# COMMENT TO
# "INDEPENDENT FISCAL COUNCILS: NEGLECTED SIBLINGS OF INDEPENDENT CENTRAL BANKS?"
# BY MARTIN LARCH

Álvaro Pina[1]

This stimulating paper by Martin Larch makes a bold proposal for strengthening the role of national fiscal councils in the European Union (EU): giving them a mandate to set the budget balance. The stabilisation role of fiscal policy would therefore be delegated to an independent fiscal institution, while the allocative and distributive roles (as per the Musgravian classification) would remain entrusted to the government. As background for this proposal, the paper provides an extensive review of the shortcomings of discretionary fiscal stabilisation, and makes a comparison of institutional arrangements in monetary and fiscal policy.

Even disregarding political resistance to the delegation of budget powers, I am sceptical about the feasibility of the proposal, and the following paragraphs try to explain why. There would be major difficulties at the level of national fiscal policy-making: for instance, separating the stabilisation function from the allocation and distribution ones is far from straightforward. At the European level, the interactions of the empowered national fiscal councils with the Stability and Growth Pact (SGP) framework could well be a source of conflicts. In my view, a more promising route is to enhance the role of fiscal councils while keeping them advisory bodies, rather than decision-making ones. The discussion offers some thoughts on priorities for doing so.

**Delegating the choice of the budget balance poses major challenges**

Several reasons make it difficult to separate the macroeconomic and structural dimensions of fiscal policy. In some circumstances, setting the budget balance has implications for the composition of public finances: for instance, recent euro area experience shows that large consolidations often imply deep cuts to public investment (OECD, 2016). Further, for a given budget balance, the composition and size of public finances can have macroeconomic impacts even in the short run, an insight dating back to Haavelmo's balanced budget multiplier (Haavelmo, 1945). Finally, structural reforms in tax and spending policies may entail short-run budgetary costs and thus require some support from the fiscal stance (e.g. Beetsma and Debrun, 2004).

In setting the budget balance, the fiscal council would need to decide how to trade off long-run sustainability against short-run stabilisation. Martin Larch's paper states that the independent national fiscal council "would (…) pursue the objective of fiscal stabilisation subject to the long-term sustainability of public finances", which could be read as granting priority to sustainability. If so, this would be reminiscent of the priority awarded to price stability over cyclical stabilisation in the mandate of the European Central Bank (Article 127 of the Treaty on the Functioning of the European Union). However, as in the case of central banks, different relative weights for the two objectives are possible, a (difficult) choice fiscal councils would need to make.

[1] OECD Economics Department, ISEG (Lisbon School of Economics & Management, Universidade de Lisboa) and UECE (Research Unit on Complexity and Economics, Lisboa). E-mail: alvaro.pina@oecd.org
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**The interactions of national fiscal councils with the EU fiscal framework could be complex**

In pursuing the objective of fiscal stabilisation, national fiscal councils could easily collide with the SGP rules. These rules make it difficult to conduct discretionary stabilisation in bad times for countries which have not yet reached their medium-term objectives (MTO) for the structural balance. In the Excessive Deficit Procedure, a benchmark annual structural adjustment of at least 0.5% of GDP is required, irrespective of cyclical conditions. In the preventive arm there is some scope to deviate from a similar 0.5% benchmark (e.g. due to cyclical conditions or under clauses for investment and structural reforms; see European Commission, 2015), but the conditions for deviating tend to be restrictive. An escape clause for euro area- or EU-wide severe economic downturns, introduced in 2011, has never been used.

One could easily conceive situations where a fiscal council, when using its “space for (…) expertise and judgment” (as phrased in Martin Larch’s paper), would decide to go against SGP rules. This could happen in a depressed economy still not at the MTO but with public debt deemed sustainable, especially in a context of very low interest rates, as is the case today. If deemed self-financing (Delong and Summers, 2012), temporary fiscal expansion could be advocated even by a council which regarded cyclical stabilisation as junior to debt sustainability.

There is a way to avoid conflicts with European rules: to quote from Martin Larch’s paper, “the mandate [of the council] would be simply defined by the current EU fiscal surveillance framework and the job of the [council] would consist in ensuring compliance with the existing rules”. But I doubt that this “solution” would be politically viable, and in any case it would risk wasting the expertise and judgment of independent fiscal institutions.

**Making the best of advisory fiscal councils**

In many European countries fiscal councils are young institutions, often having started activity after 2011 (OECD, 2016), and in my view the scope for a valuable advisory role is far from exhausted. Following SGP requirements, euro area fiscal councils mainly have responsibilities in preparing or assessing the macroeconomic forecasts used in fiscal plans, and in monitoring compliance with fiscal rules. These are important tasks, but others could also be usefully pursued. For instance, assessing the fiscal and economic impacts of reforms in public spending and taxation (known as costing of measures or policy costing), as often done by fiscal councils outside Europe, would help to address the relative scarcity of research on fiscal policy carried out by fiscal authorities (a scarcity noted in Martin Larch’s paper). A more informed debate on policy options may potentially lead to improvements in the composition and efficiency of public finances (OECD, 2016).

Before enlarging the remit of fiscal councils, one must ensure that they have enough resources to properly discharge their current duties. Some evidence suggests that lack of staff and insufficient safeguards on budgets (such as multiannual funding commitments) are more commonly found among euro area fiscal councils than among their non-EU counterparts (OECD, 2016). There is also scope to improve access to non-public budgetary information. Making the best of advisory fiscal councils is in my view the most promising way forward.

**References**

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