrent goal of brevity. To counter this, these summaries and key messages could be published separately on the web only, rather than in the main document.

The word count of the Council's main FAR publication is roughly similar to the word count of the main fiscal assessment report of the Swedish Fiscal Policy Council, upon which the Irish Council was modelled. However, compared to the Hellenic Fiscal Council, which also has a similar remit and resources, the Council could make further efforts to shorten its publications: the word count of the Hellenic Fiscal Council's

main publication (published in Greek) is around ten thousand words shorter, after controlling for differences in average word count per language.

### Figure 30. Length of the Irish FAR over time in comparison to the main reports of peers




Note: SFC refers to the Swedish Fiscal Policy Council and HFC refers to the Hellenic Fiscal Council.

Further options for the Council to cut down on the length of reports include:

- Cutting down on reiterations of the government's outlook. A simple table summarising the official outlook could instead serve as a reference to highlight assumptions of the official outlook that the Council wishes to flag to the reader.
- Revisiting and strengthening a formal one-in-one-out rule for feedback on draft reports, where if Council members or Secretariat staff want to highlight a key issue, they need to identify one other issue that could be deprioritised or cut. A soft version of this rule has been tried in the past, with little success.
- Moving more technical material to notes, or moving technical issues and special topics boxes to standalone reports, cross-referenced by the main document. This could reduce the length of the main report while bringing even more attention to the issues.

The Council may also wish to review similar reports from peer institutions which are impressive in terms of brevity, such as the Economic and Fiscal Outlook published by the Canadian PBO.

#### *Publishing independent benchmark forecasts*

The Council's main approach to scrutinising official forecasts is to use in-house modelling capacity to produce benchmarks against which to judge the government's plans. The Council currently provides its detailed independent macroeconomic benchmark as an appendix to its reports.

The details of the Council's independent fiscal benchmarks, however, are held internal. In-house fiscal models are used primarily to create and publish alternative scenarios for key risks by calibrating the results to the government's outlook. In 2020, the Council's in-house models were also used to extend the official projections to 2025 when official plans were reduced to two years because of the uncertainty of the COVID-19 pandemic.

To support transparency and enrich the analytical debate, the Council may wish to explore publishing its independent fiscal benchmarks and to feature both in-house macro and fiscal forecasts more prominently

as the baselines for scenario and risk analysis in its reports. This is the approach used, for example, by the Portuguese Public Finance Council and Canada's PBO. The Council would be best placed to judge the associated communications challenges and appropriateness of such a strategy for the Irish policy setting.

### *Transparency*

The Council has made impressive efforts to provide transparency in relation to its work. It has published journal-quality working papers for almost every model used to deliver its mandate and core reports. Its work is accompanied by background data, spreadsheets, and presentations posted alongside reports.

The Council's open-access spreadsheets of its assessments of budgetary rules with formulas preserved is a best practice initiative, giving the public a chance to review these calculations for themselves, which are important for setting the aggregate parameters of fiscal policy that will determine public services.

As highlighted in Section 1. Context, the Council also engages in transparency outreach by hosting annual conferences and promoting discussion among peers, who report benefiting greatly from the Council's willingness to engage.

The Council will provide further details including model code upon request, pursuing transparency while permitting a chance to explain the model's assumptions, limitations, and ensuring that the requester engages in good faith.

The Council has consistently prioritised transparency. It exceeds the practices of much larger well-resourced offices. The Council's transparency initiatives are to be highly commended.

### *Communication of uncertainty and risks*

The Council does well in identifying and communicating key risks and reporting associated scenarios. For example, the Council includes different scenarios for immigration, productivity, and health care enrichment in its long-term sustainability analysis. It also includes different scenarios for end-of-year tax surprises, historical forecast errors of interest rates, and debt liquidity risks in the FAR. The Council has used fan charts and distributional probabilities to present its benchmarks, although has more recently focussed on Brexit and COVID-19 scenarios. The array of alternative scenarios it provides are a more useful and concrete exercise.

The Council's Stand-Still Scenarios are a creative way to draw attention to systematic bias in the government's spending plans, which do not fully account for beneficiary cohorts, inflation, and other structural cost drivers.

### *Quality control*

The quality of the Council's work is viewed by stakeholders as having gone from strength to strength over recent years, culminating in the release of the Spring 2020 FAR, which presented scenarios for the Irish economy in the midst of the COVID-19 crisis. This filled a gap and was a trend-setter among peers in providing analysis to decision makers when governments were unwilling or unable to do so. The scenario analysis was similar to the work produced by significantly better-resourced and longer-established institutions such as the Netherlands CPB.

The Council has developed a useful framework for internal review within the Secretariat and through the regular challenge meetings with Council members. The Council has hands-on input leveraging the wide range of member backgrounds. To the extent that outside expertise can improve the products, the Council also get its work peer reviewed by others, e.g., the ESRI.

While the 2015 peer review of the Council suggested that it might establish an advisory board, and this is not uncommon among peers, these are generally more beneficial for institutions that do not already have the benefit of a panel of experts at the top of their field. It is sensible that Council members themselves provide this advisory role to the Secretariat.

### *Assessment of key activities relative to peers*

Table 25 provides an assessment of the Council's key activities relative to peers in Sweden, Greece, Portugal and Slovakia. These peers were selected to provide a variety of comparisons. The Swedish Fiscal Policy Council was the institution the Irish Council was modelled on, the Hellenic Fiscal Council has similar functions to the Irish Council and the Portuguese and Slovak IFIs have similar functions but deliver them with significantly greater resources. The analysis shows that the Council has a high output given the small size of the Secretariat. Its outputs are more comparable to the greater resources of the Portuguese Public Finance Council or Slovak Republic Council for Budget Responsibility than the more similarly resourced Swedish Fiscal Council, after which it was modelled.

The Council's range of reports is similar to other councils that play a role in EU surveillance and the European Semester; however, the Hellenic Fiscal Council and the Swedish Fiscal Policy Council (which is not in the euro zone but has similar rules) integrate more of their analysis and mandate delivery into one or two main reports a year. Few similarly resourced offices release the range of journal-quality working papers detailing their models as the Council.

The content of the Council's main reports is structured similarly to the products of other IFIs. The depth and detail of the Council's products compares favourably to the activities of other peers engaged in macroeconomic forecasting and endorsement, assessing compliance with fiscal rules, and assessing the fiscal stance. However, some other institutions place more of an emphasis on revenue and expenditure monitoring and more detailed bottom-up fiscal forecasting for assessing the official budget forecast.

All peer institutions have the capacity to produce their own macroeconomic and fiscal benchmark forecasts, except for Sweden, which primarily synthesises the forecasts of other independent institutions. The modelling approaches are broadly similar, except that other institutions that pursue an in-house benchmark approach to scrutiny generally focus on one large-scale macroeconometric model as the workhorse of their macro assessment, with the government sector of the macro model tuned by detailed independent fiscal forecasts from a range of modelling approaches. The Council, on the other hand, flips this balance using a diverse suite of models for its macro benchmark and one method for fiscal modelling (applying high-level elasticities to economic proxy tax bases).

### *Conclusions and recommendations*

The Council's main regular publication is its FAR, published biannually. This is complemented by four other regular reports or statements released throughout the year. Together these six publications are the means through which the Council's fulfils its legally mandated functions. In addition, the Council publishes work at its own initiative, including an impressive array of analytical papers and, beginning in September 2020, a new Long-term Sustainability Report. The Council also stepped up to provide valuable information and scenario analysis to stakeholders during the COVID-19 crisis when the government opted not to publish its usual Summer Economic Statement in 2020.

To deliver its outputs, the Council has developed a comprehensive suite of macroeconomic and fiscal forecasting tools and models. As the Council matures as an institution, it might consider how it could streamline its macroeconomic suite of models, to aid business continuity and lessen reliance on key senior analysts.

More streamlined macroeconomic modelling would give scope to enhance capacity across the Council's other work streams. For example, the Council and others have identified systemic bias and room for improvement in the elasticity-based forecast used by the Council and the government. Although the Council has made refinements in how it estimates elasticities over history by adjusting for past policy changes, these biases may be further addressed by exploring bottom-up approaches to capture more of the tax law structure to better integrate future changes to policy, administration and taxpayer behaviours. Additionally, the Council may require capacity for greater fiscal scrutiny and financial modelling in coming years as the Irish government adopts accrual-based international public accounting standards in its financial reporting. Further, as governments everywhere rely more on balance sheet measures and loans and guarantees through quasi-government entities, especially in response to the COVID-19 crisis, IFIs may need greater capacity for measuring accrued contingent liabilities. These developments may require more resources or a reallocation of resources, as well as greater access to tax and spending data.

The Council's outputs have grown in quality and breadth over time, with the current volume of high-quality research outputs being impressive given the small size of the Secretariat. An area where the Council performs particularly well relative to peers is in relation to the transparency it provides on its methods and models. The Council has a wide range of journal-quality working papers describing model equations and in many cases parameters and estimation tables allowing an external analyst to approximate the analysis.

While the Council has made efforts to improve the readability of its reports and to publish "Summary Assessments" that provide key messages in a succinct format, one area where there is still some room for improvement is in relation to the length of the Council's publications. The word count of the Council's reports is not entirely out of line with peers, however, there remain other options for achieving greater brevity, including: consolidating the front matter in reports through making the visual summary a standalone document, cutting down on reiterating the government's outlook, formalising a one-in-one-out rule for feedback on draft reports and moving technical boxes and special topics to standalone notes accompanying (and cross-referenced by) the main report.

## Table 25. Comparison of key activities to peer institutions

| | Reporting | Endorse and/or assess the government's macroeconomic forecasts | Assess the government's budgetary forecasts and fiscal stance | Assess compliance with fiscal rules | Assess long-run sustainability |
|---|---|---|---|---|---|
| **Irish Fiscal Council**<br>6 staff<br>EUR 820K budget<br>10 reports per year | Two reports each year required by legislation aligned with the European Semester. One significant Pre-Budget Statement. A standalone Budget Rule Assessment. Several working papers and analytical notes. | Benchmark suite of supply-side macro forecasting models and output gap models. Statement endorsing the macroeconomic projections on which the medium-term budgetary plans for the Stability Programme and domestic budget cycle are based, along with a discussion of risks. | Benchmark fiscal forecasting using high-level error-correction models for short- and long-run elasticities applied to tax bases. Fiscal and economic interaction (fiscal feedback) model. Suite of output gap models. | The Council assesses the EU and domestic fiscal rules as standard and also using its own Principles-based approach. This is based on alternative estimates of potential output rather than the CAM potential output and budget elasticities used for EU fiscal surveillance. | 30-year projections, less emphasis on summary statistics. |
| **Swedish Fiscal Policy Council**<br>5 staff<br>EUR 1 050K budget<br>3 reports per year | One report each year required by legislation, containing its assessment of the government's fiscal policy by 15 May, covering all surveillance activities. One or two self-initiated special issues notes. | Largely qualitative, using a comparison of benchmark external forecasts from other institutions. Mostly current analysis and monitoring of recent data. | Comparison of benchmark external forecasts from other institutions. Mostly current analysis and monitoring of recent data. | Ex ante and ex post in same report. Scrutiny of government calculations and analysis from other institutions. | Discusses and scrutinises work of other research agency, National Institute of Economic Research and commissions alternative scenarios and analysis. |
| **Hellenic Fiscal Council**<br>13 staff<br>EUR 1 100K budget<br>8 reports per year | Two major reports in spring and fall, aligned with European Semester. Quarterly bulletin with economic and fiscal developments. Average of three self-initiated special issues notes. Domestic economy overview one-pager twice a year. European fiscal monitor updates. Occasional special issues notes. | Statement endorsing the macroeconomic projections on which the medium-term budgetary plans for the Stability Programme are based, along with a discussion of risks. Quarterly monitoring notes of statistical releases. Vector error correction model for scenario analysis, particularly sensitive to external trading environment. | Publishes independent economic and fiscal forecasts and scenario analysis. | Ex ante and ex post assessments, monitoring activation and implementation of escape clauses. Monitors compliance with numerical fiscal rules incorporated in the national fiscal framework, in order to achieve the MTO. | Does not assess long-run sustainability currently. |
| **Portuguese Public Finance Council**<br>18 staff<br>EUR 2.7 million<br>13 reports a year | Two reports similar to FAR aligned with European Semester, titled "Public Finance: Position and Constraints", an Opinion on the macroeconomic scenarios underlying the Stability Programme, and a Fiscal Risks and Public Finance Sustainability report every second year. | Large-scale structural macroeconometric model, error correction equations, detailed fiscal block for interactions. Labour-augmented Cobb-Douglas production function for potential. Nowcasting model with MIDAS model. | Mostly bottom-up OLS-estimated structural econometric equations for tax revenue components. | Monitors compliance with numerical fiscal rules incorporated in the national fiscal framework. | Published every two years, assessing five areas: macroeconomic performance, public revenue and public expenditure, contingent liabilities, and public debt. |
| **Slovak Republic Council for Budget Responsibility**<br>14.5 staff<br>EUR 1.37 million<br>10 reports a year | Two reports a year, required by legislation and aligned with European Semester. Report evaluating the implementation of the fiscal rules and fiscal transparency rules established in the law, and a report on sustainability. Several other self-initiated surveillance and monitoring reports. | Does not have responsibility for assessing official forecasts, only its ex post forecast evaluations. Does, however, prepare its own macroeconomic forecasts. Large-scale structural macroeconometric model, error-correction equations piecemeal estimated for medium-term and fiscal interactions. Nowcasting models for short-term up to two quarters. DSGE model for simulations. | Mix of elasticity and structural econometric models, microsimulation bottom-up public finance revenue and expenditure projections for longer run. In-year estimates using seasonality. Traffic light system of risks. | Estimations of the output gap, careful identification of one-off factors, analysis of compliance with Expenditure Benchmark. Evaluations of correction mechanism and triggering escape clauses. Separate report for compliance with budgetary balance rule than other fiscal responsibility rules. | Published each year. Fiscal gap calculation, measures as the change in budget balance required to ensure that the debt to GDP ratio remains within its legal limits over 50-year period. Detailed scenario analysis. |

## 4. Impact

### *Introduction*

An IFIs' impact on fiscal outcomes is often indirect, multifaceted, and hard to quantify. A comply-or-explain provision exists in relation to compliance with the domestic fiscal rules which requires the Irish government to take decisions or provide explanations in response to specific Council assessments. However, this power has generally not been used given that the government has broadly complied with the technical requirements of the fiscal rules.[1] There is also a tradition for the Minister to respond to the Council's reports with a letter published a few weeks after their release. However, for the most part the Council relies on its influence via discussions with key stakeholders such as the Department of Finance, the Department of Public Expenditure and Reform and the Budget Oversight Committee at the Oireachtas, as well as through a strong media presence shaping public opinion. This section therefore assesses evidence on the Council's impact, mainly by reviewing its communications, with a focus on key channels such as media and the parliamentary debate. It also highlights key areas where the Council has helped contribute to fiscal transparency gains that improve understanding of public finances and fiscal management in Ireland.

