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Measurement of Fiscal Council Independence in the Countries of the European Union

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Recent years have noted a strengthening of institutional solutions serving the improvement of budgetary standing in many countries. One such solution is the functioning of independent fiscal institutions, also known as fiscal councils. The goal of the paper is to define the level of independence of such institutions. The source for the research was an analysis of the fiscal institution independence index developed on the basis of data found in the database of independent fiscal institutions published by the European Commission and the specification of fiscal councils presented by International Monetary Fund.

Keywords: public finance, financial stability, public governance.

Pomiar niezależności rad fiskalnych w krajach Unii Europejskiej

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W ostatnich latach w wielu krajach można zauważyć wzmacnianie rozwiązań instytucjonalnych służących zwiększeniu wiarygodności budżetowej. Jednym z takich rozwiązań jest funkcjonowanie niezależnych instytucji fiskalnych, zwanych także radami fiskalnymi. Celem artykułu jest określenie stopnia niezależności tych instytucji. Podstawą przeprowadzonych badań jest analiza indeksu niezależności niezależnych instytucji fiskalnych, opracowanego na podstawie danych zawartych w bazie niezależnych instytucji fiskalnych publikowanej przez Komisję Europejską oraz w zestawieniu rad fiskalnych opracowanym przez Międzynarodowy Fundusz Walutowy.

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1. Introduction

Recent years have seen an increase in the importance of independent institutions known as fiscal councils. Their role is the monitoring and assessment of fiscal policy implementation. The European Commission has indicated that the number of such institutions in the countries of the European Union as of the end of 2013 amounted to forty-five (EC, 2016). In spite of the fact that the typical tasks of these entities encompass analysis of fiscal policy, developing independent macroeconomic projections, and examining the agreement of fiscal policy as implemented with standards stemming from fiscal regulations, observation of solutions tied to their functioning in individual countries points to significant differences among them. These differences also touch upon matters of the real independence of such institutions from fiscal authorities. It is for this reason that the objective of this paper is to define the level of independence of these institutions on the basis of an index for measuring it. Data from the European Commission and the International Monetary Fund, which procure information on the activities of independent fiscal institutions, were used to construct the proposed index.

2. Qualities and Role of Independent Fiscal Institutions

The financial perturbations of recent years have led to the undertaking of actions aimed at improving budgetary discipline in many countries. A special role has been played by actions aimed at strengthening the institutional aspects of the budgetary process, including the implementation of fiscal rules, extending the budget planning horizon, and creating independent fiscal institutions (known as fiscal councils). This particularly pertains to countries of the European Union in which excessive optimism in the area of preparing macroeconomic forecasts has been observed. Jonung and Larch indicate that countries of the European Union systematically overestimate forecasts to economic growth (Jonung and Larch, 2006, p. 491–534). Beetsma et al. note that performance of the budget balance in countries subject to the rules of the Stability and Growth Pack is, on average, worse than defined in official projections (Beetsma, Giuliodori, and Wierts, 2009, p. 753–804). Studies by Frankel and Schreger indicate that the countries of the Eurozone are especially inclined towards excessively optimistic forecasts when, in fact, the deficit level exceeds 3% of the GDP (Frankel and Schreger, 2013, p. 247–272). Acting against such practices is the reason for establishing independent fiscal institutions. Debrun and Kinda have demonstrated on the basis of twenty-six countries over the years 1998–2010 that countries in which fiscal councils operate are characterized by greater accuracy in budgetary projections (Debrun and Kinda, 2014).

Basically, fiscal councils are tasked with making independent macroeconomic forecasts or providing the assumptions behind key parameters

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serving as the basis for budgetary forecasts. This is intended to restrict any temptation to make revenue projections that are too optimistic, which would allow politicians to create a larger fiscal space than the indicated level of expenditures. Fiscal councils also have the job of assessing the impact of tax and expenditure initiatives as undertaken by politicians on the long-term fiscal situation. Thus, these institutions foster transparency in fiscal policy as conducted, and prevent creative accounting and policies of excessive spending of public funds. Thanks to this, they can calm financial markets as well as cause parliamentary decisions to be taken more competently.

What should be stressed is that the functioning of independent fiscal institutions has been secured by European Union legislation. Council Directive 2011/85/EU of November 8, 2011 on Requirements for Budgetary Frameworks of the Member States indicates that the monitoring of fiscal rules should be "based on reliable and independent analysis carried out by independent bodies or bodies endowed with functional autonomy vis-à-vis the fiscal authorities of the Member States" (*Official Journal of the European Union* …, 2011). Also stressed is the validity of using macroeconomic and budgetary forecasts as provided by such independent institutions. Moreover, Regulation (EU) No. 473/2013 of the European Parliament and of the Council of May 21, 2013 on Common Provisions for Monitoring and Assessing Draft Budgetary Plans and Ensuring the Correction of Excessive Deficit of the Member States in the Euro Area indicates that "Unbiased and realistic macroeconomic forecasts can be provided by independent bodies or bodies endowed with functional autonomy vis-à-vis the budgetary authorities of a Member State and which are underpinned by national legal provisions ensuring a high degree of functional autonomy and accountability" (*Official Journal of the European Union* …, 2013).

