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A new breed of fiscal watchdogs

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Few would disagree with the view that a root-cause of the ongoing Greek debacle has been the opacity of public accounts. As it became evident that the budget deficit was far larger than anticipated, Greece suffered a sharp erosion of credibility and financial markets reacted with a vengeance. But Greece is not unique. In a number of other countries as well, the lack of transparency has masked a rapid accumulation of public debt, driven by the unprecedented confluence of deteriorating demographic trends, generous social entitlements, and footloose tax bases—all exacerbated by the accumulation of contingent liabilities associated with recent financial rescue operations. The room for manoeuvre has narrowed significantly and fiscal policy will have to be tightened already before a sustained upswing has taken hold.

Within Europe, supranational institutions, such as the European Commission and Eurostat were meant to ensure fiscal discipline and clarity by enforcing the Stability and Growth Pact through multiyear convergence and stability programs. However, lacking sufficient political support—as Ecofin chose not to exercise meaningful peer pressure—these institutions practiced surveillance without teeth. The 2005 reform, designed to accommodate violations by France and Germany, implied a further weakening of the Pact.

Faced with a looming debt sustainability problem, EU member governments have been left to their own devices. Both inside and outside the euro area, they are weighing well-known options for reforming entitlement programs and the tax system, to be complemented with the introduction of a new breed of independent fiscal institutions at the national level. Inspired by the experience of the US Congressional Budget Office (CBO) and the Netherlands' Central Planning Bureau (CPB), in recent years, Belgium, Canada, Sweden, Hungary, and Slovenia have adopted similar institutions, in some cases under the aegis of a council of fiscal experts.

Unlike a traditional state audit office, charged only with ex post evaluation of compliance by public sector entities with legal norms, the new institutions perform real-time assessments of the budget bill, or of other legislative proposals, with a view to ensuring the transparency and reliability of official budgetary estimates and forecasts. Typically, a fiscal council estimates the impact of proposed legislation against its own baseline macro-fiscal projection. The council also monitors implementation of permanent balanced-budget requirements, debt ceilings, expenditure limits, or pay-go rules. Moreover, it can provide an early warning (long before credit rating agencies) on future fiscal risks and stress that must be met with structural reforms.

A fiscal council, much like an independent central bank, can go a long way in promoting transparency and in depoliticizing the macroeconomic policy framework. However, whereas monetary policy may be outsourced to a monetary policy committee, it is difficult to delegate fiscal policymaking to an independent fiscal institution. Accordingly, a fiscal council has no enforcement tools beyond publicizing assessments through the media, which the government can ignore at its peril and suffer a reputational loss.

Among countries considering adoption of an independent fiscal institution—including France, Greece, Romania, and Slovakia—the United Kingdom stands out with the proposal to set up an office of fiscal responsibility. In addition to the common goal of reining in public indebtedness, each country is defining its own approach, mindful of local traditions and needs, so as to garner sufficient popular support. By contrast, no such initiatives can be found in Italy, Portugal, or Spain—in some instances due to the opposition of certain powerful interest groups—despite an obvious case for institution-building in this area.

At a recent conference in Budapest,* public officials, experts, and academics gathered from more than twenty countries to draw lessons from the experience of existing institutions and to discuss future prospects. Conference participants agreed that a fiscal council needs to start its activities with broad support from most political parties. Also, from the very outset, the council must assert its independence from government influence and build sufficient expertise, so as to gain the confidence of the press and the public at large. As Alice Rivlin put it, establishing trust takes hard work and may require at least one change in government, as illustrated by the shift from a Republican to a Democratic administration during her tenure as the first director of CBO. Only then was the CBO able to prove its impartiality, which by now is taken for granted.

Building on a track record of competence and impartiality, independent fiscal institutions—though admittedly not as a magic wand—can play a useful role in restoring fiscal sustainability and credibility. Arguably, timely oversight and warnings by such an institution would have helped avert the Greek crisis.

*See www.mkkt.hu/conference-on-independent-fiscal-institutions.

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