### *Influence on the public debate*

The Council has a proactive approach to communicating its outputs to the public. While it does not have a formal communications strategy, some communications elements are covered in the Council's overall Strategy and its Communications Policy. There are also informal communications guidelines that the Council follows. For its two main reports the Council will issue a media notice a week in advance and follow this up two days before publication with a two-page press release and the summary assessment. The full report is also sent under embargo to around 10-15 trusted journalists. The day before publication, the Council will hold a press briefing, attended by around 10-15 journalists. The video of the Council's presentation from the press briefing is then put online on the day of publication.

In order to make its briefings more accessible to the press and the public, the Council has made concerted efforts to improve the readability of its publications (detailed previously in Box 15). The Council has also increased its efforts in relation to social media in recent years, partly because its second Chair was a keen Twitter user. Even with this Chair departed, the Council continues to pursue an active social media approach. In addition to issuing Tweets after key publications and around Oireachtas appearances, the Council now aims to issue something topical on Twitter every two weeks, often linking back to previous publications. The Council has also started to use Twitter threads, a series of five to six tweets on the same subject, to communicate key messages. If the Council senses that a key message has not received the traction that it should or could, then it also occasionally writes op-eds in Irish newspapers in an effort to reach a broader audience.

Furthermore, as set out in Section 1. Context, the Council has added an annual "Path for the Public Finances" conference to its calendar in order to stimulate public debate around long-term public finance issues, such as climate change and long-run spending pressures. These are an opportunity to further disseminate key messages regarding public finances.

To assess the Council's impact so far on the public debate on fiscal issues, quantitative indicators covering the range of communication outlets available to the Council are analysed. They include activity on the Council's website, social media (Twitter), as well as the Council's presence in the news (online news articles). Three dimensions seem particularly relevant:

1. **The trend**. A sustained upward trend in the Council's presence indicators would suggest that it has been gradually establishing itself as an influential actor in the public debate.

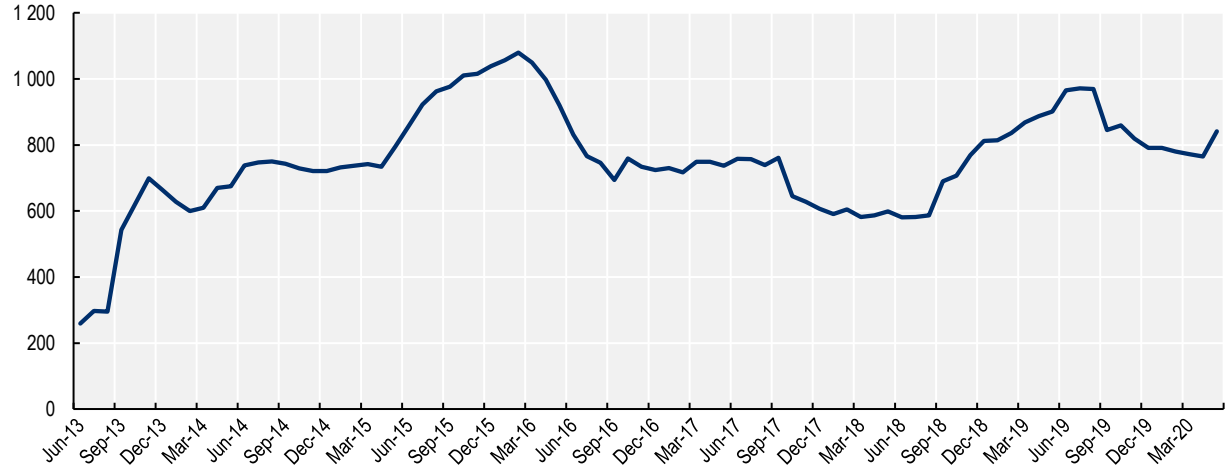
2. **The timing**. Is the Council particularly present in the public debate at key steps of the budget process and at moments of policy debates with deep implications for fiscal sustainability?
3. **The voice**. It is useful to know how the Council's presence compares to the presence of broader discussion related to budget issues. The "voice" refers to the number of references to the Council in news about budget issues.

*Overall trends in impact on the public debate*

Analysis of the number of monthly visits to the Council's website (Figure 31) suggests that there have been two periods when there has been sustained increased interest in the Council's work.

### Figure 31. Number of monthly visits to the Council's website 2013 to 2020

12-month moving average



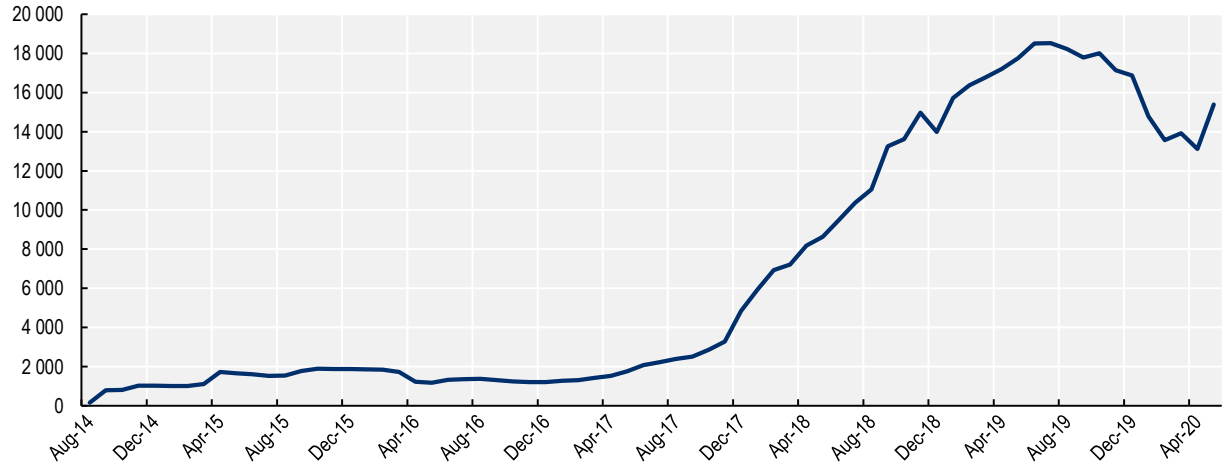

Source: Information provided by the Council.

The first was subsequent to the release of the June 2015 FAR, which set out critical views on the government's fiscal plans for 2016. In particular, the Council was critical of the government's medium-term budget plans which it said would breach fiscal rules. This report was followed by the Council's first Pre-Budget Statement in September 2015 which sustained interest in the matter. The second was subsequent to the release of the September 2018 Pre-Budget Statement, which highlighted the risk of budget over-runs in 2018 and of the budget going beyond plans in 2019. Furthermore, the Council's June 2019 FAR increased concerns about the use of corporation tax receipts to fund overspends. In response to the light shed on these issues by the Council, the Minister for Finance committed to a review of the sustainability of corporate tax income.[2]

Analysis of the Council's social media presence shows a clear upward trend, particularly since the beginning of 2017 when the second Chair took office and increased Council efforts in this area (Figure 32). Interest dipped in the latter half of 2019 when campaigning began for the General Election held in February 2020. However, Twitter impressions started to pick up again post-election in Summer 2020.

### Figure 32. Number of monthly Council Twitter impressions 2014 to 2020

12-month rolling average




Source: Information provided by the Council.

Some stakeholders mentioned that they would like to see the Council having an increased media presence, through increasing the assertiveness of its media messaging and interacting more with the media. For example, a number of stakeholders mentioned that months can go by when the Council is invisible in the media, and they would like to see the Council do more regular commentary on public finances. However, even if the Council were to have a more assertive approach, the part-time nature of the Chair (the public face of the Council) holds it back from being as 'present' in the public debate as it might want.

Another group of stakeholders are of the view that the Council's effectiveness is enhanced because it limits its engagement with the media to periods around its key publications and budgetary events, and does not overload the media with information. It would be interesting for the Council to debate these options and set out its preferred course of action in a formal communications strategy, as is done in peer institutions such as the Portuguese Public Finance Council (Box 16).

#### Box 16. The Portuguese Public Finance Council's Communications Plan

Each year, the Portuguese Public Finance Council develops a Communications Plan. The Plan sets out relevant context as well as institutional strengths, weaknesses, opportunities and threats in the area of communications. It then identifies goals for the Council's communications activities and a plan to achieve these. Furthermore, it provides an evaluation of recent communication efforts, including through satisfaction surveys and monitoring of media coverage and website traffic.

The annual Communications Plan is complemented by a Manual for Communications Procedures. This sets out procedures for communications around Council reports and press conferences. It also sets out the regular analysis that should be undertaken to monitor the Council's media impact.

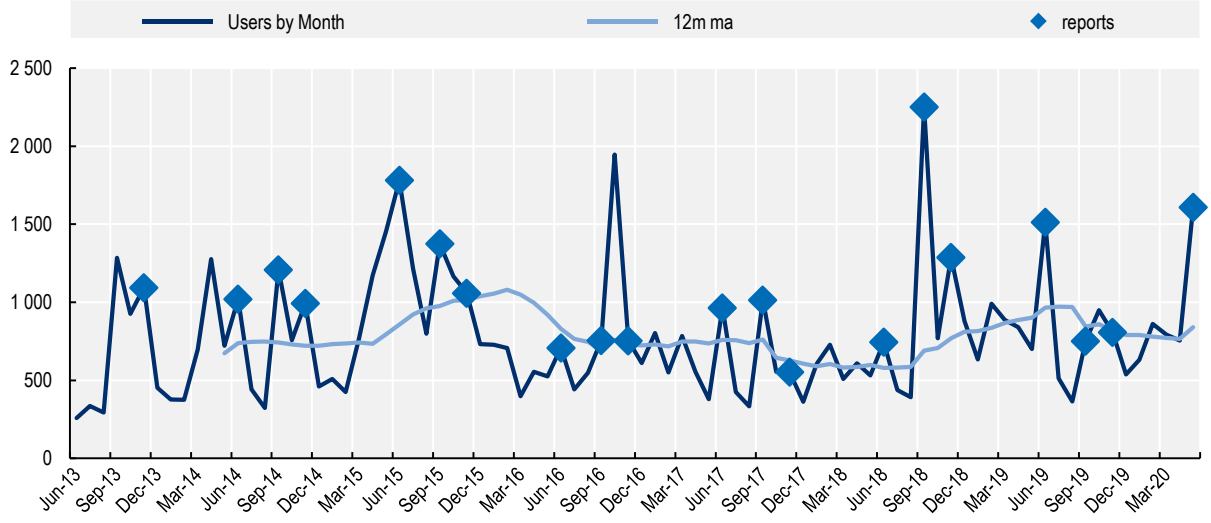
### *Timing of impact on public debate*

The Council's communications are more likely to result in impact if they intensify around major budgetary developments (such as unexpected outturns or ad-hoc policy announcements), key dates in the budget process, or specific public activities of the Council, including the launch of flagship reports or other useful reports. Regardless of whether the Council actually contributes to raise public awareness of public finance issues during these critical periods, an effective IFI should at least be more present whenever the public shows greater interest in these matters. By contrast, the absence of spikes and troughs in public attention might suggest a lack of focus in communication and/or difficulties to catch the public eye and influence opinions when it matters.

Data on the Council's web users by month (Figure 33) shows that there are spikes in the number of web users around the publication of reports, identified by red diamonds, suggesting that the Council's communications are well-targeted and effective.

## Figure 33. Fiscal Council's web users by month

Unique users initiating at least one session during period




*Note:* Dotted line shows 12-month moving average, red diamonds show publication of Fiscal Council reports.
*Source*: Information provided by the Council.

The increased attention around Council publications with important public finance messages signals the Council's ability to communicate effectively and influence public opinion when it matters the most. The Council's relatively well-spaced out publication schedule and associated media interventions likely foster the high correlation between the launch of Council reports and web traffic. Succinct summaries and strong messaging associated with these reports have also helped generate interest.

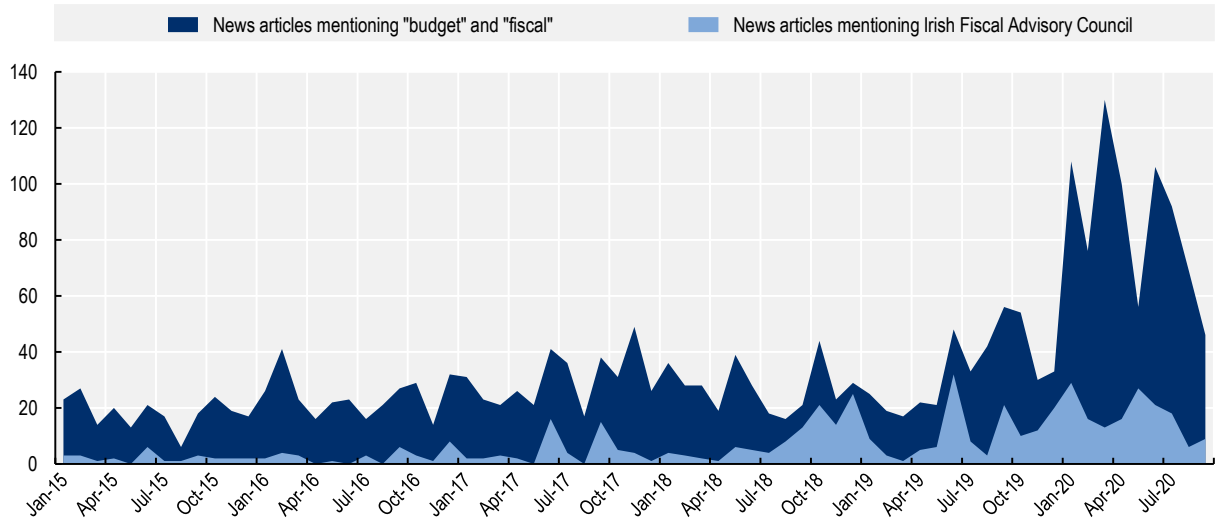
### *Media impact: Voice*

While the absolute indicators reported so far suggest that the Council is effective at using targeted communications to influence the public debate, they do not show whether the Council's messages are heard when key fiscal issues are being discussed. Since being heard is a necessary condition for being listened to, simple relative indicators can give a prima facie indication of the Council's importance in the public discourse on fiscal issues.

Figure 34 provides an indicator of the "voice" that the Council has[3], measuring the number of articles mentioning budget and fiscal issues vis-à-vis the number of articles mentioning the Council. The analysis shows that the Council's voice tends to rise and fall along with the number of articles relevant to budget and fiscal issues. This shows that the Council's work is relevant to topical public finance concerns.