These institutions are defined as being non-partisan public institutions that are independent of the government, central bank, and parliament, and develop macroeconomic forecasts meeting budgetary needs, monitor the state of public finance, and support the government by providing advice in budget-related matters. In spite of the fact that such institutions are usually financed out of public funds, they demonstrate functional autonomy from fiscal authorities. In line with obligatory nomenclature, this group of institutions incudes courts of auditors (counterparts to the Polish Supreme Audit Office – NIK), assuming that their activities go beyond auditing and encompass the tasks as specified above.

In practice, independent fiscal institutions have been assigned a role that is somewhat different than that of central banks. In as much as that central banks bear formal responsibility for shaping conditions for the functioning of the monetary sphere, independent fiscal institutions are tasked with monitoring public finances. Thus, the concept of independent fiscal institutions is derived from institutions that had existed earlier and whose competencies guaranteed that they served a role of observers (watchdogs) of budgetary decisions. Among such institutions was the Conseil Supérieur des Finance (High Council of Finance) of Belgium that was established as early as 1936, the Centraal Planbureau (Bureau for Economic Policy Analysis) of the Netherlands that has been active as of 1947, De Økonomiske Råd (Economic Council) of Denmark established in 1962, and the Congressional Budget Office established in the United States in 1975. In practice, the operation of such institutions is based on them serving the role of advisors or monitors without any powers to make fiscal decisions.

Empirical evidence of the influence of the functioning of fiscal councils on budgetary outcomes is limited (Hagemann, 2011, p. 1–24). Some analyses indicate that fiscal councils do play a role in improving budget results (Lebrun, 2006; Coene, 2010). In studying the countries of the European Union, Debrun and Kumar found that fiscal councils can play a part in improving budget results, especially in combination with the application of fiscal rules (Debrun and Kumar, 2007).

In light of the fact that the reform process that was introduced in reaction to the most recent crisis assumes a set of diverse solutions (e.g., the strengthening of the Stability and Growth Pact in the European Union), it cannot be stated at this time that positive effects in the fiscal sphere are exclusively the result of the established fiscal councils. This has been confirmed by Debrun and Kinda (2014) who maintain that the mere existence of fiscal council does not guarantee better fiscal balance. However, they do note that certain characteristic features of fiscal councils do have a significant impact on fiscal discipline. Autonomy with respect to fiscal authorities is a characteristic that is stressed among these.

Thus, there is reason to indicate those features of fiscal councils that bear witness to their independence.

3. An Index of Fiscal Council Independence: Empirical Results

Questions of fiscal council independence find their reflection in the principles of the functioning of independent fiscal institutions as developed by the OECD (2014). In accordance with these principles, the independence of fiscal councils is identified with selection of the council management on the basis of achievements and competencies in the area of public finance without reference to any political affiliation as well as the independence of terms in office with respect to the electoral cycle. It is also indicated that the mandate of such institutions should be clearly defined at the level of high-ranking legislative acts. Moreover, attention is called to the financial independence of the fiscal councils so that the funds at their disposal are adequate with respect to their mandate. Such institutions should also have guaranteed access to all significant information in a timely manner,

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including to the methodology and assumptions at the base of developing the budget and other fiscal proposals.

What is vital in the process of creating independent fiscal institutions is defining their place in the structure of the budgetary process. This is true from the point of view of at least three criteria: level of independence, possibilities of having influence, and composition.

Several aspects of this question are worth calling attention to. Firstly, what it means is a need for the council makeup to have a term in office such that they can conduct their operations in isolation from the electoral calendar. Secondly, how council members are selected is important. Thirdly, it is necessary to define the relationship between council members and the government. What is especially important is the development of standards of contacts between representatives of the council and members of the government. In the longer perspective, possibilities for influence on the part of the fiscal council on the political and economic environment are determined by the quality and impartiality of its analyses. This provides a basis for the building of a reputation creating public opinion pressure on government actions that, in such a situation, cannot ignore opinions and recommendations presented by the council. In the short term, council opinions can be used by the government as a basis for discussion on budgetary restrictions. This means that council recommendations may be used by the government as a form of support in taking decisions that are difficult to accept by public opinion, especially subject to conductions of crisis in public finances.

