How can independent fiscal institutions support the resilience of public finances?

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Public finances will face significant challenges after the Covid-19 crisis and due to the consequences of the Russian invasion of Ukraine. Government debt has reached the highest levels in decades, albeit interest payments are at historical lows. Population ageing and climate change will weigh on government budgets. Fiscal policy may also need to provide more macroeconomic stabilisation if monetary policy remains constrained by low interest rates.

While providing adequate responses to these challenges, governments will confront political economy biases. These biases have contributed in the past to higher deficits, a tendency towards short-termism (e.g. by cutting public investment disproportionately after the Global Financial Crisis (GFC)), and a procyclical fiscal policy stance.

In this blog post, building on our recent paper: **Constraints and demands on public finances: Considerations of resilient fiscal policy** (Rawdanowicz et al., 2021), we discuss how credible and transparent fiscal frameworks can contribute to sustainable fiscal policies by minimising those biases. In particular, we focus on independent fiscal institutions (IFIs), reviewing their increasing popularity and taking stock of recent country experiences.

What are IFIs?

IFIs are public institutions with a mandate to critically assess and, in some cases, provide non-partisan advice on fiscal policy and performance (von Trapp, Lienert and Wehner, 2016). Examples include the Congressional Budget Office in the United States, the Bureau for Economic Policy Analysis (or CPB) in the Netherlands, the Office for Budget Responsibility in the United Kingdom and Spain's Independent Authority for Fiscal Responsibility.

In contrast to audit institutions, their assessments are forward-looking (Kopits, 2011) and unlike independent central banks, they do not have the authority to make policy. Rather, they ensure that unbiased information about the government's fiscal policies and their consequences is available. This additional transparency enhances the quality of the political debate, making governments more accountable for their policy choices and more credible vis-à-vis citizens and financial markets. IFIs thus support the sustainability of public finances.

In most countries, IFIs were established after the GFC, though in a few they have existed for more than 50 years (Table 1). The main motivations for establishing IFIs were improving the transparency of the budgetary process and monitoring compliance with fiscal rules in the context of high debt.

Table 1. Most independent fiscal institutions are young

Timing of foundation

Before 1969	1970-1989	1990-2009	2010-today
Belgium, Denmark and the Netherlands	Austria and the United States	Canada, Korea, Mexico and Sweden	Australia, Chile, Costa Rica, the Czech Republic, Estonia, Finland, France, Germany, Hungary, Iceland, Ireland, Italy, Latvia, Lithuania, Luxembourg, Norway, Portugal, the Slovak Republic, Slovenia, Spain and the United Kingdom

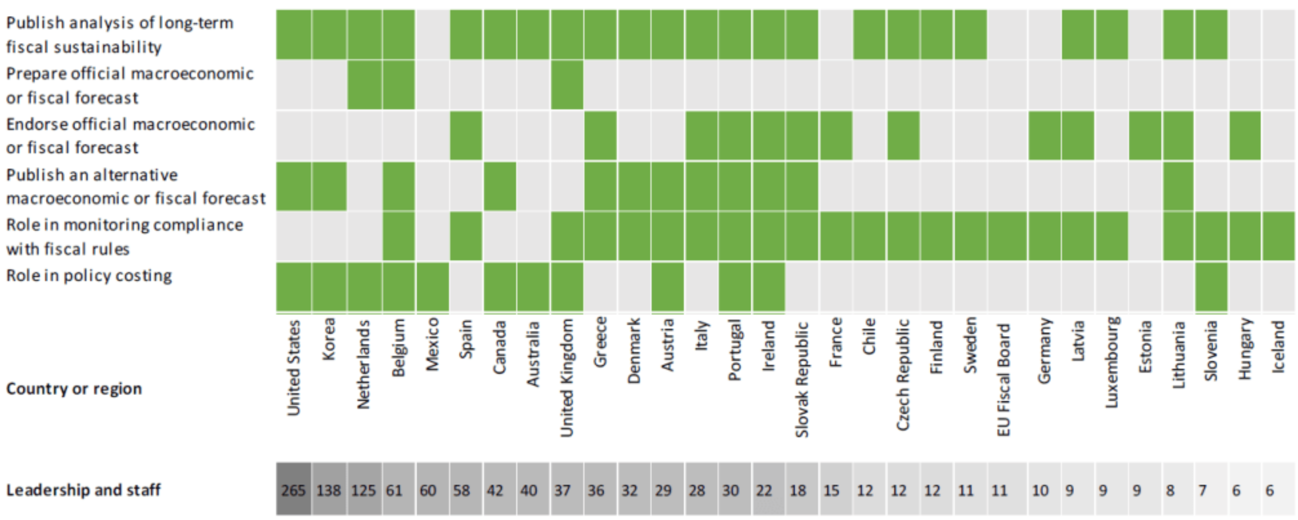
Note: Norway's Advisory Committee for Fiscal Policy Analysis has recently had its mandate extended to independently assess the sustainability of fiscal policy, bringing it closer to some European IFIs. The Norwegian ministry of finance acts as