## Figure 34. Number of articles containing the words "budget" and "fiscal", vis-à-vis the number of articles mentioning the Irish Fiscal Advisory Council

Google search: news, Ireland

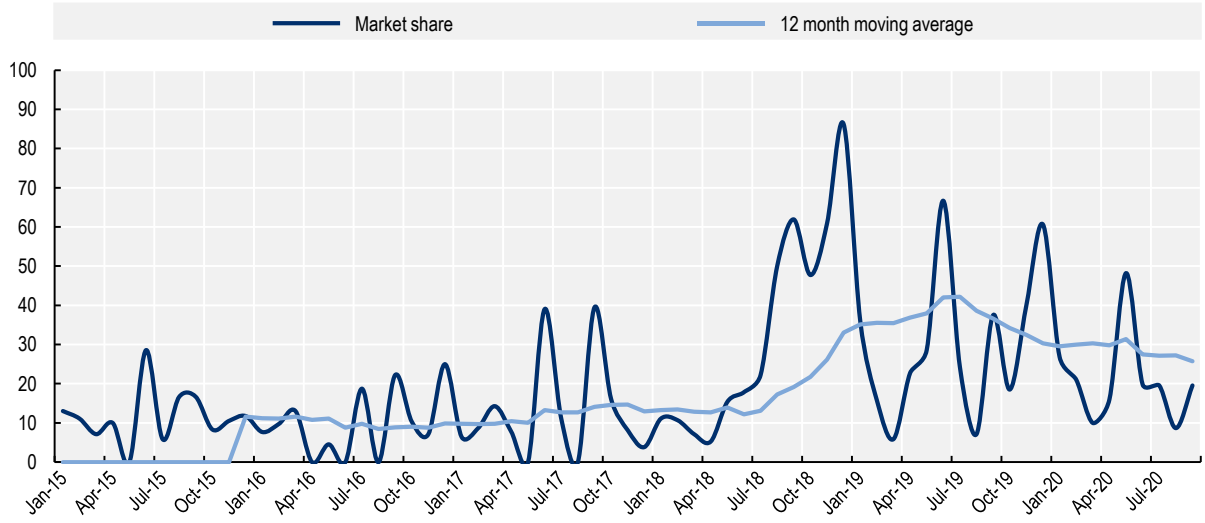



Note: Search terms used for the Irish Fiscal Advisory Council were "fiscal council" OR "fiscal advisory council"
Source: Information provided by the Council.

Further analysis in Figure 35 shows that in recent years the number of articles that the Council is mentioned in is 30-45% of the number of articles mentioning the keywords "budget" and "fiscal". This compares relatively favourably with earlier years in the Council's existence. It also compares favourably with similar analysis done for the Slovak Council for Budget Responsibility, showing that references to the Council were made in less than 10% of all of the media reports mentioning "government debt" and "budget". The Irish Council's "voice" peaked at 86% in December 2018. This is likely to be because of the Council's November 2018 FAR that warned about the risk of health over-runs becoming long-lasting spending items and concluded that the government's medium-term budgetary plans were not credible (Irish Fiscal Advisory Council, 2018[5]).

## Figure 35. Number of articles mentioning the Fiscal Council as a % of articles mentioning "budget" and "fiscal"

Google search: news, Ireland




Note: 12-month moving average
Source: Information provided by the Council.

### *Influence on the parliamentary debate*

Exerting a positive influence on fiscal policy decisions is usually easier when an IFI is able to influence the parliamentary debate. Although the Oireachtas has limited direct influence on the direction of fiscal policy, parliamentary debate can nevertheless exert pressure on the government decisions.

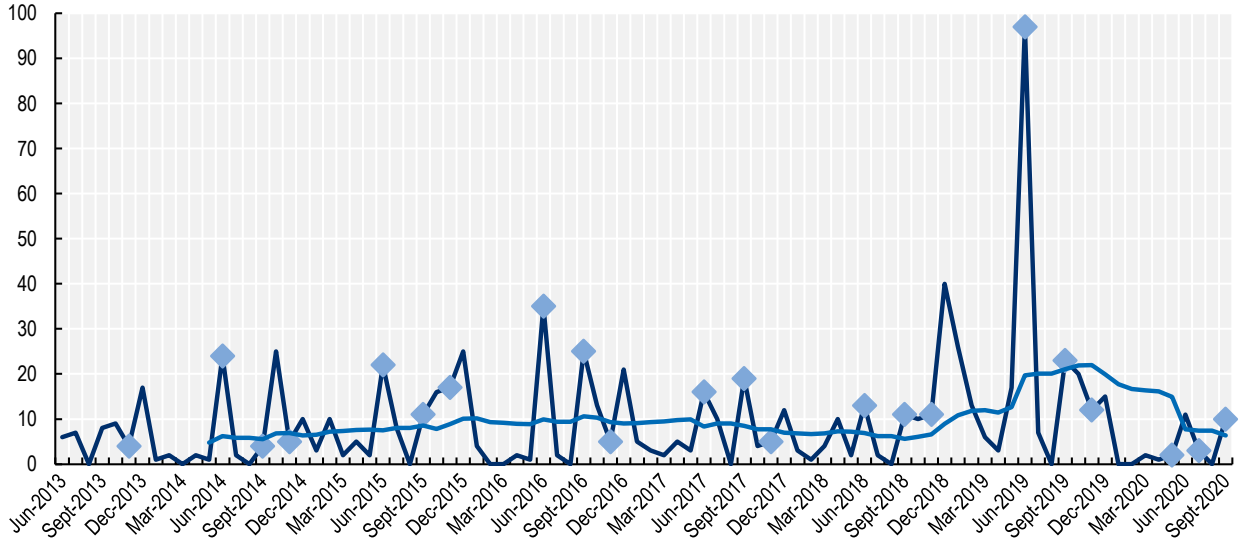
As mentioned in Section The Council's governance structure and key accountabilities, the Council usually appears before the Oireachtas Budgetary Oversight Committee on three occasions per annum. In general, the current level of engagement that the Council has with the Oireachtas allows the Council to have limited but meaningful engagement with parliament. Parliamentary appearances usually occur in the same week, or the week after, the Council report is published. Given the timing, it is unlikely that Committee Members have had the opportunity to read more than the report's Summary Assessment. However, Members of the Budget Oversight Committee often also benefit from a private briefing from the PBO that helps ensure that they are informed of the key issues raised in Council reports. Committee discussions with the Council have in the past framed a lot of the parliamentary debate around fiscal policy, and interactions with the Department of Finance.

One measure of the Council's impact on the parliamentary debate is the number of Council parliamentary mentions. Figure 36 shows the number of times that the Council was mentioned in either plenary or committee session each year since it was established, and the extent to which peaks correlate with Council publications.

The data shows that parliamentary mentions increase around the publication of the Council's reports. As was the case with visits to the Council's website, mentions were particularly high around the publication of the Council's June 2019 FAR which raised concerns about the use of corporation tax receipts to fund budget overspends. The political discourse around this in parliament is likely to be one of the factors that put pressure on the Minister for Finance to commit to reviewing the sustainability of corporation tax receipts.

### Figure 36. Parliamentary mentions by month

Number of mentions of "Irish Fiscal Advisory Council" across all debates




Note: Dotted line shows 12-month moving average, red diamonds show publication of Fiscal Council reports.

The majority of parliamentary mentions occurred in Committee debates (59%), with a third taking place in Dáil debates (33%) and just 8% in the Seanad. While Committee mentions often relate to the appearances of the Council, the mentions in Dáil debates more often relate to the numerous debates that happen throughout year on fiscal issues, for example the Summer Economic Statement, and regular parliamentary questions.

### *Enhanced fiscal transparency and improved fiscal management*

Stakeholders across the board are very positive about the effect that the Council has had on enhancing fiscal transparency in Ireland and improving fiscal management. This has occurred via a number of channels including through:

- efforts by the Council to help improve fiscal understanding;
- the Council raising concerns about areas of poor fiscal management; and
- the Council's work and interactions pushing the boundaries of the analytical community in Ireland.

The Council has made targeted efforts to help improve fiscal understanding among stakeholders, including the general public. As an example, its recent work on Stand-Still Scenarios details the cost of maintaining the current level of services into the future, taking into account inflationary pressures and demographics – information that was previously not available. Additionally, its work assessing the fiscal stance and in calculating fiscal space ahead of elections has helped broaden general understanding of the sustainability of different budget options. For example, the Council's fiscal space calculations ahead of the 2016 election were widely used by all parties and helped set the parameters of the election debate. The Council continues to invest in new outputs to help further fiscal understanding including, for example, publishing a Visual Summary of the Budget. This is a valuable resource for stakeholders seeking to quickly get to grips with the government's budgetary plans. Some stakeholders would like to see the Council dedicate greater efforts to increasing fiscal understanding among the public, for example through greater interaction with

the local press in Ireland. Options for this could be considered by the Council as part of the development of a formal communications strategy.

The Council has also been successful at raising concerns about areas of poor fiscal management. Parliamentarians often use the Council's material in this regard to frame political debate, helping to elicit a response from the government. For example, when the Council drew attention to health overspends and how they were being managed by the government. These were being treated as one-off expenditure items, however, the Council highlighted that each year's overspends were having an effect on the following year's budget. The Council's work was picked up in the political debate and this led to the government changing the way it treated health overspends, thereafter including the expenditures in subsequent budget baselines.

The Council also tried to highlight concerns about the design of a Rainy Day Fund that the government was proposing for Ireland, in order to improve its effectiveness. However, the impact of this work has been limited to date, with stakeholders hindered by the technical nature of the discussion. It shows the difficulty for any IFI in successfully raising concerns where the matter is of a more technical nature. Key challenges also remain around the communication of the Council's work with regard to fiscal rules, given the complex nature of EU fiscal rules, and fiscal space as a concept. The Council should continue to develop its communications across these area in a way that resonates with non-technical stakeholders so that its strong technical work can have greater impact.

The arrival of an IFI, whose work and methods are openly available, often enriches the technical community for fiscal policy. This is certainly the case in Ireland, where stakeholders report that the Council's work has helped push the boundaries amongst economic and fiscal analysts. For example, the new process that the Department of Finance goes through in explaining its forecasts to the Council is reported to have improved general analytical rigour around the forecasts. The Council's work on nowcasting prompted the Central Statistics Office (CSO) to start work in this area too. The CSO was also prompted to look again at its methodology for revisions affecting GDP in Ireland after the Council published a working paper on "Uncertainty in Macroeconomic Data: The Case of Ireland". However, the Council's biggest area of influence is likely in relation to the new methods it developed for assessing compliance with fiscal rules and measuring the output gap that are now used by wider stakeholders (Box 17).

### Box 17. New analytical methods developed by the Council and their impact

The EU's Commonly Agreed Methodology (CAM) for assessing fiscal rules suffers from large annual fluctuations in small open economies such as Ireland's. To address this, the Council developed a new approach that gives more stable and – according to stakeholders – more plausible results.

The Council's custom methodology differs in several ways. For example, the expenditure benchmark, GDP deflator, and convergence margins grow with the latest official estimates, rather than being frozen at certain vintages. The natural unemployment rate is held constant according to a rule of thumb based on Central Bank research on the labour market.

To estimate and project potential GDP and the output gap, the Council introduced suite modelling (using a number of different methodologies and averaging them). This is a simple but powerful solution to the problem of volatile results under a single model given the challenging modelling environment of the Irish economy.

To overcome the uncertainty stemming from frequent large revisions in Ireland's quarterly economic data, the Council developed a nowcasting tool using dynamic factor analysis to predict revisions. The CSO regarded the Council's work with great interest and reviewed their own approaches and methodologies in light of the Council's findings.

The Council also estimated and published new policy-adjusted revenue elasticities to forecast tax revenue. Previous elasticities were estimated from raw revenue series that conflated the impact of changes in government policy with the underlying growth of revenues with respect to their base. The Council created historical time series that deduct these policies to arrive at a more precise relationship between economic bases and revenues.

Stakeholders reported that the Council's impressive work in this regard has helped encourage Irish stakeholders, including the Department of Finance, to rethink their methods. Indeed, the Department of Finance has adopted many of the Council's approaches including suite modelling of the output gap. The EC also recognises the Council's approaches as useful complementary analysis to the CAM, helping provide a better understanding of the underlying Irish economic developments.

### *Conclusions and recommendations*

The Council has a proactive approach to communicating its outputs. While metrics such as website visits have not changed significantly year-on-year, peaks in interest around times when the Council is raising concerns about public finances shows it is able to be an effective communicator when it matters the most. The Council makes a limited number of media interventions relating to its core outputs. While the Council could make efforts to increase its media presence throughout the year, this could also risk diluting the attention given to its core publications. It would be interesting for the Council to debate these options and set out its preferred approach in a formal communications strategy.

Some stakeholders would like to see the Council taking further actions to increase fiscal understanding among the public, for example, through greater interaction with the local press. The viability of suggestions such as this can also be considered as part of the communications strategy.

A particularly positive development is the increased social media presence that the Council has gained in recent years. This provides the Council with additional opportunities to reinforce the key messages from its work, for example through making topical interventions that link back to previous publications. While social media was a particular strength of the – now departed – second Chair, the Council continues to utilise this as one of its main communications channels.

The Council's work is often picked up in political debate. Parliamentary mentions peak around the time of the Council's outputs, which are usually followed by appearances in front of the Budget Oversight Committee. Mentions were particularly high around the publication of the Council's June 2019 FAR which raised concerns about the use of corporation tax receipts to fund budget overspends. The political discourse around this is likely to be one of the factors that led the Minister for Finance to commit to reviewing the sustainability of corporation tax receipts.

The Council has also achieved significant impact through enhancing fiscal transparency, highlighting concerns about fiscal management and pushing the boundaries of fiscal policy analysis in Ireland. Key achievements include; providing fiscal space calculations that have helped set the parameters of election debates; drawing attention to health overspends being treated as one-off budget items; and developing an improved methodology for the calculation of the output gap in Ireland which is now used by a range of national and international stakeholders.

However, the Council still struggles to achieve impact in relation to more technical communications, for example around the Council's work with regard to the Rainy Day Fund, fiscal rules and fiscal space as a concept. The Council should continue to develop its communications in this area in a way that resonates with non-technical stakeholders so that its strong technical work can have greater impact.

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## Notes

[1] This is in line with the recommendations of a 2015 Peer Review of the Irish Fiscal Advisory Council.

[2] The Oireachtas Parliamentary Budget Office provides independent and impartial information, analysis and advice to the Houses of the Oireachtas. This is further discussed in Sub-section “Oireachtas Parliamentary Budget Office (PBO)”.

[3] The mandate was expanded in 2013 to comply with new EU regulations. These changes gave the Council an endorsement function in relation to the official the macroeconomic forecasts underlying national medium-term fiscal plans and the draft budget.

[4] The limit was originally two terms, but this was amended to three terms as of December 2020 - https://www.oireachtas.ie/en/bills/bill/2020/61/

[5] The “One Person One Salary” principle requires that public servants who sit on state boards should not be paid remuneration in the form of board fees when serving in such a representational capacity.

[6] This being said, Regulation (EU) No 473/2013, which is directly applicable for euro area Member States, empowers IFIs to have “*appropriate access to information to carry out their mandate*”.

[7] Both of these actions align with recommendations in a 2015 Peer Review of the Irish Fiscal Advisory Council

[1] Given the possibility of conflicting assessments from the Council and the EC in marginal cases, the Council prefers to reserve this tool for occasions when there are severe issues in relation to compliance with domestic fiscal rules.

[2] See Irish Times, Donohoe to review corporation tax sustainability, June 19 2019.

[3] The Irish Fiscal Advisory Council refer to this as their “market share measure”.

# Annex 1.C. Review team and acknowledgements

The review team would like to thank the Council and Secretariat at the Irish Fiscal Advisory Council, as well as the many individuals who agreed to be interviewed for the review, for their frank and candid discussions of all issues during the review process.

The review team would also like to thank Jon Blondal, Head of the Public Management and Budgeting Division at the OECD for his thoughtful comments.