The compositions of a fiscal council can be diverse. Examples of such institutions indicate that representatives of four communities can be identified among members: scientists and researchers, specialists in public finances originating from public administration structures, analysts originating from the financial sector, and former politicians. At the same time it should be stressed that the dominant group consists of representatives of academia.

Thus, independence for fiscal council means legal guarantees of political independence, a secured budget, personal independence of members of the institution authorities, and influence over the course of the budgetary process.

Bearing in mind the indicated aspects of the functioning of fiscal councils it is possible to build an index depicting their level of independence. Twelve qualities allowing an assessment of the level of independence of these institutions were selected thanks to the database of the European Commission. The content of the defined characteristics of the given quality from the point of view of influence on the independence of the fiscal institutions was quantified using values from zero (lack of independence) to one (complete independence). A list of these qualities together with the scale of values for each of them is presented in Table No. 1.

No.	Criterion name	Assessment scale for the criterion
1.	Interactions with the government during the budgetary process	The government is obligated to consult with the council – 1 The government may consult with the council – 0.5 No custom of the government consulting with the council – 0
2.	Interactions with the parliament during the budgetary process	The parliament is obligated to consult with the council – 1 The parliament may consult with the council – 0.5 No custom of the parliament consulting with the council – 0
3.	Issuing of opinions on fiscal policy that are binding on the government	Yes – 1 No – 0
4.	Government reaction to fiscal council forecasts	There is a legal obligation to use council forecasts – 1 Custom dictates the use of council forecasts – 0.67 The government uses its own forecasts, but is obligated to justify any deviation from forecasts published by the council – 0.33 The government is completely free to use its own forecasts – 0
5.	Presence of politicians or civil servants on the fiscal council	No politicians or civil servants – 1 No politicians – 0.5 Politicians present – 0
6.	Selection procedure	No participation of the government or parliament in selection – 1 No participation of the government – 0.5 Government participation – 0
7.	Apolitical nature of members	Yes – 1 No – 0
8.	Length of term in office	More than five years – 1 Up to five years – 0
9.	Institutional status	Outside government or parliamentary structures – 1 Within parliamentary structures – 0.5 A part of the government – 0
10.	Sources of financing	Nongovernmental – 1 Governmental – 0
11.	Legal status	Defined in the constitution – 1 Defined in legislation – 0.5 Other – 0
12.	Access to information available to the government	Full – 1 Privileged – 0.5 No privileges – 0

Tab. 1. Criteria and Scale of Assessment of the Independence of Fiscal Councils. Source: Own study.

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Figure No. 1 shows the values for the fiscal council independence index for the examined countries of the European Union. The values were calculated as the arithmetic mean of points received for meeting individual criteria (numbered from one to twelve, respectively). In building the index for countries where there is more than one institution that may be considered an independent fiscal institution (Austria, Belgium, Germany, Greece, Spain, France, Hungary, Portugal, Sweden, and Great Britain), only one institution was selected for analysis. This selection was dictated by whether the institution is considered a fiscal council, including by the International Monetary Fund.

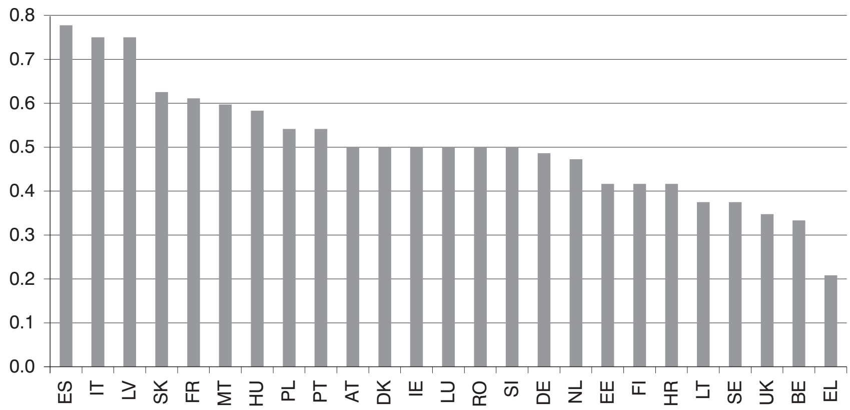

Fig. 1. Fiscal Council Independence Index for Individual European Union Countries. Source: Own calculations based on the Database on Fiscal Governance, European Commission.

