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Fiscal Councils as an Element of the Concept of Fiscal Governance in the European Union Member States

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Abstract: *Fiscal governance is defined as a combination of institutions, rules and norms that structure good governance in the area of fiscal policy. It can be named as the specific mechanism of coordination by using of tools such as: budgetary procedures (legislative fiscal rules), fiscal rules (numerical) and independent fiscal institutions/ fiscal councils. Fiscal governance focuses on how the fiscal policy is planned, approved, conducted and monitored, including the involvement of not only public bodies, but the business sector and civil society too. In this study, particular attention was paid to capturing the essence of the relationship between the qualitative elements of fiscal councils activity and its impact on stabilizing the public finances in the view of fiscal governance concept. During the last world crisis in the EU countries, an interest in establishing fiscal councils has increased. Before 2008 there were only seven institutions in the EU, while in 2014 there are already 19. The question is - are these institutions efficient in stabilizing public finances? Therefore, the main objective of the article is the assessment of the role of the fiscal councils in the coordination of the fiscal policy in the EU Member*

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States. The conducted analysis verifies this role on the basis of theoretical deliberation of the current state of the art. The empirical research verifies fiscal councils' dependence on fiscal balance of EU countries. Research was conducted on the basis of the European Commission, Eurostat and International Monetary Fund data sets.

Introduction

The main objective of European economic integration is the coexistence of a centralized monetary policy and national decentralized fiscal policies (Sarrat de Tramezaïgues, 2010; von Hagen & Mundschenk, 2003). In order to include both the European dimension and conditions concerning other areas of economic planning more fully into the national fiscal policy, the Maastricht Treaty introduced fiscal convergence criteria, completed in 1997 by the Stability and Growth Pact, which sets out the principles and rules to ensure sustainability of public finances (for more information: Godbillon & Sidiropoulos, 2001; Kosior & Rubaszek (Eds.), 2014). The unreliability of Community mechanisms of supervision of the national fiscal policy was revealed during the global financial crisis of 2008, which resulted in excessive debt of member states exceeding significantly the reference criteria, and as a result – aggravating the problem of a drop in the credibility and solvency of these countries on an international scale. One of the remedial tools to counter unsustainable public finances and prevent a crisis of public finances in the future are fiscal councils. According to scientific research being part of the idea of fiscal governance, fiscal councils, as one of the institutional solutions available, are an effective tool for limiting the discretion of the public authorities, which is one of the main objectives of a responsible fiscal policy. Therefore, the need for their existence is indicated as a condition to ensure the rationalization of the fiscal policy pursued by the public authorities. In the years 2008–2013, in the EU Member States there was a significant increase in interest in this type of instruments to rationalize public finances.

This article aims to evaluate the role of fiscal councils in rationalizing the public finances of Member States of the European Union. The main objective of the article will be implemented in two ways. First, the real competences of fiscal councils functioning in the EU will be indicated. The assessment of these competencies will be carried out on the basis of proposals formulated in relation to the concept of fiscal governance. Then, using statistical methods, the impact of these institutions on the result of public finances in the EU Member States will be verified.

Methodological Assumptions

Assessment of the role of fiscal councils in coordinating the public finances of EU Member States was conducted on the basis of an analysis of literature dedicated to the determinants of the effectiveness of fiscal councils formulated within the concept of fiscal governance. The effectiveness of this type of institutions resulting from theoretical assumptions was confronted with the verification of the statistical role of councils operating in EU Member States. Fiscal councils which operated in the EU in the years 2008–2013 were analysed. To assess the impact of the effectiveness of fiscal councils on the state of public finances, EU Member States were grouped according to the criterion of the functioning of the fiscal council, i.e. 1) lack of fiscal council, 2) fiscal council was established in years of crisis, 3) fiscal council was established before 2008, in order to then verify the statistical differences in the balance of the general government sector and the level of public debt in relation to GDP between the groups distinguished. For the purposes of verification, non-parametric tests of statistical significance were used, i.e. Mann-Whitney U test and Kruskal-Wallis test. The study allowed us to verify the hypothesis formulated as follows: Sustainability of public finances measured by the balance of the general government sector and the level of public debt in relation to GDP varies between EU Member States, where such fiscal councils operate and the countries where such institutions do not exist. The analysis used source data from the European Commission, Eurostat database and the International Monetary Fund.