## Review team

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**Christina Håkanson** is a Senior Economist at the Swedish Fiscal Policy Council. Her role includes assessing fiscal policy, evaluating macroeconomic forecasts, and performing micro-simulations of taxes and transfers. She has previously worked at the Forecasting Department, Monetary Policy Department at Sveriges Riksbank with a focus on labour market forecasting and analysis. She holds a PhD from the Institute of International Economic Studies, Stockholm University.

**Stephen Kinsella** is Associate Professor of Economics at the University of Limerick's Kemmy Business School, Senior Fellow at the Melbourne School of Government at the University of Melbourne and Research Associate of the Rhodes Centre at Brown University. Stephen's research centres on the macroeconomics of small open economies, and particularly Irish fiscal policy.

**Scherie Nicol** is a Senior Policy Analyst in the Public Management and Budgeting Division, Directorate for Public Governance, OECD. She specialises in the areas of independent fiscal institutions and parliamentary budget oversight. 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.

**John Smidt** is Director at the secretariat of the Danish Economic Council (DEC, the Danish Independent Fiscal Institution). He has been with the DEC for 25 years, and he has been directly involved in short and medium term forecasting, analysis of long-term fiscal sustainability, development and usage of macroeconomic models, and assessments of public finances and economic policy. Prior to his engagement with the DEC, he worked for seven years at the Statistics Denmark as part of the macroeconomic modelling team.

# Annex 1.D. Interview list

The review team would also like to thank all those who have contributed evidence and insights to this review, in particular individuals from the following institutions and groups who met with the review team during its virtual discussions in June and July 2020:

- Academics and think tanks:
  - Dublin City University Business School, Economic and Social Research Institute, Nevin Economic Research Institute, Trinity College Dublin, University College Dublin, University of Limerick.
- Adviser, Minister for Public Expenditure and Reform
- Central Bank of Ireland
- Central Statistics Office
- Department of Finance
- Department of Public Expenditure and Reform
- European Central Bank – Professor Phillip Lane
- European Commission – Ireland Country Desk DG ECFIN
- Houses of the Oireachtas
  - Parliamentary Budget Office, Clerk to the Budget Oversight Committee, Current and former Teachtaí Dála (TD) from Fianna Fáil, Irish Solidarity–People Before Profit and Labour.
- Independent Authority for Spanish Fiscal Responsibility (AIReF)
- Irish Fiscal Advisory Council
  - Chair and former Chairs, Council members and former Council members, Secretariat.
- Media
  - Irish Times, RTÉ.
- Minister for Finance - Paschal Donohoe
- National Economic and Social Council
- National Treasury Management Agency
- Office of the Comptroller and Auditor General
- Private sector forecasters
  - Bank of Ireland, Brady, Davy, Goodbody Stockbrokers, Ulster Bank.
- Office of the Revenue Commissioners

# Annex 1.E. Assessment of Council adherence to international standards

## Annex Table 1.E.1. Does the Irish Fiscal Advisory Council meet the OECD Principles for Independent Fiscal Institutions (assessment of legislation and practice)?

| OECD Principle | Is there a related EU-IFI standard? | Assessment | Notes |
|---|---|---|---|
| 1. LOCAL OWNERSHIP | | | |
| **1.1 Broad national ownership, commitment, and consensus across the political spectrum. Models from abroad should not be artificially copied or imposed.** | In preamble | ● | Although the Council was established largely through externally imposed reforms following a fiscal crisis, it has been implemented at the national level with broad buy-in from stakeholders. Ireland exited the external Troika procedures, and the office has continued with cross-party support and appreciation from other domestic institutions. |
| **1.2 Local needs and the local institutional environment should determine options for the role and structure of the IFI.** | In preamble | ● | Ireland's twin economic and fiscal crises and volatile macro-fiscal framework generated a need for a monitoring body with the mandate of the Council regardless of external pressure from lenders. The institutional context has resulted in a creative and sensible made-in-Ireland option with the Council placed arms-length within ESRI, leveraging that institution's operating capacity and long history while remaining analytically and operationally independent. |
| 2. INDEPENDENCE AND NON-PARTISANSHIP | | | |
| **2.1 Does not present its analysis from a political perspective; strives to demonstrate objectivity and professional excellence, and serves all parties. IFIs should be precluded from any normative policy-making responsibilities to avoid even the perception of partisanship.** | | ● | Stakeholders report confidence in the Council's political neutrality. The Council and its secretariat are respected professionals. The Council avoids normative programme-level recommendations and analysis not explicitly required by its mandate. The Council is independent from the legislature, with little interaction with legislators and parties other than during committee appearances. |
| **2.2 The leadership of an IFI should be selected on the basis of merit and technical competence, without reference to political affiliation. The qualifications should be made** | ✓ | ● | The Council is appointed by the Minister, who is explicitly required by the schedule of section 7 (c) of the *Fiscal Responsibility Act 2012* to "have regard to the desirability of their having competence and experience in domestic or international macroeconomic or fiscal matters." Council members thus far have been well-respected and neutral economic and policy experts. |

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|---|---|---|---|
| **explicit.** | | | |
| **2.3 Term lengths and number of terms that the leadership of the IFI may serve should be clearly specified in legislation along with dismissal criteria and process.** | | ● | Members are appointed for 4 years, can serve three consecutive terms, but are eligible for reappointment after a break. Termination criteria are specified in Schedule 4 (2) of the *Fiscal Responsibility Act 2012* and range from health, bankruptcy, convicted offences, conflict of interest, or other severe malfunctioning of the Council, and only by a resolution passed by the Dáil Éireann. |
| **2.3 The leadership's term should optimally be independent of the electoral cycle.** | ✓ | ● | Ireland's political cycle has a statutory limitation of 5 years, a constitutional limitation of 7 years, and in practice it has averaged slightly over 3 years over history. Member term length is 4 years. |
| **2.4 The position of head of the IFI should be a remunerated and preferably full-time position. Strict conflict-of-interest standards should be applied.** | ✓ | ◖ | Remunerated, not full-time. The remuneration has received criticism, both from being insufficient for the time demands of the office, and for its context within Ireland's public sector one income policy, whereby academics cannot supplement, but merely displace their university incomes, and universities are hesitant to reduce their responsibilities. Members can be dismissed for conflicts of interest. |
| **2.5 The leadership of the IFI should have full freedom to hire and dismiss staff in accordance with applicable labour laws.** | ✓ | ● | The Council has full freedom to hire and dismiss staff within the bounds of its financial and human resources parameters, which are determined by negotiations with the Minister for Public Expenditure and Reform. Formally, the *Fiscal Responsibility Act 2012* prescribes that the Fiscal Council is free to appoint "such and so many persons to be members of the staff of the Fiscal Council, and on such terms, as may be determined by the Fiscal Council with the prior consent of the Minister given following consultation with the Minister for Public Expenditure and Reform." |
| **2.6 Staff should be selected through open competition based on merit and technical competence, without reference to political affiliation, in line with civil service conditions.** | | ● | Staff are recruited based on their ability to carry out analytical and administrative tasked to fulfil the Council's functions. Vacancies are advertised. That said, financial constraints mean the Council can offer few permanent positions. Research assistant positions are temporary and with few paths to senior positions retaining talent is difficult. |
| 3. MANDATE | | | |
| **3.1 The mandate should be defined in legislation, including types of reports and analysis they are to produce, who may request them and timelines for release.** | | ● | Annual reports are specified. Required assessment and endorsement functions are specified in legislation. No requirement to fulfil requests for clients. Timelines "as soon as practicable" in relation to major budget and European Semester events. |
| **3.2 IFIs should have the scope to produce reports and analysis at their own initiative and autonomy to determine their own work programme within their mandate.** | ✓ | ● | Council can and does produce reports of its own autonomy. While it is not specified explicitly in legislation, this power is considered to fall under the clause of independence and "all such powers as are necessary for, or incidental to, the performance of its functions". |
| **3.3. Clear links to the budget process should be established within the mandate.** | | ● | Yes, clear ties for assessment of the official forecasts and rules surrounding the budget, as well as the European Semester. |

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| 4. RESOURCES | | | |
| **4.1 The resources allocated to IFIs must be commensurate with their mandate.** | ✓ | ● | Resources are sufficient for now. The Council exceeds its strictly mandated endorsement and assessment requirements. If left unadjusted, the current legislated budget could bind in time, but the government is open to discussions for more funding in the future. To strictly fulfil its mandate the Council could cut back on its research programme, but transparency and availability of important self-initiated reports would suffer. |
| **4.1 The appropriations for IFIs should be published and treated in the same manner as the budgets of other independent bodies.** | ✓ | ● | The Council's funding arrangement exceeds the practice of other bodies. It is set in legislation and paid directly out of the state's central fund. This arrangement protects the funding from political interference as it is not subject to annual decisions by the Dáil. |
| **4.1 Multiannual funding commitments may further enhance the IFIs independence and provide additional protection from political pressure.** | | ● | The Council's budget is set in legislation guaranteeing multi-annual stability in real terms as it is indexed to inflation. Some stakeholders were concerned over an eventually binding ceiling as wages and rent have exceeded consumer price inflation, but the arrangement compares very favourably to other offices in terms of protection from political pressure. |
| 5. RELATIONSHIP WITH THE LEGISLATURE | | | |
| **5.1 Mechanisms should be put in place to encourage appropriate accountability to the legislature.** | ✓ | ● | Under the Ministers and Secretaries Amendment Act (2013), the Council is required to produce an annual report for the Minister for Public Expenditure and Reform who forwards a copy to the parliament "as soon as reasonably practicable" (Article 13).<br>The Council is also required to submit its annual accounts before the Oireachtas in a timely fashion and Dáil committees can also request that the Chair give evidence on the accounts. Committees in both houses can request that the Chair account for the performance of the functions of the Council. |
| **5.1 The budgetary calendar should allow sufficient time for the IFI to carry out analysis necessary for parliamentary work.** | ✓ | ● | There is sufficient time to carry out the necessary analysis according to feedback from Council members and the secretariat. |
| **5.2 The role of the IFI vis-a-vis the parliament's budget committee (or equivalent), other committees, and individual members in terms of requests for analysis should be clearly established in legislation.** | | ● | The Council's operational independence does not require it to fulfil requests for analysis (although it will do so voluntarily). The Council's obligations to the Oireachtas and its committees on governance issues are defined clearly in Schedule 7 Section 11 of the *Fiscal Responsibility Act 2012*. |
| 6. ACCESS TO INFORMATION | | | |
| **6.1 IFI should have full access to all relevant information in a timely manner.** | ✓ | ◖ | The Council reports that it receives the information it requires, but that it often involves time and energy that strains the small team. Further, if the Council is to increase the depth of its fiscal analysis and prepare for the government's transition to international public-sector accrual reporting standards it may need greater access to micro tax and programme spending data. |

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|---|---|---|---|
| **6.2 Any restrictions on access to government information should be clearly defined in legislation.** | ✓ | ■ | The *Fiscal Responsibility Act* only prescribes generally that "The Fiscal Council has all such powers as are necessary for, or incidental to, the performance of its functions." This places essentially no restriction on access to government information, which is untenable and leaves the Council exposed to challenges of its access rights. |
| 7. TRANSPARENCY | | | |
| **7.1 IFI should act as transparently as possible, including full transparency in their work and operations.** | | ■ | The Council provides no confidential research—all is published on its website. Committee appearances are always open to the public. |
| **7.2 IFI reports and analysis (including underlying data and methodology) should be published, made freely available to all and sent to parliament.** | | ■ | All of the IFI's analysis are published and freely available, and the underlying methodologies are provided in journal-quality working papers, including not just stylised equations but also in many cases the parameters and model estimation information that would easily allow outsiders to recreate the results. The secretariat will engage with interested outside analysts to share code and assist further with replicability. |
| **7.3 The release dates of major reports and analysis should be formally established, especially in order to co-ordinate them with the release of relevant government reports and analysis.** | | ■ | Release dates of major reports are as predictable as possible under the budget cycle, and align with the requirements of surveillance dates under the European Semester. |
| **7.4 IFIs should release their reports and analysis, on matters relating to their core mandate on economic and fiscal issues, in their own name.** | | ● | All reports are released under the Council's own name and letterhead on its own website. |
| 8. COMMUNICATIONS | | | |
| **8.1 IFIs should develop effective communication channels from the outset.** | ✓ | ● | Stakeholders commended the Council's use of press releases, social media engagement, conferences, and briefings. Many were in place from the beginning, or were improved upon after the 2015 external review. |
| 9. EXTERNAL EVALUATION | | | |
| **9.1 IFIs should develop a mechanism for external evaluation of their work.** | ✓ | ● | The Council has regular external reviews targeted at five-year intervals, most recently in 2015 and this review in 2020. |
| Key: ●=yes; ◖=partial; ○= no | | | |

Note: This table has been updated from previous OECD IFI reviews to reflect the newer EU IFI standards released in January 2019.
See https://www.euifis.eu/download/statement_reinforcing_and_protecting_ifi_s.pdf

# The finance function of line ministries in the Netherlands

Dirk-Jan Kraan

The author is grateful to Sander Harmes, Bureau Budget Administration of the Directorate Budget Affairs; Petra Lugtenburg, Director General of the Budget; Peter van den Berg, former Dep. Director General of the Budget; Hans Monnickendam, Director Financial and Economic Affairs of the Ministry of General Affairs (Prime Minister's office); Corina den Broeder, Director of the National Academy of Finance and Economics of the Ministry of Finance; and Jon Blondal, Head of the Public Management and Budgeting Division of the OECD for helpful comments on an earlier version of this paper. The opinions expressed and arguments employed herein are solely those of the author, written in his personal capacity.

**JEL classification:** E62, H11, H60, H61

**Keywords:** budgeting, budget reform, machinery of government, the Netherlands

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## The finance function in line ministries

### *The case of the Netherlands*

The finance function is conceived in this paper as the range of activities required for the formulation and implementation of the budget. In OECD countries this work is usually carried out by the Ministry of Finance and by the line ministries. The role of line ministries and the organisation of the finance function in line ministries differs widely between countries. This paper focuses on the finance function in line ministries in the Netherlands, where each ministry has an established finance directorate.

The finance directorates in line ministries in the Netherlands move beyond general financial administration to encompass: (a) the supervision of aggregate spending in the line ministry (further to be called budget control), (b) priority setting within the ministerial portfolio (further to be called reallocation), and (c) the supervision of the efficiency and effectiveness, or value for money of the ministerial spending programmes (further to be called operational control). In short, the finance directorates function as the internal finance ministry of each line ministry.

### *Contents of the paper*

Since there is a close connection between the role of the finance directorates in line ministries and the procedure of medium term fiscal planning, the paper will first look at the latter (Section on “Medium Term Budgeting in the Netherlands”). This procedure is based on ministerial ceilings and delegation of the responsibility to maintain the ceilings to the line ministries. Subsequently the paper will pay attention to their role in ensuring budget control (Section on “Budget control”), reallocation (Section on “Reallocation”) and operational control (Section on “Operational control”). Finally the paper will look at the typical organisation of the finance function in line ministries and provide some quantitative data (Section on “The organisation of the financial function in line ministries”). In the last section some conclusions will be presented (Section on “Conclusions”).