Note should be taken of countries where it was decided that the role of the independent fiscal institution is filled by the court of auditors (e.g., Finland and Luxembourg). The example of Poland can show that such a qualification by the European Commission is not always justified. It is truly difficult to consider the NIK Supreme Audit Office an institution filling the function of an independent fiscal institution since its activities relating to assessment of the budgetary process are *ex post* in character. This finds expression in the preparation of the "Analysis of the Performance of the State Budget and Monetary Policy Assumptions" [in Polish] as a basic document containing the results of budgetary audits, presented annually, following the conclusion of the fiscal year, to the Sejm, [Parliament].

The data presented in the figure show that the highest values of the fiscal council independence index are visible in countries that only recently introduced such a solution into their budgetary system. Spain and Latvia established their fiscal councils in 2013. Italy and Slovakia did so in 2012. At this point it should also be noted that from among the forty-five independent fiscal institutions as indicated by the European Commission, only twenty-eight of them functioned prior to 2008.

From among the twelve criteria, the first four involve operational independence (defining the influence of the fiscal institution on the course of the budgetary process), the next four are concerned with personal independence (defining the autonomy of members of the fiscal institution with respect to representatives of fiscal authorities), and the last four deal with organizational and legal independence (defining to placement of the fiscal institution in the structures of public authority). The conducted analysis indicates that, on average, personal independence takes on the highest value for the examined countries. In eight of them (Germany, Denmark, Hungary, Italy, Latvia, Portugal, Romania, and Slovakia) at least three of the four criteria for this area of independence were met, although the Hungarian fiscal council is the only one from among the examined institutions that includes people belonging to political parties in its ranks. From among the three identified areas of independence, the lowest average values for the examined countries were linked with criteria defining operational independence, which is an expression of limited formal possibilities of fiscal councils influencing changes in government policy and confirms their advisory-monitoring role. This particularly pertains to Criterion No. 4 for which the average value for the examined countries amounts to a mere 0.2 (Figure No. 2). This means that forecasts prepared by the fiscal councils have minimal influence over the shaping of the budgetary parameters used by the government. It is only in the case of the Slovenian Urad RS Slovenije Za Makroekonomske Analize In Razvoj (Office of the Republic

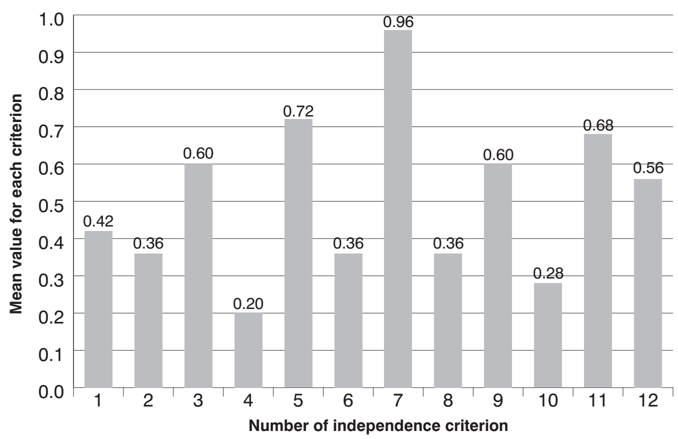

Fig. 2. Average Assessment Value for Each Independence Criterion in the Examined Countries. Source: Own calculations based on the Database on Fiscal Governance, European Commission.

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of Slovenia for Macroeconomic Analysis and Development) and the Irish Fiscal Advisory Council that the government is legally obligated to apply them in the budgetary process.

Thus, independent fiscal institutions do not play a leading role in the budgetary process. They are more like support institutions. Their impact on fiscal policy is small. Essentially, it comes down to playing the role of a reviewer of the executive authorities by pressuring them to conduct transparent fiscal policy.

Analysis of the meeting by these institutions of the individual independence criteria unequivocally indicates that they have significant space for improving their level of autonomy with respect to the executive authorities. The average value of the independence index for the examined institutions is at a level of 0.51, where for the area encompassing operating independence (the first four criteria) the average is only 0.4. This means that even if the activities of these institutions were significantly cleared of political aspects, the unequivocal effects of their activities in the area of creating fiscal policy and influencing the decisions of the fiscal authorities are very limited. Thus, it seems more appropriate that they be called fiscal councils rather than independent fiscal institutions because the real value of their independence is limited.

4. Conclusion

The experiences of the countries of Europe indicate that independent fiscal institutions are an element of a broader look at the transformations of the public finance sector, with the significant role of fiscal rules and other solutions serving as support for actions increasing the fiscal standing of economies in the long term. However, their role defers from the importance of independent central banks. They rather tend to provide analytical and advisory support for fiscal authorities, influencing an increase in budgetary transparency and applying pressure to the government in the area of ensuring fiscal discipline. It is for this reason that it seems more appropriate to treat such institutions as fiscal councils rather than independent fiscal institutions.

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