Model of Functioning of Fiscal Councils – Theoretical Comments

Stabilization of public finances is seen today as the main goal of fiscal policy. The body of scientific research conducted in this area clearly emphasizes the need to ensure a high fiscal discipline that prevents, among others, the increase in public spending during economic boom, and thus carrying out activities of an expansive (pro-cyclical) character, undesirable in terms of their implications in the form of increased deficit, as well as the deterioration of the structure of expenditures. Determining certain “rules of the game”, whose enforcement is to limit the discretion of the realized fiscal policy for the benefit of its responsibility is the subject of interest in the concept of fiscal governance.

Fiscal governance is understood as a combination of institutions, rules and standards that structure co-government in the area of fiscal policy. The concept of fiscal governance focuses on the development of planning the governmental budget policy, its approval, conduct and monitoring, including the involvement of not only public entities, but presenting the approach of three sectors – including the business sector and civil society (for more information: Anheier, 2013).

Theoretical and practical aspects of the concept of fiscal governance were first comprehensively described by M. Hallerberg *et al.* (2009). M. Hallerberg defines fiscal governance as the budget process, but stresses that this should be a widely understood concept – a combination of institutions, rules and standards that structure the quality of governance in the area of fiscal policy (Hallerberg *et al.*, 2009). It is therefore a specific mechanism of coordination under which tools like the following are used: the budgetary procedure (legislative fiscal rules), numerical fiscal rules (balance, debt, income, expenditure) and fiscal council[1]. Tools forming the mechanism of fiscal governance are intended to support efforts to stabilize public finances, and in the long run also contribute to their sustainability.

In the present study, leaving considerations of numerical fiscal rules and organization of the budget process on the sidelines, special attention has been paid to capture the essence of the relationship between the elements of the qualitative functioning of fiscal councils and the efficient functioning of the mechanism of fiscal governance.

Fiscal councils, referred to in literature as independent fiscal institutions or national fiscal agencies, are defined as independent institutions monitoring the fiscal policy pursued by public authorities. Fiscal councils, in contrast to the central bank and the parliament, carry out monitoring and assess the government's actions independently and autonomously, in other words, they "depoliticize fiscal policy" (Hagemann, 2011, p. 80). The competences of fiscal councils include in particular the macroeconomic projections for the state budget, and advising the government on matters of fiscal policy. Delegating these functions to fiscal councils is justified primarily by the tendency of public authorities to adopt overly optimistic macroeconomic assumptions that constitute the foundation of their budgets (Salto, 2014).

[1] The European Commission sees the coordination tools of fiscal policy similarly to Hallerberg. It defines the mechanism of fiscal governance as the organization of the budget process, including numerical fiscal rules (balance, public debt, expenditure, income), independent fiscal institutions/fiscal councils and medium-term budgetary framework (budget planning) – the so-called legislative rules. More in: Fiscal governance in the EU Member States. Retrieved form http://ec.europa.eu/economy_finance/db_indicators/fiscal_governance/index_en.htm (10.04.2015).

Therefore, the aim of the fiscal councils should be to reduce the risk connected with decision-making in this area (Hagemann, 2011).

Increased interest in fiscal councils is stimulated by the proposals formulated by the scientific community since the mid-1990s. The common motif of activities undertaken is the desire to repeat the success in the public sector that was achieved by the independent institutions of the central bank (Calmfors, 2011, p. 652). However, so far there has been little consensus as to the scope of competence that should rest on the appointed fiscal councils. Debrun (2009) proposes, for example, models of the functioning of fiscal councils, differentiating between the scope of their intervention in the fiscal policy pursued by public authorities:

- Independent Fiscal Authorities – institutions, which set annual targets for the balance of the state budget and public debt levels or define fiscal rules, adjust the level of taxation and public expenditure;
- Fiscal Councils – institutions, which have the task of influencing the shape of fiscal policy by independent analyses, projections, and advice.

This comes down to determining the two main goals of the fiscal councils created. On the one hand, they may be institutions that perform projections, analyses and assessments of the fiscal policy, and therefore are only opinion-forming bodies, so opinions formed by them can, but need not, be taken into account in the policy of public authorities. However, fiscal councils will have real impact on the coordination of public finances when they receive the powers to make essential decisions in the context of fiscal policy, i.e. determining criteria for fiscal balance (budget balance level) or the target level of public debt (more in: Hagemann, 2011, p. 81). Thus, the effectiveness of fiscal councils in coordinating public finance is determined by the model of their functioning, which Gołębiowski (2010, pp. 2-4) describes as follows:

- very soft model – councils play a role in forming opinion, they prepare independent and optional expert opinions (among others, the German Council of Academic Experts);
- soft model – councils play an advisory, prognostic and opinion-forming role (e.g. the Danish Economic Council, the High Council of Finance in Belgium and The Swedish Fiscal Policy Council);
- hard model – the councils set the budget level and expected level of public debt each year.