The paper uses information provided by four finance directors, who were interviewed for this purpose.[1] The paper also makes use of the last periodic survey by the Ministry of Finance of the financial function in the Dutch government (Ministry of Finance, 2019[1]).

## Medium Term Budgeting in the Netherlands

### *The role of line ministries in medium term budgeting*

In the Netherlands, the line ministries always had relatively strong finance directorates as a consequence of coalition governments and the absence of a strong centre of government. There are currently 13 line ministries in the Netherlands. In contrast to the situation in many OECD countries, the responsibility for the State budget is divided between the Minister of Finance and the individual ministers. The Minister of Finance submits the budget to Parliament and is held responsible for its main features (the macroeconomic aspects, taxation and the main expenditure priorities), but the line ministers are responsible for their own budget chapters and represent the government in the Parliamentary debate on these chapters.

The strong position of individual ministers was enhanced with the introduction of trend based medium term budgeting in 1994. From then on line ministries were made responsible for the maintenance of their medium term budget ceilings. These ceilings included social security, health care and other mandatory spending. Stabilisation was to work via the revenue side of the budget (by allowing revenues to fluctuate with the economy), not via the expenditure side.

There have been some policy changes since 1994 with respect to the inclusion under the ceilings of: (a) interest on public debt, (b) unemployment benefits and (c) wage and price inflation, based on arguments related to controllability and automatic stabilisation, but over the whole period more than 90% of central government and social security expenditure has been included in the ceilings.[2]

### *The Medium Term Expenditure Framework of the Dutch central government*

The Dutch Medium Term Expenditure Framework (MTEF) is prepared during the cabinet formation and applies to the entire cabinet period. It consists of an aggregate ceiling for central government, consisting of the 13 ministerial ceilings of the budget chapters for which the line ministers are responsible, and 2 special ceilings for social for social security and for health care. The special ceilings include the expenditures of the social insurance and health care insurance funds[3] and also some related expenditures that are included in the state budget. The ministerial ceilings include all state expenditures, except the ones that are included in the special ceilings.

The minister of Social Affairs and Employment is responsible for the social security ceiling and the minister of Health, Wellbeing and Sport is responsible for the health care ceiling (in addition to their ministerial ceilings).

### *Medium term line item estimates as political agreements*

Realistic medium term estimates at the line item level[4] help to maintain the expenditure framework. In the Netherlands the realism of the estimates is furthered by the involvement of the Bureau of Economic Analysis[5] in the forecasting of the macro variables that affect many estimates (GDP, wages, inflation, demographics, etc.). However, the realism of the medium term estimates is not the main reason for the strength of the Dutch expenditure framework. The main reason is that the medium term estimates have the status of political agreements among ministers, under the proviso that future changes are possible if they are fully offset by changes in other line items.[6] In this light the factual accuracy of the estimates is a matter of secondary importance. This is a crucial matter, because in many areas factual accuracy is intrinsically hard or impossible to achieve in view of permanently changing social and economic circumstances.

Given the character of the line item estimates as political agreements, the question arises whether there is any difference in formal status between the MTEF (the ceilings) and the line item estimates. In the Dutch case, the answer is no. The formal status of the MTEF and the medium term estimates is exactly the same: both are politically agreed targets. This implies that at the moment of revision both may increase or decrease spending vis-à-vis the previous situation. The difference does not concern the normative status, but the conditions for revision. Although both the MTEF and the medium term estimates are part of the coalition programme, and thus hard to change, the conditions for change of the medium term estimates are somewhat less strict than those for change of the MTEF. The MTEF thus provides more stability and the medium term estimates more flexibility.

### *The Dutch four-year budget*

Given the status of the line item estimates in the Netherlands it can be said that at the start of the cabinet period, there is not only an MTEF, but a complete four year budget, including an aggregate total, ministerial totals and line item estimates.

The line items can be changed if off-set or “compensated” by reverse changes on other line items, ministerial totals can only be changed if compensated by other ministries, the aggregate total can in principle not be changed although in practice it has occurred occasionally (with permission of the cabinet)

as a consequence of major external shocks, such as the global financial crisis, major long term reform packages, such as the recent pension reform and climate agreement, and the current COVID-19 crisis.

Formally there is still an annual budget law in the Netherlands, but materially, there is a four-year budget. The budgetary and medium term line item estimates are updated (with compensation) three times per year: once in the early spring, communicated to Parliament in the first supplementary law (and the Spring Memorandum), and twice in the summer, communicated to Parliament in the annual budget bill (and the Budget Memorandum).[7] Changes beyond the current and upcoming budget year are not formally authorised but can of course be debated in Parliament.

Line ministries are advised to concentrate important proposals for new policy and the complementary compensation proposals to cabinet sessions in the spring, which are devoted to the upcoming budget (the so-called "main decision moment"). This is the default option. When new policy proposals arise during the year the ministry of Finance will seek to make it part of the upcoming main decision moment. In practice this is not always possible. If necessary, important and urgent budget decisions are sometimes taken outside the main decision moment.

It can be concluded that in the Netherlands there is a four-year budget with relatively important periodic adjustments, which are intermittently communicated to Parliament through budget laws and supplementary budget laws. This arrangement implies that "budget formulation" is a permanent process, rather than an annual process, with an entirely different procedure at the occasion of the cabinet formation. The differences at the latter occasion are twofold: (1) during the cabinet formation, the process is free and there are no compensation requirements, whereas the periodic updating procedure is strictly regulated and subject to the compensation requirements, and (2) during the cabinet formation the process is led by the party negotiators with often an important supporting role for the Ministry of Finance, whereas the periodic updating procedure is dominated by the line ministries. These differences can be explained as follows.

### *Procedural constraints and compensation requirements*

Since 1994, the four-year budget is part of the coalition programme, including all estimates at the line item level (around 160 line items). The coalition programme is prepared by the party negotiators, but the procedure is not set and can differ from case to case. Sometimes there is a role for members of parliament, sometimes not. Sometimes, some key ministries are strongly involved, sometimes not. The negotiations start from the existing medium term estimates. These estimates are "policy poor". This is a consequence of the rule that during a cabinet formation no policy decisions can be taken that affect the budget exclusively after the cabinet period (the cabinet cannot govern beyond its grave) and that during the cabinet period the compensation rules fully apply to the period after the cabinet period. Line item estimates can go up and down without compensation internally or between ministries and there is no aggregate ceiling that has to be respected. In practice the aggregate ceiling is decided in view of macroeconomic considerations and party priorities for new spending or tax relief.

In contrast, the process of periodic updating during the life time of the MTEF is strictly regulated. All changes have to be compensated, while respecting the rules of budgetary discipline. These rules provide detailed prescriptions about the forms of compensation that are allowed and prohibited. All changes and compensations have to be approved by the Ministry of Finance.

### *Roles of the Ministry of Finance and the line ministries*

The formulation of the coalition programme is a centralised process. In fact it is the most centralised process that exists in the Dutch government. Only a few party leaders are fully informed. The process can take several months and is very secretive. Nothing is decided before everything is decided. Party negotiators can invite advisors and experts to provide information, for instance the director of the Bureau of Economic Policy Analysis or parliamentarians with sectoral knowledge. The staff of the Prime Minister

provides secretarial support. The Ministry of Finance is usually asked to provide support with the formulation of the four-year budget. Once the process is completed, the coalition programme presents the complete four-year budget. Line ministers are not formally consulted, although they may try to understand what is going on via befriended party leaders.

In contrast, the process of updating is to a large extent dominated by the line ministries. They have to propose the changes in the line items. The Ministry of Finance has to approve the changes, but changes that comply with the compensation requirements are hard to challenge.[8] The role of the Ministry of Finance in the updating process focuses on the interpretation of the compensation requirements and in some years on the brokerage of inter-ministerial compensation, including the implicit general compensation round that sometimes takes place at the occasion of the main decision moment. In the last cabinet period large financial packages, containing implicit inter-ministerial reallocations, have regularly been decided at various times during the year outside the main decision moment. In view of the importance of these packages, it can be argued that the dominating role of the line ministries in the updating process has become less marked than has been the case in previous cabinet periods, but then it must also be noted that each of these packages were responses to rare and unique external developments (climate agreement, pension reform, housing agreement). It is well conceivable that such developments will not occur in future cabinet periods.

## Budget control

### *The process of updating budgetary and medium term estimates*

Budget control consists in the supervision of aggregate ministerial spending. This includes the assessment of the budgetary expenditure estimates of existing and new policy in the budget year and future years and taking timely action if changes are required. The primary responsibility for the estimates is with the sectoral directorates of the line ministries, but the supervising role implies that the finance directorate has to assess the estimates and can advise about changes on its own initiative.[9]

When updating the budgetary and medium term estimates, the line ministry has to categorise every change as: (a) policy, (b) autonomous, or (c) technical.

- Policy updates have to be based on policy information, for example, a new law or ministerial regulation or a ministerial instruction to an agency concerning a change of executive policy. Policy updates can be increases, but also decreases. Decreases must be justified in terms of savings measures in the underlying policy.
- Autonomous updates have to be based on information about changes in the costs of services or the demand for services. Like policy updates, autonomous updates can lead to increases or decreases of expenditures. Many autonomous updates apply to entitlement expenditures, but they can also apply to discretionary expenditure. For instance, an unexpected salary increase for a certain group of public sector employees, can lead to the cost increase of a certain service. In such a case it is generally not possible to maintain the service level without additional expenditure.
- Technical updates occur in case of internal financial transfers or changes in the accounts structure and are per definition neutral for the budget balance.

According to the rules of budgetary discipline, all policy increases have to be offset by policy decreases under the same ceiling. Autonomous increases can be compensated by autonomous decreases. However, in the absence of sufficient autonomous decreases, autonomous increases have to be compensated by policy decreases. Autonomous decreases that cannot be used to compensate autonomous increases have to be given back to the Ministry of Finance. In principle increases should be fully covered by compensation in the same year, but with the approval of the Ministry of Finance, compensation can take place in other

(earlier or later) years (intertemporal compensation). Only if the scale of an increase exceeds the responsibility of a single ministry, the cabinet may allow compensation from decreases in other ministries (general compensation).

The budget approved by Parliament is an upper limit. Because it is practically impossible to precisely forecast expenditures, line ministries will in general spend less than their budget. In order to prevent inefficient spending towards the end of the year, line ministries are allowed to transfer 1% of actual gross expenditures to the next budget year. This rule does not apply to expenditures of funds[10] which can be transferred without limit. The total of actual transfers in a given year, must be compensated in the next year (possibly by a similar transfer to the following year), so that the transfers do not burden the budget balance in any year (the "in = out rule").

If no agreement is reached about updates between the finance directorate and the Inspectorate of Finance[11] of the Ministry of Finance, the problem can be submitted to higher levels in the administration and ultimately to the ministers. However, finance directors who were interviewed for this paper, indicated that in practice conflicts over budget updates occur rarely. Differences of opinion between line ministries and the Inspectorate of finance are usually solved in deals that include more issues simultaneously, for instance estimation assumptions (for instance of student numbers, or unemployment numbers) and intertemporal compensations (between budget years), next to specific compensations. These deals are concluded by the relevant section head of the Inspectorate of Finance and the finance director of the line ministry. It should be kept in mind that there are daily contacts (by mail and telephone) between the finance directorates and the Inspectorate. The finance directors and section heads of the Inspectorate meet at least once per week and more often if necessary. Differences of views build up over the weeks and are then solved in deals that precede cabinet decisions on new policy initiatives (when compensation has to be approved) or budgetary documents (the budget law and the supplementary laws). Sometimes deals need prior approval by the Director General of the Budget and the Secretary General or a Director General of the line ministry.[12] It is up to these officials whether and when they want to be involved. Deals may also require prior approval by the line minister. The most important issues may be discussed and agreed by the ministers themselves. One finance director said that 90% of controversial issues are solved at the level of the Inspectorate of Finance and the finance director (possibly with prior approval of higher levels) and 10% at the level of ministers. Another finance director said: 80% of issues are solved between the Inspectorate of Finance and the finance director (possibly with prior approval of higher levels), 10% between the Director General of the Budget and the Secretary General (and/or the relevant Director General) of the line ministry and 10% at the level of ministers. However, these are rough estimations, that may not apply to all ministries.

The process of budget control in the line ministries allows the Ministry of Finance to monitor and approve all changes in the budget and the medium term estimates. The consultation with the Ministry of Finance proceeds mainly through the ICT system IBOS (Interdepartmental Budgetary Consultation System, see Box 18).

### Box 18. The Interdepartmental Budgetary Consultation System (IBOS)

IBOS includes for every line item of the budget: the actuals of the previous budget year, the current budget appropriation and the medium term estimates for the next five years. In the Netherlands the budget year coincides with the calendar year. After the budget for the upcoming year is submitted in September to Parliament the actuals of the previous year are dropped from the system and a new year is added to the medium term estimates.

Prior to the moments that Parliament is informed about changes in the budget or the medium term estimates, changes can be proposed by the line ministries when the Ministry of Finance opens the system for updating. There are three updates when both budgetary and medium term estimates can simultaneously be adjusted: one in the early spring, reported to Parliament in the first supplementary budget law, and two in the summer, reported to Parliament in the Budget Bill. Furthermore, the current budget is normally updated once in the autumn (without changes of medium term estimates), reported to Parliament in the second supplementary law (in November). Finally, there are two updates of last year's budget in the first months of the year. Thus in total there are usually six updates during the year of which three including the medium term estimates.

Every increase in a line item has to be compensated by a decrease in the same year under the same ceiling (specific compensation). The Inspectorate of Finance of the Ministry of Finance has to approve all updates, including compensations. The Inspectorate can consult with the line ministry before approving and ask for better explanation or better compensation.

The finance directors interviewed for this paper felt that in general the compensation rules are working well, but that in practice they are used with some flexibility. Sometimes the Ministry of Finance allows the use of windfalls (autonomous decreases) to finance new policy. Formally this is general compensation, but since everybody knows that some windfalls are not purely autonomous and that line ministries have a certain influence on their occurrence and size, it is logical that the Minister of Finance is compliant in the use of these windfalls.

The 1% rule for transfer of expenditures to the next budget year is used with flexibility as well. The Minister of Finance has waived the rule for development assistance (multi-year transfer) and major investment projects (unlimited transfer), thus allowing for more flexibility. Moreover, cash shifts[13] are allowed to a considerable extent to move resources from and to future budget years thus avoiding the need for (formal) intertemporal compensation.

### *Risk analysis*

Another task of the finance directorate in the sphere of budget control is the supervision of the conduct of ministerial risk analyses. Although this task has only recently been acknowledged as a mandatory task of all finance directorates,[14] according to the report of the Central Audit Service of March 2020 on the financial function "all ministries state that they avail of a system of risk management, in which the principles are clearly defined and it is clear which ministerial units are involved" (Ministry of Finance, State Audit Service, 2020[2]). In most ministries the finance directorate fulfills a co-ordinating role with respect to ministerial risk analysis (in two ministries a sectoral directorate fulfils this role). Finance directors interviewed for this paper indicated that this role is still in development and that there are still wide differences between ministries in how this task is approached.[15]

## Reallocation

### *Reallocation within the ministerial portfolio*

This task consists in priority setting within the ministerial portfolio. In the Netherlands, after the start of the cabinet period, the coalition partners are bound by the cabinet programme and the four year budget. This implies that they cannot propose new policy that deviates from the programme and the budget on penalty of upsetting the coalition agreement, unless, of course, new circumstances arise that were not foreseeable during the cabinet formation and that necessitate adjustments.