To sum up, fiscal councils can play a very important role in enforcing the fiscal rules and in supporting fiscal discipline. Assuming their high efficiency and effectiveness, the developed macroeconomic projections can be more realistic, being both a brake for preparing "too optimistic budgets" and hiding the emerging imbalances.

Fiscal Councils in the European Union Member States

The scientific achievements in the search for optimal conditions of the functioning of fiscal councils under the mechanism for fiscal governance is much younger than the practice of creating these institutions in EU Member States. The first fiscal council began operations in 1945 in the Netherlands (i.e. Netherlands Bureau for Economic Policy Analysis) and was the first institution of this type both in Europe and in the world[2]. Subsequent councils were created in the 1960s in Denmark and Germany. The greatest interest in creating fiscal councils in the EU Member States coincides with the period of the financial crisis, i.e. for the years 2008–2011, during which 6 new institutions were created. In 2014, already 19 fiscal councils operated in the Member States of the European Union (Table 1).

Table 1. Fiscal councils in the EU Member States

Country	Name of the Fiscal Council	Start of activity (year)
Netherlands	Netherlands Bureau for Economic Policy Analysis	1945
Denmark	Danish Economic Council	1962
Germany	German Council of Economic Experts	1963
Belgium	High Council of Finance	1989
Slovenia	Institute of Macroeconomic Analysis and Development	1991
Belgium	Federal Planning Bureau	1994
Austria	Fiscal Advisory Council	2002
Sweden	Swedish Fiscal Policy Council	2007
Hungary	Fiscal Council	2009
Slovenia	Fiscal Council	2009
Romania	Fiscal Council	2010
United Kingdom	Office for Budget Responsibility	2010
Ireland	Irish Fiscal Advisory Council	2011
Slovak Republic	Council for Budget Responsibility	2011

[2] The database published in February 2014 by the International Monetary Fund (i.e. *Fiscal Council Dataset*) was the basis adopted for identifying fiscal councils in the EU Member States. A similar database is also published by the European Commission *(Independent fiscal institutions in the EU Member States in 2013).* The choice of the database was made on the basis of preliminary studies conducted by the authors. As a result, it was found that the definition adopted by the IMF is consistent with the definition of the fiscal council, signaled earlier in the paper.

Table 1 continued

Country	Name of the Fiscal Council	Start of activity (year)
Portugal	Portuguese Public Finance Council	2012
Croatia	Fiscal Policy Council	2013
Finland	National Audit Office of Finland	2013
France	High Council of Public Finance	2013
Italy	Parliamentary Budget Office	2014

Source: *Fiscal Council Dataset* (2014).

Currently, the EU Member States' premise for appointing fiscal councils is the obligation of implementing the provisions of Council Directive 2011/85/EU on the requirements for budgetary frameworks of Member States. Following the introduction of the Directive, in the coming years continued growth is expected in the number of appointed institutions of this type[3].

Fiscal councils functioning in different EU countries differ significantly in terms of the scope of the powers delegated to them. Analysing the competence of fiscal councils established in the EU during the recent crisis, i.e. in the years 2008–2011, it can be stated that one of the strongest mandates was received in 2009 by the *Fiscal Council of Hungary*, whose tasks included: preparing analyses of fiscal policy, providing macroeconomic projections and normative assessments. Unfortunately, due to political changes that occurred in 2010, its competences were clearly limited[4]. The British *Office for Budget Responsibility*, has quite broad powers, whose tasks include the preparation of macroeconomic projections, assessment of operating tax laws and public debt sustainability.