Experience shows that in almost every cabinet period since 1994, there has been a great deal of new policy during the cabinet period. One can think of big social or economic upheavals such as the financial crisis, the migration crisis and now the pandemic crisis, but there have been many more smaller emergencies or sudden political developments that have led to new policies during the cabinet period.

In these cases the financial directorates of the line ministries are in the front line of policy co-ordination. Sectoral directorates of the line ministries have the lead in the elaboration of the policy initiative, but the financial directorates have to ensure financing. Under the rules of budgetary discipline this implies first and foremost the elaboration of a reallocation package within the ministerial budget. This requires close co-ordination with the minister about priorities and opportunities for temporisation or postponement of other expenditures or for savings.

All finance directors interviewed for this paper felt that finding resources to finance new policy is a very important task of finance directors. This task requires extensive knowledge of the spending programmes of the ministry and a feeling for the political priorities and posteriorities of the minister. The finance director must also keep close contact with the Directors General of the ministry and know exactly what is going on in each of their programmes in terms of chances of underspending or overspending and the causes of these developments.

Under the rules of budgetary discipline underspending can be used for new policies if it can be shown that policy measures have contributed to the savings. This tends to occur at a large scale during the first years of a cabinet period when new policies cannot be implemented as quickly as assumed in the coalition programme. However, these are incidental means that can only be used for incidental spending. Structural means can sometimes be found when assumptions of spending programmes turn out as too high (student numbers, labour market subsidies, innovation subsidies) and it can be shown that ministerial policy has contributed to the savings (otherwise the windfalls can only be used for compensation of set-backs or be given back to the Ministry of Finance under the rules of budgetary discipline). Structural means can also be found by implementing new policies in a different form than assumed in the coalition programme.

Finance directors said that the reallocation within the ministry is a decision that they cannot bring about by themselves. They are largely dependent on the relations between the Directors General of the ministry. If these relations are good, it becomes easier to broker reallocation packages, which often involve transfers of resources between Directorates General. One finance director said that in his ministry Directors General kept informal lists of “loans” they made to their colleagues so that at future occasions they could themselves claim some leniency from them. The role of the Secretary General is also important in relation to reallocation within the Ministry. The finance director is directly subordinated to the Secretary General (not to any Director General). Since the Directors General are also subordinated to the Secretary General, it usually helps when the finance director is supported by the Secretary General.

### *Inter-ministerial reallocation*

Only if financing within the ministerial budget is not feasible or the scale of the problem exceeds the responsibility of a single ministry, does the Ministry of Finance become involved. One possibility is that the Ministry of Finance takes over the brokerage of an inter-ministerial reallocation package (general compensation). This used to be exceptional, but has become more common in recent years (Hadley, Kraan and Welham, 2018[3]). Another possibility is that the problems of individual ministers are collected and solved simultaneously at the main decision moment. This way of solving problems have become more usual in the current cabinet period. Finance directors interviewed for this paper indicate that in this cabinet period every year several ministries have received additional resources above their ceilings which were financed by windfalls in the health and social security budgets. In this way it was possible, for instance, to solve the "gas problem" in the province of Groningen (termination of the natural gas extraction ahead of schedule because of earthquakes and reparation of home damage) and to increase teacher salaries in primary and secondary education.

### *Adjustment of the expenditure framework*

An entirely different matter is the wholesale abandonment of the aggregate ceiling. This has occurred rarely[16] since the introduction of trend based medium term planning in 1994, but in the current cabinet period it has happened several times. During decision making on the budget of 2018, the cabinet formation of the cabinet Rutte III was still ongoing, so that there was no expenditure framework or aggregate ceiling. In 2019 and 2020 the aggregate expenditure ceiling was increased at the occasion of the pension reform, the climate agreement and the housing package.[17] Furthermore in 2020 all additional spending in relation to the COVID-19 pandemic is put outside the aggregate ceiling. Additional spending has been authorised in the areas of labour market subsidies (for the financing of personnel in a number of affected branches of industry),[18] business support (loans, subsidies and tax relief for individual enterprises),[19] and various items in the areas of preventive and curative health care (for procurement of vaccines, hospital equipment and compensation of personnel). These increases go uncompensated (neither through specific nor through general compensation) and lead directly to higher aggregate expenditure or lower tax revenues, and a higher deficit.[20]

### *Spending review*

Another task of the financial directorates that can be seen as a form of fiscal co-ordination, is the contribution to spending reviews. Spending review looks back at existing policy (often by use of previous evaluations) and develops policy options that lead to more efficiency or effectiveness or to alternative service levels. Efficiency options and lower service level options lead to savings (until the current round of comprehensive reviews plus options were not allowed). Every review must produce at least a 20% savings option. The spending review procedure is co-ordinated by the Ministry of Finance. Every review is conducted by a working group in which all relevant line ministries and the Ministry of Finance are represented and which is chaired by an independent prominent person.

Spending review is organised in the Netherlands in two forms. The first consists of selective annual reviews, under the name of "interdepartmental policy reviews". In the last two decades the number of interdepartmental policy reviews has amounted to around 5 to 7 per year. Selective reviews are mainly aimed at use during the cabinet period. The second form consists of rounds of numerous (20 to 25) reviews that cover the bulk of public expenditures, so-called comprehensive reviews. Comprehensive reviews have mostly been organised in the run up to parliamentary elections, for instance in 2009 and 2020 (not in 2011 and 2016). In this way they could be used by political parties during the preparation of their election platforms.

Spending review are used by the party leaders, the ministry of Finance and the finance directorates of the line ministries to solve budgetary problems. It creates fiscal space and facilitates aggregate expenditure control and reallocation. During the negotiation process at the start of the cabinet period it is used for that purpose by the party leaders. During the cabinet period, when compensation must be found for new expenditures, it is used for that purpose by the Ministry of Finance and by the finance directorates of the line ministries.

Finance directors interviewed for this paper agree that spending reviews are a useful instrument for the Minister of Finance but also for the line ministries. Good savings options can be used by the finance directorates of line ministries to facilitate reallocation of resources within the ministry. In general finance directors have a positive view of spending review and they try to co-operate with the Ministry of Finance in order to select good topics for review.

Some finance directors noted that the latest round of comprehensive review (in 2020, during the run up to the elections of 2021) was not primarily aimed at producing savings options and hence was less useful for solving budgetary problems. The initiative for this round of reviews was not taken by the Ministry of Finance but by the Commission for Government Expenditures of the Second Chamber of Parliament. This commission wanted to focus this round on policy options to meet the big social and economic challenges of the coming cabinet period. For this purpose plus options (leading to additional spending) were allowed next to mandatory savings options. The topics for these reviews were not selected by the Ministry of Finance in co-operation with the finance directorates, as has usually been the case, but by the Secretaries General. The idea was that the Ministry of Finance would be involved from the beginning in the development of strategic new policy initiatives. It is too early to say whether this use of the spending review process has been successful and whether the resulting reports will bear added value next to the documents that line ministries, political parties, social partners and interest groups are producing for consideration during the cabinet formation.

## Operational control

### *Tasks in the area of operational control*

This task (also referred to as ensuring “value for money”) consists in the supervision of the effectiveness and efficiency of spending programmes and includes advice to the line minister about improvements in this respect.

The tasks of the finance directorates in this domain can be described under the following headings: (a) supervision of policy evaluation, (b) supervision of performance information, (c) management of the planning and control cycle, and (d) supervision of agencies.

### *(a) Policy evaluation*

In the Dutch central government various forms of policy evaluation have been developed over the last few decades.[21] The finance directorates bear responsibility for the supervision of the certain forms of policy evaluation that are seen as particularly relevant from a budgetary point of view.

The fact that the finance directorates are tasked with the supervision of evaluations, does not mean that evaluation is primarily seen as a budgetary instrument. On the contrary, it is generally recognised that evaluation is an important part of all policy development (including development of executive and regulatory policy). New policy can only be developed on the basis of good insight in the effectiveness and efficiency of existing policy and of alternative policy options for the future. Therefore policy evaluation is seen as the primary responsibility of the sectoral directorates in line ministries, not of the finance directorates. The task of the finance directorates is limited to the supervision of certain kinds of evaluations.

Evaluations can be distinguished in *ex ante* and *ex post*. Important forms of *ex post* evaluation are: (a) policy screening ("beleidsdoorlichting"), (b) instrument evaluations and (c) agency evaluations.

- *Policy screening* is made obligatory by the revision of the Budget Code of 2016. The Code provides that ministers are responsible for periodical evaluation of the effectiveness and efficiency of spending under each article (line item) of the budget law. The Regulation Periodical Evaluation of the Minister of Finance elaborates this requirement. It establishes quality requirements and provides that each programme must be subjected to a policy screening at least every seven years. The policy screenings are usually a synthesis of separate evaluations. An important requirement is the publication of the research design prior to the conduct of the evaluation for the benefit of parliament. The regulation Budget Prescriptions of the Minister of Finance provides for the publication of the start, completion and results of policy screenings in budget documents and financial reports.
- *Instrument evaluations* include subsidy evaluations and regulatory evaluations. Since 1996 the General Administrative Law obliges ministers to evaluate all subsidies that are based on a legal provision at least every five years. The quality requirements of the Regulation Periodical Evaluation of the Ministry of Finance apply also to the subsidy evaluations. As to regulatory evaluation, many laws include provisions to the effect that the law must be evaluated, either once or periodically, and that the results of the evaluation must be published. These provisions follow up on the stipulation in the Instructions for Regulation (an internal regulation of the Prime Minister) that in principle ("if desirable") the effectiveness and non- intended effects of every regulation, or of aspects or parts of the regulation, must be evaluated and that the standard evaluation frequency should be five years.
- *Agency evaluations* are prescribed by two laws. The Framework Law Independent Agencies prescribes that the responsible minister must report on the effectiveness and efficiency of the independent agencies under the umbrella of the ministry. The Regulation Ministerial Agencies of the Ministry of Finance includes an analogous prescription concerning the ministerial agencies (the "arm's length agencies").

Given this set-up of evaluation in the Netherlands, each line ministry is responsible for the evaluation (*ex ante* and *ex post*) of its own policies. The Minister of Finance is responsible for the supervision[22] of some specific kinds of *ex post* evaluation, namely: (a) all policy screenings, (b) evaluations of subsidies and (c) evaluations of ministerial agencies.[23] These are the evaluations with the most direct budgetary relevance.

The task of the finance directorates concerning policy evaluation is in line with the supervisory role of the Ministry of Finance. It thus applies to the (internal) supervision of the same kinds of evaluations.[24] This includes setting the agenda for new evaluations, seeing to it that evaluations are carried out on time, and reporting about the results in the budgetary documents. It also includes advice to the minister, in co-ordination with the responsible sectoral directorates, about the follow up of these evaluations. This follow up may include measures to improve efficiency which may lead to savings, that can be used to solve budgetary problems in the ministry.

There is of course a certain tension between the fact that evaluations can in principle lead to savings (next to more effective policies) and the fact that the sectoral directorates of the line ministries are formally responsible for these evaluations. This tension partially explains that sectoral directorates are sometimes hesitant to initiate evaluations or to fully co-operate with their conduct. However, this tension is inherent to the operational control task of the finance directorates. It is also fully in line with the responsibility of the Ministry of Finance for the operational control function of the budget.[25]

### *(b) Performance information*

In the Netherlands, as in many OECD countries, there were high expectations about the role of performance information in budgeting during the 1990s. These expectations were inspired by the influential school of thought in public administration that is known as New Public Management. The reform plan “From policy budgeting to policy accounting”, that was adopted in 1999 by the Dutch government, took over some of these ideas. In particular the government decided that the budget structure would be simplified and based on spending progammes with identifiable objectives (160 articles instead of 800). The budget would contain targets for outcome indicators for each article. The financial reports would contain actuals of outcome indicators for each article.

The experience with this new organisation of the budget documentation was not fully satisfactory. For some policy areas it is difficult to define clear objectives (foreign affairs, defense, culture, etc.). Many outcomes cannot be measured in an objective way, or proposed indicators do not fully capture the objectives and thus lead to perverse incentives when used in policy. Line ministries have an interest in defining objectives and indicators in such a way that policy seems successful and the Ministry of Finance is not capable of supervising this information. It turned out that Parliament is interested in certain forms of input information, in particular in the area of subsidies and administrative expenditures (for instance on personnel, ICT and on outsourcing) that had disappeared from the budget structure. Outcome information does not always provide good insight in the effectiveness of policy, because the contribution of policy to outcomes is sometimes limited compared to social and economic developments over which the government has little control.

In the light of these experiences the government decided in 2010 to adjust the budget structure and budget documentation.[26] This reform introduced for each ministry a central budget article that contains all administrative expenditures (personnel, administrative equipment, etc.). As a consequence these expenditures are no longer attributed to the programme articles. Furthermore, the character of the budget as a financial document has been strengthened. For that purpose for each programme article a survey is provided in the budget documentation about the cost of all policy instruments funded by the article. Outcome indicators are only provided if they say something about the effectiveness of the ministerial policy interventions. If this is not the case, or if no policy relevant indicators can be formulated at all, no indicators are provided in the budget documentation.[27] The government also emphasised the role of good evaluations, which in its view provided more relevant information than “large quantities of policy information, which say little or nothing about the concrete policy initiatives of the minister”. As a consequence of these changes, the size of the budget documentation has significantly been reduced and its readability has been enhanced.

The new budget presentation has also had consequences for the finance directorates of the line ministries. Whereas previously the finance directorates simply passed on whatever performance information sectoral directorates provided, the finance directorates now have to filter out all information that does not satisfy the new criteria and they have to serve the purpose of the Ministry of Finance to keep the budget documentation concise and readable. In practice the most important criterion in this respect is the one which says that outcome indicators must only be provided if they say something about concrete policy interventions of the responsible minister. In that case the budget documentation must explain how the changes in policy or policy execution have contributed to the changes in outcomes. If there is no causal connection between changes in policy or policy execution and changes in outcomes, the budget documentation can only include “general indicators of developments in the policy area”. More specific performance information must in that case be relegated to policy documents of the line ministry. In practice the new guidelines have not led to a large burden on the finance directorates. Apparently the new guidelines have been internalised by the sectoral directorates relatively quickly. They are now complied with as a matter of course.

### *(c) The internal planning and control cycle*

The management of the internal planning and control cycle (P&C cycle) is a task of the finance directorates that has become more prominent in recent years, partly as a consequence of the activities of the ministerial audit committees. The aim of the internal P&C cycle is that the progress of operational management and sectoral policy is systematically monitored, described and accounted for. Operational management covers the activities of the ministerial support services (human resources, information, organisation, finance, internal control and audit, communication, accommodation and procurement). Sectoral policy covers the (new) policy initiatives of the sectoral directorates.