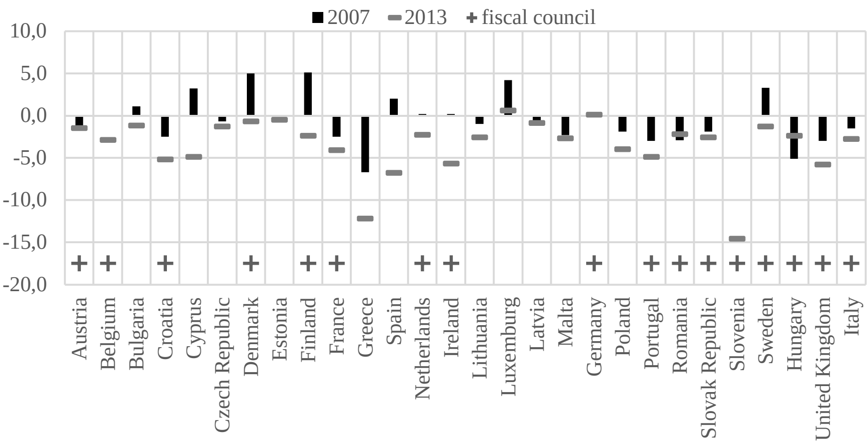
Normative assessments and recommendations on the fiscal policy can also be issued by the *Swedish Fiscal Policy Council*, which does not have the authority to prepare projections. The fiscal council functioning in Slovenia has only consultative powers on fiscal policy. In contrast, in Roma-

[3] The tasks set out in this Directive, which should be implemented by the fiscal council, include: 1) preparation and evaluation of macroeconomic and budgetary planning of the state budget, 2) verification of the efficiency and effectiveness of the implemented fiscal rules and the development of recommendations for actions to stabilize the budget and debt of public finances in the medium and long term, 3) development of analyses on the implementation of mechanisms and system changes involving all levels of government and local government authorities.

[4] Another pretext for the statutory limitation of operation of the fiscal council in Hungary was the publication of a medium-term budget strategy for the new government prepared by the council, contained in the budget act for 2011 (Hagemann, 2011).

nia, the independent *Consiliul Fiscal* issues opinions and recommendations on the fiscal strategy, the annual budget act, the implementation of the budget and major legislative initiatives, which may have an impact on the level of budget income and expenditure (Moździerz, 2012). However, none of the functioning fiscal councils has decision-making powers. Only the fiscal councils in Sweden and Belgium have an advisory character. Furthermore, in Belgium, the government is legally obliged to adopt the macroeconomic projections of the *High Council of Finance.*

Figure 1. The balance of the general governance sector of the EU Member States in 2007 and 2013 (% GDP)

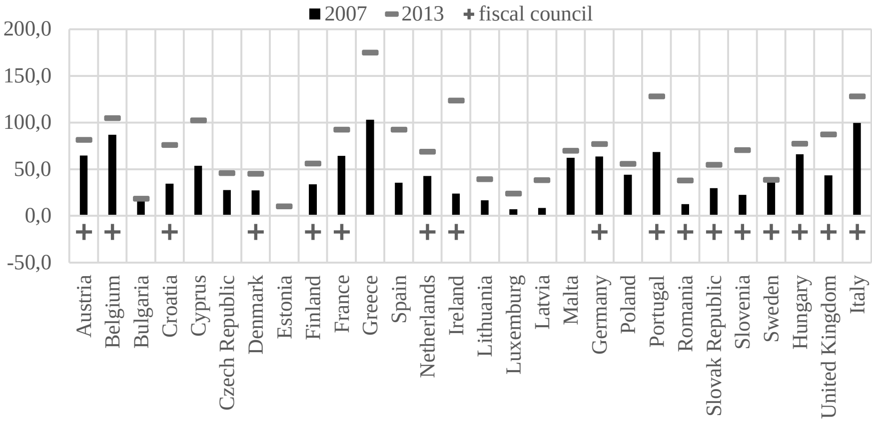


Source: own study based on Eurostat (2015).

The aim of the fiscal councils appointed in the Member States of the EU is to strengthen fiscal discipline and reduce the degree of imbalance of public finances. In the analysed period in the European Union, 19 fiscal councils were operating, of which 6 were appointed during the crisis years. Did they contribute to improving the state of public finances and increasing the level of coordination of fiscal policies of countries in which they are appointed?

The last economic crisis has clearly contributed to the deterioration of public finances in the EU Member States. In the years 2007–2013, the budget deficit in relation to GDP in EU-28 fluctuated between -0.5% (2007) to -6.5% (2009), while in the Euro zone respectively -0.6% to -6.3% (Figure 1). From 2010 onwards, however, it started to decrease gradually, also in absolute terms. In 2009, the majority of EU countries did not meet the nominal convergence criteria on budget deficits, in 2013 there were only eleven. As many as seventeen countries in the years 2007–2013 reduced their deficits in absolute terms. In the same period, the average public debt in relation to GDP in EU-28 increased from 58.8% to 87.1%, while in the Euro zone respectively (EU-18) from 66.2% to 96.2% (Figure 2).