The implementation of the P&C cycle differs strongly between ministries. However, a common practice is that at the start of the budget year annual financial plans are put up for the development of all support services and at the end of the year reports are made up about the results.[28] These plans and reports are discussed in the managing board of the Ministry (which includes the Secretary General and the Directors General). The P&C cycle in principle also includes "policy control" which aims to monitor, describe and account for the progress of the financial plans of the sectoral directorates, but the way this part of the P&C cycle is filled in differs considerably per ministry. In some ministries the annual plans and reports contain sections on the progress of policy development in the sectoral directorates, in other ministries policy control is supposed to be included in the task of the finance directorate concerning the supervision of evaluation. In the latter cases policy control is not included in the P&C cycle.

### *(d) Supervision of agencies*

In the Netherlands policy execution takes mostly place in ministerial and independent agencies. The separation of policy execution from the core ministries can have beneficial effects on the quality of services, the job satisfaction of personnel and the effectiveness of both policy development and policy execution. On the other hand, there is a concern about the capability of the line ministries to supervise their agencies. As far as the ministerial ("arm's length") agencies are concerned this has led to a split in the steering tasks between the sectoral directorates and the Secretary General. The sectoral directorates are responsible for the steering of executive policy in the agencies. The Secretary General is responsible for the "ownership role", which includes the supervision of the effectiveness and efficiency of agency operations. As far as the independent agencies are concerned, there is by definition no steering of executive policy by the core ministry (for the very reason that these agencies are independent),[29] but the ownership role must still be carried out by the Secretary General.

In many line ministries the Secretary General has formally or de facto delegated the ownership role to the finance directorate. There is some discussion of whether this role is compatible with the other responsibilities of the finance directorate. If the ownership role is supposed to include the responsibility for operational management, this may lead to financial claims, for instance for additional personnel, new ICT systems, etc. It is not logical that within a finance directorate, there is a unit that fulfills the role of a spender, rather than a guardian.[30] However, the supervision of the effectiveness and efficiency of agency operations does not necessarily include the responsibility for operational management and financial claims. It can also be argued that the agency itself is responsible for its operational management and for the financial claims that may flow from this responsibility. The finance directorate can then carry out its normal task of operational control vis-à-vis the agency, possibly in a special agency unit, and there is no need for a special "agency ownership unit" under the Secretary General. However this may be, in practice there is no uniformity and we see a variety of models, ranging from a separate ownership unit under the Secretary General or the deputy Secretary General, to separate agency units, with or without "ownership" role, in the finance directorate.

## The organisation of the financial function in line ministries

### *The organisation of the finance directorates*

The finance directorate is placed in all ministries directly under the Secretary General. The finance director is appointed by the line minister. Experience with public financial management and good working relations with the Ministry of Finance are essential requirements. The Minister of Finance needs to approve the appointment and the dismissal of the finance director.[31] Apart from the finance directorates, there are in all ministries other support service directorates, directly subordinated to the Secretary General or the Deputy Secretary General, for instance for information, communication, human resources or accommodation. Sometimes one or more of these other support service directorates are combined in a directorate for operational management.

In the Netherlands there is a strong sense of community and shared values among the finance personnel of the entire State organisation. Officials tend to circulate between the Inspectorate of Finance of the Ministry of Finance and finance directorates of the line ministries in their professional career. Many finance directors of line ministry have previously worked as section head or budget analyst in the Inspectorate. Shared values include the need for efficiency and the control of aggregate spending and respect for the Parliamentary power of the purse.

The sense of community is enhanced by the activities of the Government Academy of Finance, Economy and Management. This Academy is a division of the Directorate of Budget Affairs of the Ministry of Finance. It functions as a training institute for all finance personnel of the State. All freshly appointed officials of the Directorate General of the Budget of the Ministry of Finance and of the finance directorates of the line ministries are sent to the courses of this institute. The Academy provides for a wide variety of courses in the sphere of public financial management, budget procedures, public administration, accounting, public economics and macroeconomics.[32] For some job categories there are mandatory courses: for instance courses on budget procedures for junior staff of the Inspectorate of Finance and the finance directorates. The Academy also organises a two-year programme for university graduates who have completed a master's degree and who are recruited by the government as financial trainees. The programme includes internships as well as courses and offers an excellent preparation for recruitment by a ministry or public agency. Furthermore, all government staff in the Netherlands has to participate regularly in training activities and financial staff tends to choose the courses of the Academy, since they can meet there with colleagues from other ministries and from the Ministry of Finance.

Policy consultations within line ministries are concentrated on the highest level in the meetings of the ministerial staff and of the Administrative Board of the Ministry. The ministerial staff typically consists of at least the Minister, the State Secretaries (who are politicians), the Secretary General, the Directors General, the communication director and the finance director. Other officials may be included, depending on the tasks and organisation of the ministry.[33] The Minister consults with the ministerial staff on all policy matters. The ministerial staff usually meets once per week, but if necessary it may meet more frequently. The Administrative Board of the Ministry consists of the Secretary General, the deputy Secretary General[34] and the Directors General. The finance director and one or more other directors under the Secretary General (for instance a director for operational management, for information and ICT, or for communications) are usually invited on a permanent basis. Other officials may be included depending on the tasks and organisation of the ministry. The Secretary General consults with the Administrative Board on all matters of administration and operational management. The Board may meet weekly or less frequently, depending on needs.

Line ministers often consult with the finance director about budgetary problems, usually in attendance of the Secretary General and/or the Director(s) General involved. These consultations focus on the financing of new policy initiatives, the prevention of overspending and the preparation of budgetary documents

(budget law, supplementary laws, financial report). One finance director mentioned that in his ministry the rules of budgetary discipline had been decentralised to the level of the directorates general, so that all additional spending had to be financed by savings within the same directorate general and so that windfalls in the directorate general could only be used to cover set-backs. In his ministry the consultations with the directorates general about the correct application of the rules of budgetary discipline, amounted to a major task of the finance director and of all officials of the finance directorate. Disputes on the application of the rules could also escalate and be submitted to the minister.

The finance director is the first advisor of the line minister in all bilateral meetings with the Minister of Finance. Usually there is a single round of bilateral meetings between the Minister of Finance and all line ministers in the run up to the single decision moment, but there are regularly bilateral ministerial meetings throughout the year about budgetary problems of specific ministries (financing of new policy, overspending, etc.).

The finance director also assists the Minister in Parliament when the line minister presents and debates the budget of the ministry. Civil servants cannot speak in Parliament, but they can assist the minister by providing information on paper during the debates.

The organisation of the finance directorates differs widely between ministries. The size of the finance directorates differs between 18 (Prime Minister's Office) and 82 (Ministry of Economic Affairs and Climate) and amounts to 50 on average. Usually there is a relatively large budget division which keeps contact with the Directorates General, prepares the budget documents (budget law, supplementary laws, financial accounts) and carries out the tasks in the area of budget control and fiscal co-ordination. In many cases there is a special division for performance information and evaluation that carries out the tasks in the area of operational management, including the P&C cycle discussed above. This division may also be responsible for spending review. In ministries with large mandatory expenditures (social security and health) there are special divisions that are responsible for the expenditure forecasts (on the basis of current policy and alternative policy scenarios). Finally there is staff in the finance directorate that mostly deals with financial administration.[35] The size of this staff differs widely between ministries because financial administration may be largely decentralised to the Directorates General, or rather delegated to other central units of the ministry or to a shared services centre outside the ministry.

### *Internal decentralisation of the finance function*

The finance function as conceived in this paper does not only consist of the provision of support services for budget formulation and implementation but also of regulation or standard-setting for these services and supervision of compliance. Much of the work that is done in finance directorates of line ministries and even more of the work that is done in the Ministry of Finance is concerned with standard-setting/supervision. In line ministries this concerns decentralised-standard setting in the form of circulars and instructions to the sectoral directorates. In practice service provision and standard-setting/supervision are intertwined. Many official of finance directorates are simultaneously working on both.[36]

Although the financial function of line ministries is co-ordinated and led by the finance directorates, financial staff is not only to be found in the finance directorates. Firstly, many sectoral directorates avail of their own financial unit, or broader support service unit that includes finance. In the 1990s of the previous century there has been a wave of decentralisation of the support services from central directorates under the Secretary General to the sectoral directorates inspired by the ideas of New Public Management ("Let managers manage"). In the beginning of this century this has partly been rolled back under the banner of "compact government", but still many sectoral directorates avail of their own financial units or support service units. Secondly, there may be other central units of the line ministries that carry out financial support services, for instance a separate directorate evaluation or a separate financial administration. Thirdly, agencies have their own finance units given their raison d'être as separate government units. Finally, some line ministries have outsourced some financial tasks to external consultants.

Table 26 shows employment of the financial function in line ministries by organisational units.

### Table 26. Employment of the financial function by organisational unit

Full-time equivalent (fte) per ministry and percentage of total per ministry

| Organisational unit | Finance directorate | Other central units | Decentral core ministry | Ministerial agencies | Out-sourcing | Total |
|---|---|---|---|---|---|---|
| Average fte's per ministry | 49.9 | 31.2 | 106.6 | 112.7 | 5.6 | 305.9 |
| Percentage of total | 17.3 % | 10.2 % | 34.8 % | 36.8 % | 1.8 % | 100% |

Source: Ministry of Finance (2019[1]) and own calculations.

The most important observation that can be made about this table is that the finance directorates employ only a relatively small part of the personnel in the financial function (17.3%). In spite of a certain roll back of the decentralisation of support services in the first decade of the century, still a much larger part (almost twice as large) is working in the sectoral directorates (34.8%). This does not only regard financial administration. Many directors general make use of financial advisors within their own organisation.

Another important observation is that the agencies employ the largest part of the personnel in the financial function (36.8%).[37] This is explainable by the fact that during the 1990s almost all policy execution has been moved out of the core ministries in combination with the fact that agencies by definition have the responsibility for their own operational management. The "agency movement" that started in the UK with the "next step agencies" has been pursued in the Netherlands even more radically than in the UK with the consequence that currently there is hardly any policy execution left in the core ministries. The largest part of central government employment is now in the agencies (56.8 versus 43.2% of central government employment, (OECD, 2015[4])).

The substantial size of the other central units (10.2%) is explainable by the existence of the Financial Service Centre at the Ministry of Social Affairs (89.9 fte), and of the Financial Service Organisation at the Ministry of the Foreign Affairs (132.0 fte) which function as shared service centres for financial administration[38] for a number of ministries, respectively for the network of foreign posts.

It is also interesting to compare the employment of the financial function in line ministries with those in the Ministry of Finance. According to the mentioned periodic survey total employment of the Directorate General of the Budget amounted to 165 fte's in 2019. This amounts to a share of 4% of total employment of the financial function (including standard setting). This percentage is a clear illustration of the level of decentralisation of the financial function to the line ministries in the Netherlands.

### *The financial tasks carried out in the line ministries*

As to the nature of the financial tasks that are carried out in line ministries, the periodical survey of the Ministry of Finance uses a categorisation that differs from the four roles (or task domains) that are distinguished in this paper. Nevertheless it is possible to establish a connection between both categorisations. This connection is presented in Table 27.

## Table 27. Financial tasks of the line ministries by task domain

| Tasks | Task domains | | | |
|---|---|---|---|---|
| | Financial Administration | Budget control | Reallocation | Operational control |
| Financial administration | X | | | |
| Budget cycle | | X | | |
| Risk management | | X | | |
| Policy control | | X | X | X |
| P&C cycle | | | | X |
| Supervision of agencies | | | | X |
| Evaluations | | | | X |

Source: own analysis.

The table shows that with one exception the tasks distinguished in the periodic survey can be attributed one on one to the task domains distinguished in this paper. The exception is the task indicated in the periodic survey as "policy control" which is described as follows: "among other things: assessment of the effects of policy proposals on outcomes, advice on efficient solutions (choice of financial instruments), conducting of cost-benefit analyses, advice to Directors General and Secretary General, advice on documents for Council of Ministers, and expenditure forecasts". This task is clearly contained in each of the task domains distinguished in this paper.[39]

In the periodic survey there are also two tasks that fall outside any of the task domains, namely "overhead" and "administrative organisation/internal control and departmental regulation". Overhead refers to support services that are internally decentralised from other support directorates (human resources, information, etc.) to a support service unit of the finance directorate itself. Administration/internal control and departmental regulation mostly concerns the support service of internal control and auditing that in this paper is conceived as a separate support service (other than finance).[40] These tasks are left out of consideration, because they (mostly) do not refer to the support service of finance.[41]

Employment of financial support services differs widely between line ministries and so does its distribution over the tasks. The need for finance support is dependent on the policies of the ministry. Financial instruments require more financial support than other policy instruments. Task burdens of finance directorates are also different for other reasons, for instance: some are responsible for more budget chapters than others (for instance the ministries of Social Affairs and Employment and of Health, Wellbeing and Sports have premium financed budgets next to ministerial budgets) and some are involved in policy areas that require complicated expenditure forecasts (education, social security, health, etc.).

Table 28 presents the average employment of the financial services in the line ministries by task.

## Table 28. Employment of the financial services in the line ministries by task

| Tasks | Financial administration | Budget cycle | Risk Management | Policy control | P&C cycle | Supervision of agencies | Evaluation | Total |
|---|---|---|---|---|---|---|---|---|
| Average fte's per ministry | 108.7 | 33.8 | 5.6 | 34.2 | 74.3 | 5.6 | 3.1 | 100% |
| **Percentage of total** | **41%** | **13%** | **2%** | **13%** | **28%** | **2%** | **1%** | **265.3** |

Source: Ministry of Finance (2019[1]) and own calculations.

It appears from this table that financial administration is still by far the largest financial task of line ministries, taking up on average 41% of total employment in the financial support services. Internal planning and control is the second largest task, taking up on average 28% of the employment. The budget cycle, including the management of the IBOS system, and policy control each take up around 13% of employment. Risk management, evaluations and ownership/support of agencies are relatively small tasks.

In line with the diversity of the task distribution, the organisation of the finance directorates differs widely among ministries. The task package of the directorates is mostly determined by the level of decentralisation of the financial support services within the ministry and the policies of the ministries. In some cases the history of the ministry, its traditions and the personalities of its ministers and finance directors have also left their traces.

## Conclusions

### *Decentralisation of the finance function and medium term fiscal planning in the Netherlands*

The extent to which the finance function of government is decentralised to the line ministries differs between OECD countries. In the last few decades finance directorates in some countries have taken on new tasks in the areas of budget control, fiscal co-ordination and operational control in addition to the traditional task of financial administration. If this is the case it can be said that the finance directorate functions as the internal ministry of finance of the line ministry. There is a close connection between the decentralisation of the finance function and the reform of medium term fiscal planning. The Netherlands are an example of a country with a strongly decentralised financial function and an advanced procedure of medium term fiscal planning.

### *Budget control*

At the level of line ministries budget control consists in the supervision of aggregate ministerial spending. In the Netherlands the process of budget control is subject to the rules of budgetary discipline. These rules assume that a four-year budget is decided during the cabinet formation and prescribe that during the cabinet period every increase of a budgetary or medium term estimate must be off-set by a decrease under the same ceiling of the medium term expenditure framework, regardless of whether the increase is autonomous (under current policy) or due to policy change. All updates of budgetary and medium term estimates must be approved by the Ministry of Finance, and ultimately, when they end up in budget laws, by the Council of Ministers and Parliament. According to a recent survey of the financial function in line ministries, all finance directorates carry out fiscal risk analysis, as part to their responsibility for budget control. This is a relatively new task that is still in development.

### *Reallocation*

Fiscal co-ordination consist in priority setting within the ministerial portfolio. In the Netherlands new policy is in principle decided during the cabinet formation, but experience shows that in practice there has been a great deal of new policy during the cabinet period. The sectoral directorates have the lead in the elaboration of the new policies, but the financial directorates have to ensure financing. The finance directors interviewed for this paper felt that finding resources to finance new policy is a very important task of the finance directors. Finding resources primarily implies reallocation within the ministry with co-operation of the sectoral directorates. Inter-ministerial compensation requires the permission and co-operation of the Ministry of Finance. It used to be exceptional but has become more common in recent years. Spending review is an instrument that finance directors can use to facilitate reallocation. In the

Netherlands spending review takes two forms: selective reviews (5 to 7 per year) and comprehensive reviews (more than 20). Comprehensive reviews have mostly been organised in the run up to parliamentary elections for use during the cabinet formation. Finance directors who have been interviewed for this paper agree that spending reviews are a useful instrument to solve budgetary problems, not only for the government as a whole but also for the line ministries.

### *Operational control*

Operational control (also referred to as ensuring value for money) consists in the supervision of the effectiveness and efficiency of spending programmes and includes advice to the line minister about improvements in this respect. The tasks of the finance directors in this domain include: supervision of policy evaluation, supervision of performance information, management of the P&C cycle and supervision of agencies. The task of the finance directorates concerning policy evaluation is in line with the responsibility of the Ministry of Finance: it includes supervision of policy screenings, evaluation of subsidies, and evaluations of ministerial agencies. It also includes advice to the minister, in co-ordination with the responsible sectoral directorates, about the follow up of these evaluations. The presentation of performance information in the budget documentation has been changed as a consequence of a reform in 2010. As a consequence of this reform the character of the budget as a financial document has been strengthened. Under the new rules, finance directorates have to filter the performance information in line with strict criteria. The management of the P&C cycle is a task that in many ministries is still in development. It includes the planning and reporting of internal policy in the area of operational management (the activities of the support services of the line ministry) and in some ministries also in the area of the sectoral policies of the ministry. The supervision of agencies (ownership role) is at task of the Secretary General, that in many ministries is delegated to the finance directorate.

### *The organisation of the finance directorates*

The finance directorate is placed in all ministries directly under the Secretary General. The finance director is appointed by the line minister. Experience with public financial management and good working relations with the Ministry of Finance are essential requirements. The Minister of Finance needs to approve the appointment and dismissal of the finance director.

In the Netherlands there is a strong sense of community and shared values among the financial personnel of the entire State organisation. Officials tend to circulate between the Inspectorate of Finance of the Ministry of Finance and the finance directorates of line ministries in their professional career. This sense of community is enhanced by the Academy of Finance, Economy and Management which functions as the training institute for all financial personnel of the State.

The finance director takes part in the consultations of the ministerial staff and the Administrative Board of the Ministry. The Minister consults with the ministerial staff on all policy matters. The Secretary General consults with the Administrative Board on all matters of administration and operational management.

Line ministers often consult directly with the finance director about budgetary problems, often in attendance of the Secretary General and the relevant Director(s) General. The finance director is also the first advisor of the line minister in all bilateral meetings with the Minister of Finance. The finance director assists the Minister in Parliament when the line minister presents and debates the budget of the ministry.

The organisation of the finance directorates differs widely between ministries. The size of the finance directorates differs between 18 (Prime Minister's Office) and 82 (Ministry of Economic Affairs and Climate) and amounts to 50 on average. Usually there are three or four divisions in the directorate. In most cases there is a relatively large budget division which carries out the tasks in the areas of budget control and reallocation. Another division typically takes charge of the tasks in the area of operational control: evaluation, spending review, performance information and the Planning and Control Cycle. The size of the

staff working on financial administration differs widely between ministries and is mostly dependent on the extent of decentralisation of financial administration to the sectoral directorates of the ministry and of delegation to other central units of the ministry or to a shared services centre outside the ministry.

### *Decentralisation of the finance function within the line ministries*

The finance directorates employ only a relatively small part of the personnel in ministerial financial support service (17.3%). In spite of a certain roll back of the decentralisation of support services in the first decade of the century, still a much larger part (almost twice as large) is working in the sectoral directorates (34.8%).

The largest part of financial support personnel is working in the agencies (36.8%). This is explainable by the fact that during the 1990s almost all policy execution has been moved out of the core ministries in combination with the fact that agencies by definition have the responsibility for their own operational management. Financial administration is partly delegated to shared support centres outside the finance directorate. This leads to a substantial share of financial support personnel (10.2%) working in other central units of line ministries (outside the finance directorate).

The employment of the financial support services in line ministries can also be compared to that in the Ministry of Finance. Total employment of the Directorate General of the Budget amounted to 165 fte's in 2019. This amounts to a share of 4% of total employment of the financial function (including standard-setting/supervision).

### *The financial tasks carried out in the line ministries*

Employment of financial support services differs widely between ministries and so does the distribution over the tasks. The need for support services is dependent on the policies of the ministry. Financial instruments require more financial support that other policy instruments. Some finance directorates are responsible for premium financed budget sectors next to the ministerial budget. Some are involved in policy areas that require complicated expenditure forecasts.

Financial administration is still by far the largest financial task of line ministries, taking up on average 41% of total employment in the financial support services. Internal planning and control is the second largest task, taking up on average 28% of total employment. The budget cycle, including the management of the IBOS system, and policy control each take up around 13% of total employment. Risk management, evaluations and ownership/support of agencies are relatively small tasks.

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## Further reading

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## Notes

[1] Interviews were conducted with Joost Clerx, Dep. Director Financial and Economic Affairs of the Ministry of Social Affairs and Employment; Hans Leenders, Director Financial and Economic Affairs of the Ministry of Health, Wellbeing and Sports; Jens Risberg, Team manager Budget and Concern of the Directorate Financial and Economic Affairs of the Ministry of Education, Culture and Science; and Hans Monnickendam, Director Financial and Economic Affairs of the Ministry of General Affairs (Prime Minister's office). The author is grateful to these officials for the time they made available to talk to him, and for the frank and open way in which they responded to the questions. (All mentioned interviewees will in this paper be denominated as "finance director").

[2] The inclusion and exclusion of these items in the course of time is described in the 13th report of the Study Group Budget Policy "Risks and certainties", pp. 55 to 58 (Ministry of Finance, 2010[6]) and the 15th report of the Study Group Budget Policy "From balance steering to stabilization", pp. 35-37 (Ministry of Finance, 2015[7]).

[3] The social security and health care funds are not included in the state budget and can thus be considered as extra-budgetary funds. However, they are fully integrated in the regular budget procedure, which covers the whole of central government.

[4] The term "line item" is used in this paper for a category of expenditure at the most detailed level of authorisation in the budget law (in Dutch terminology: budget article). In the current budget classification the line items mostly refer to programmes (based on policy objectives) and sub-programmes. There are around 10 to 15 line items per ministry.

[5] The Dutch name is: Central Planning Bureau (CPB). The Bureau is an independent forecasting office that is responsible for all macro-economic forecasts on which the budget is based.

[6] This agreement is formally recognised in the so called "constitutional session" (the first session of the Council of Ministers after the cabinet formation). At that occasion the Council agrees to a document of the Ministry of Finance that contains the rules of budgetary discipline. Since 2010 the rules of budgetary discipline are also included as an annex in the coalition agreement. In this way, the rules become binding for the parliamentary parties that are included in the coalition.

[7] In addition more limited updates of the current and previous budget occur at the beginning and end of the year (see Box 18). In contravention of the normal procedure, in 2020 there have been four (rather than two) supplementary laws. This was necessary for the timely authorisation of emergency spending programmes in connection with the COVID-19 crisis, and led to an adjusted time schedule of updates.

[8] In virtue of the Budget Code ("Comptabiliteitswet"), the Ministry of Finance is entitled to object to every budgetary change on policy grounds, but it is common sense among the budget analysts of the Ministry of Finance that it is hard to start, and even harder to win, a battle with the line ministry on those grounds if no budgetary consequences are involved.

[9] In the Netherlands the tasks of the finance directorates of the line ministries are defined in regulation: Royal Decree Financial Economic Affairs of the Government ("Besluit FEZ Rijk") of 31 January 2019. The finance directorates are mandated among other things to supervise the "proposals, intentions and promises with financial consequences for the government which are submitted to the Council of Ministers or the Chambers of Parliament".

[10] Budgetary funds are special accounts that are entirely or partly financed by taxes and other revenues that are earmarked for specific expenditures. An example is the infrastructure fund that is partly financed by a road tax. Budgetary funds are included in the state budget (in contrast to extra budgetary funds, such as the social insurance funds).

[11] The Inspectorate of Finance is the expenditure division of the Directorate General of the Budget. The other main directorate of the Directorate General is the Directorate of Budget Affairs. The latter is responsible for general budget policy and a number of specific tasks (including budget regulations, policy evaluation and financial reporting).

[12] The Secretary Generals is a permanent official (not a politician or politically appointed person), who is the head of the ministerial civil service.

[13] A cash shift is a payment of an amount in another budget year than the year in which it is due, for instance payment in December of an amount due in January, or payment in January of an amount due in December. Cash shifts are possible in the Netherlands, because the budget is based on cash accounting (not accruals).

[14] Art. 1d sub 4 of the decree Financial Economic Affairs of the Government states that the finance directorate is mandated to supervise "the execution of ministerial risk analyses".

[15] Whereas the work on risk analysis in the line ministries is still in development, the Ministry of Finance has done important work in this area for the government as a whole. See for this work: Schilperoort, Wierts (2013[9]).

[16] Before the current cabinet period, this has happened: (a) in 2009 and 2010 when in the aftermath of the global financial crisis, recession related unemployment benefits and differences between the price indexes of domestic and public consumption were excluded from the relevant ceilings, (b) in 2013, when the Netherlands had to adjust the overall ceiling because of EU requirements flowing from the excessive deficit procedure of the Growth and Stability Pact, and (c) in 2017 in order to deal with "societal priorities" in the areas of security, defense, health care, education and poverty prevention (Ministry of Finance, 2010, p. 23[6]; State Government, 2012, p. 76[10]; State Government, 2016, p. 64[11]).

[17] For an overview see Policy Review Budget Policy, annex to the 16th report of the Study Group Budget Policy (Ministry of Finance, 2020, pp. 33-36[8]).

[18] This includes the Temporary Emergency Bridging Measure Employment ("Noodmaatregel Overbrugging voor Werkgelegenheid", NOW) and the Temporary Bridging Measure Self Employed Enterpreneurs ("Tijdelijke Overbruggingsregeling Zelfstandige ondernemers", TOZO)

[19] This includes the Contribution Fixed Costs ("Tegemoetkoming Vaste Lasten", TVL) and a number of loan guarantees and tax postponement regulations as well as a range of support measures for the agricultural sector and the cultural sector.

[20] This is accommodated in IBOS by the raising of the line item estimates, from which the emergency programmes are financed.

[21] A recent overview of all forms of evaluation that are applied in the Dutch central government is provided in annex 2 of the first progress report of the operation "Insight in Quality" (Ministry of Finance, 2019[5]).

[22] Supervision includes the setting of rules or standards on the timely conduct and quality assurance of evaluations. Quality is mainly assured by involvement of external experts. For this purpose evaluations are often carried out by ministerial research units or research institutes. They can also be outsourced to universities, independent research institutes or commercial consultancy firms. Many evaluations make use of experts from the planning bureaus (Central Planning Bureau, Social Cultural Planning Bureau and Planning Bureau for the Living Environment), the Central Statistical Office and members of advisory councils or inspectorates.

[23] Hence, referring back to the forms of *ex post* evaluation mentioned above, the Minister of Finance is not responsible for the supervision of regulatory evaluations (which rests with the Minister of Justice and Security), and of evaluations of independent agencies (which rests with the Minister of the Interior).

[24] The internal supervision of forms of evaluation that are not subject to the external supervision of the Ministry of Finance, differs per ministry. For instance, in the Ministry of Education, Culture and Science, there is a Research Directorate under the Secretary General. In other ministries comparable evaluation units may be organised under a Directorate General.

[25] The public finance literature recognises four functions of the budget, namely: parliamentary authorisation, aggregate expenditure control (also known as the macroeconomic function), allocation, and operational control. The last function allows the Minister of Finance to assess the efficiency and effectiveness of expenditures independently from line ministers.

[26] Submitted to Parliament in the letter “Accountable budgeting” of the Minister of Finance of 22 March 2011.

[27] This also implied that the rule “obey or explain” that previously prevailed concerning the obligation to provide performance information, has been abolished.

[28] Although all ministries have separate directorates for each or several of the support services under the Secretary General or the dep. Secretary General, the management of the P&C cycle, including the formulation of an integral annual plan and an integral annual report, is the responsibility of the finance directorate.

[29] An example of an independent agency is the Social Insurance Bank. This institution is responsible for the execution of the universal social insurance laws (old age pensions, child benefits, surviving relatives benefits, etc.). It is independent in its executive policy, but it is “owned” by the Ministry of Social Affairs and Employment.

[30] The distinction between spenders and guardians in the budget process goes back to Wildavski 1964.

[31] Decree Financial Economic Affairs of the Government art. 3 section 1 and 2.

[32] Most courses are open to officials who are not working in financial support services but are still interested, possibly because financial matters affect their work.

[33] In a number of ministries, there is also a political assistant of the minister. In the Netherlands the number of political assistants is limited to one per minister, but some ministers do not make use of this privilege.

[34] In the Ministry of Education, Culture and Science there is no Deputy Secretary General.

[35] In the ministry of Education, Culture and Science, there is a separate division for labour affairs. Since in this ministry there are separate Directorates General for the various types of education, it is logical that labour conditions are attributed to a “horizontal directorate”, in particular, given the large budgetary impact, the finance directorate.

[36] In the accountancy literature financial service provision is sometimes called “the first line process”. Standard-setting/supervision is called “the second line process”. The third line process of auditing is in this paper not included in the finance function, but conceived as a separate support service.

[37] The table only contains the financial support personnel in the ministerial agencies, not in the independent agencies.

[38] The Financial Service Centre also carries out procurement tasks.

[39] In the area of operational control it includes the task of advice on performance information that is not separately distinguished in the periodical survey.

[40] This view of internal control and auditing is in accordance with OECD (2015[4]).

[41] Departmental regulation belongs to the support service of finance, but on the basis of the available data it cannot be split off from “administrative organisation/internal control and departmental regulation”. It takes less than 10.9% of total employment of the financial support service in line ministries (because in is included in the larger category from which it cannot be split off). Note that these tasks were included in Table 26. This explains the difference between the totals of Table 26 (305.9) and Table 28 (265.3).

# OECD Journal on Budgeting

The OECD Journal on Budgeting is published three times per year. It draws on the best of the recent work of the OECD Committee of Senior Budget Officials (SBO), as well as special contributions from finance ministries, academics and experts in the field and makes it available to a wider community in an accessible format. The journal provides insight on leading-edge institutional arrangements, systems and instruments for the allocation and management of resources in the public sector.

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