Figure 2. The debt of the general governance sector of EU Member States in 2007 and 2013 (% GDP)



Source: own study based on Eurostat (2015).

In the analysed period, due to the state of public finances, only a few of the countries could be distinguished definitely positively, i.e. Sweden, Luxembourg and Estonia. In contrast, the budgetary situation of some of the countries of the so-called old European Union could be assessed as strongly negative, i.e. Ireland, Greece, Spain, Great Britain and accepted in 2004 – Slovenia and Cyprus. In 2013, 17 EU Member States reported a budget deficit lower than -3%. The lowest deficits were achieved by Estonia (0.2%), Denmark (-0.7%) and Lithuania (-1.0%), a small budget surplus was achieved only by Luxembourg (0.1%), while Germany offset their public finances.

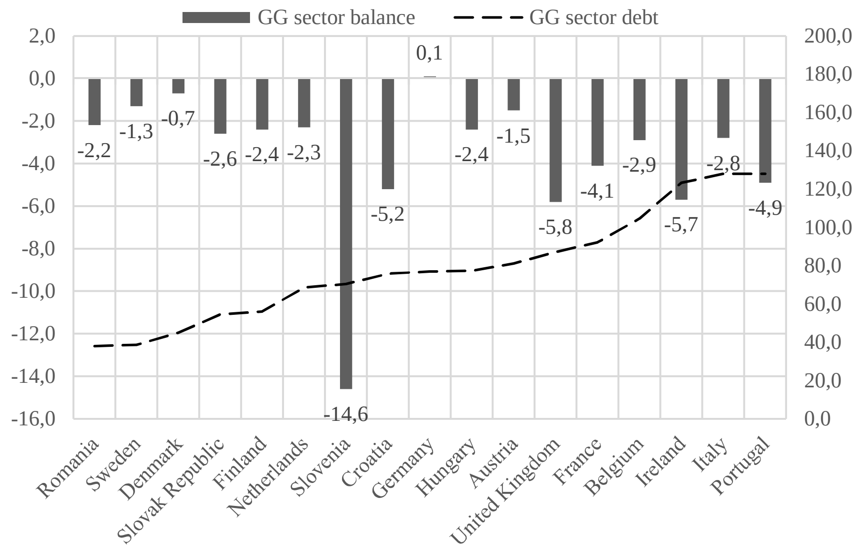
Table 2. The results of the general governance sector in the EU Member States (% GDP)

Country	The general governance sector balance			The general government sector debt		
	2008	**2013**	**Δ**	**2008**	**2013**	**Δ**
1. Fiscal council was established before 2008						
Austria	-1,5	-1,5	0,0	68,5	81,2	12,7
Belgium	-1,1	-2,9	-1,8	92,2	104,5	12,3
Denmark	3,2	-0,7	-3,9	33,4	45,0	11,6
Germany	0,0	0,1	0,1	64,9	76,9	12,0
Netherlands	0,2	-2,3	-2,5	54,8	68,6	13,8
Sweden	2,0	-1,3	-3,3	36,8	38,6	1,8
2. Fiscal council was established after 2008						
Croatia	-2,7	-5,2	-2,5	36,0	75,7	39,7
Finland	4,2	-2,4	-6,6	32,7	56,0	23,3
France	-3,2	-4,1	-0,9	67,8	92,2	24,4
Hungary	-3,7	-2,4	-1,3	71,9	77,3	5,4
Ireland	-7,0	-5,7	1,3	42,6	123,3	80,7
Portugal	-3,8	-4,9	-1,1	71,7	128,0	56,3
Romania	-5,6	-2,2	3,4	13,2	37,9	24,7
Slovak Republic	-2,4	-2,6	-0,2	28,2	54,6	26,4
Slovenia	-1,8	-14,6	-12,8	21,6	70,4	48,8
United Kingdom	-5,1	-5,8	0,7	51,6	87,2	35,6
3. Lack of fiscal council						
Bulgaria	1,6	-1,2	-2,8	13,3	18,3	5,0
Cyprus	0,9	-4,9	-5,8	44,7	102,2	57,5
Czech Republic	-2,1	-1,3	0,8	28,7	45,7	17,0
Estonia	0,2	-0,5	-0,7	6,5	10,1	3,6
Greece	-9,9	-12,2	-2,3	109,3	174,9	65,6
Italy	-2,7	-2,8	-0,1	102,3	127,9	25,6
Latvia	-4,0	-0,9	3,1	18,6	38,2	19,6
Lithuania	-3,3	-2,6	0,7	15,4	39,0	23,6
Luxemburg	3,3	0,6	-2,7	14,4	23,6	9,2
Malta	-4,2	-2,7	1,5	62,7	69,8	7,1
Poland	-3,6	-4,0	-0,4	46,6	55,7	9,1
Spain	-4,4	-6,8	-2,4	39,4	92,1	52,7

Source: own study based on *Fiscal Council Dataset* (2014).

Table 2 presents the balance of the general governance sector and the level of debt in relation to GDP of Member States where fiscal councils have been introduced. The balance of the general governance sector does not differ significantly between countries where there are or are no fiscal councils. In both groups, countries can be distinguished where the balance was maintained at the same level or improved (this is the case, e.g. in Austria and Germany), while e.g. in Slovenia the introduction of a fiscal council did not prevent a drastic increase in the deficit of the general governance sector from the level -1.8% to -14.6% GDP. Noteworthy are the differences between the average balances of the general governance sector, which are the lowest in the countries where fiscal councils functioned before 2008 (0.5 and -1.4% GDP in 2008 and 2013). Interestingly, a higher average level of this index (-2.6 and -3.5% in 2008 and 2013) was recorded in the countries where no fiscal council functions. No impact of fiscal councils on the described balance of the general governance sector confirms the conducted Kruskal-Willis test: the medians of change of the balance of the general governance sector in the analysed groups are not statistically significant (p=0.992).

Figure 3. Balance and debt of the general governance sector of EU Member States where fiscal councils operate, 2013 (% GDP)



Source: own study based on Eurostat (2015).

Evaluation of the effectiveness of fiscal councils in stabilizing public finances in the long term, however, leads to different conclusions. Although the general trend of increase in the level of debt is observed in all Member States of the European Union, the increase in the level of debt is the lowest in countries where the fiscal councils have operated for over 7 years, i.e. in Austria, Belgium, Denmark, the Netherlands, Sweden and Germany. This relationship has been positively verified by the Kruskal-Willis test at the significance level of $p>0.05$. The same countries have proved to be the most resilient to the crisis on the financial markets. Although the average level of debt noted here in 2008 fluctuated around 58% GDP, and so it was close to exceeding the nominal convergence criterion, in 2013, despite exceeding it, it remained the lowest in comparison with the countries where councils either had just been introduced or where councils did not function until 2013. Public finances measured by the level of debt has proven to be the most stable during the recovery from the crisis in the countries where a fiscal council was established. This means that in the long term, fiscal councils positively affect the level of debt measured by the ratio to gross domestic product.

Similar conclusions can be drawn basing on the results of verification of the effectiveness of fiscal councils carried out based on the Mann-Whitney U test for independent samples. Changing the balance of the general governance sector does not differ significantly between the countries where fiscal councils were introduced after 2008 and the other countries. Previously formulated conclusions are confirmed by assessing the differentiation level of public debt in countries where councils were introduced and other countries. The statistical verification confirmed that the level of debt differs significantly between them ($p=0.05$).

Conclusions

To conclude, fiscal councils functioned in most Member States of the European Union where treaty fiscal rules were significantly exceeded. Therefore, their effect did not guarantee sustainability of public finances in the short term. The studies confirm, however, that the long-term impact of fiscal councils can lead to more discipline in terms of public debt. Unreliability of operation of this type of fiscal institutions in terms of balancing the public finances results from too narrow a mandate of competences at their disposal. Therefore, they cannot fully meet the objectives requested by the concept of fiscal governance. Thus, the problem lies in their structure, and without verifying their role in the coordination of fiscal policy it may not be possible to increase the effectiveness of the fiscal councils. The study shows that the mere establishment of a fiscal councils does not guarantee stabilization of public finances. However, this does not mean that fiscal councils should not be created. Ensuring their effectiveness undoubtedly requires further research to allow a more accurate assessment of the quality characteristics of these institutions and the conditions of their operation.

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