its secretariat and one committee member is employed by the ministry, though this member is not involved in assessing the sustainability of fiscal policy.
Source: OECD Independent Fiscal Institutions Database 2021; OECD Secretariat.

IFIs are common but their functions differ

Today, there are IFIs in three out of four OECD economies, although they vary widely with regard to their mandate and resources (Figure 1). A new OECD dataset (OECD, 2021a) shows that typical tasks of IFIs include assessing long-term fiscal sustainability, endorsing or producing economic and fiscal forecasts, monitoring compliance with rules, and estimating costings of policies. IFIs with more demanding mandates, particularly those involved in cost estimations, tend to have more staff at their disposal, for example in Korea, the Netherlands and the United States. By contrast, IFIs in some of the largest OECD economies, such as Germany and France, have limited mandates and relatively few staff.

Figure 1. Mandates and resources of IFIs vary widely across the OECD countries



Note: Several OECD countries have chosen to have their official macroeconomic forecasts supplied by an independent organisation other than an IFI, for example, Austria (the Austrian Institute of Economic Research), Finland (an independent body within the Ministry of Finance), Luxembourg (STATEC, the national statistics advisor), Slovenia (the

Institute of Macroeconomic Analysis and Development), and Sweden (the National Institute of Economic Research). Canada takes its macroeconomic assumptions from an average of private-sector forecasts.
Source: OECD Independent Fiscal Institutions Database 2021.

IFIs contribute to fiscal stability but they do not guarantee it

While research has tentatively associated IFIs with increased fiscal rule compliance, more accurate forecasts (Fall et al., 2015; Beetsma et al., 2018), and less pro-cyclical fiscal policy (Debrun and Kinda, 2017), they are neither a necessary nor a sufficient condition for sustainable public finances. Some countries with a reputation for fiscal prudence and transparency have a small fiscal council with a very limited mandate, like Sweden, or none, like New Zealand. IFIs may not need to be strong to maintain compliance with fiscal rules if there is a political consensus in favour of low deficits. Conversely, even an IFI with a far-reaching mandate will not be able to keep a government from circumventing fiscal rules that are not supported by the electorate. The interaction between the elements of a fiscal framework plays a key role.

Still, there are numerous examples of how IFIs can contribute to fiscal performance across various areas:

- ***Assessing long-term fiscal sustainability***. The Canadian Parliamentary Budget Officer produces an annual fiscal sustainability report covering all levels of government and public pension plans. The analysis has been used to challenge official narratives in several high-profile policy debates on changes to the age of eligibility for elderly benefits and adjustments to subnational transfer programmes for health care (Parliamentary Budget Office of Canada, 2021).
- ***Endorsing or producing economic and fiscal forecasts***. Italy’s Parliamentary Budget Office is mandated with endorsing the budget’s macroeconomic assumptions under

domestic legislation to meet requirements of the EU's fiscal surveillance framework. In 2016, the Italian IFI determined that the government's forecast was optimistic and declined to endorse it. Following a parliamentary hearing, the government revised its plans using more conservative assumptions (Ufficio parlamentare di bilancio, 2019).

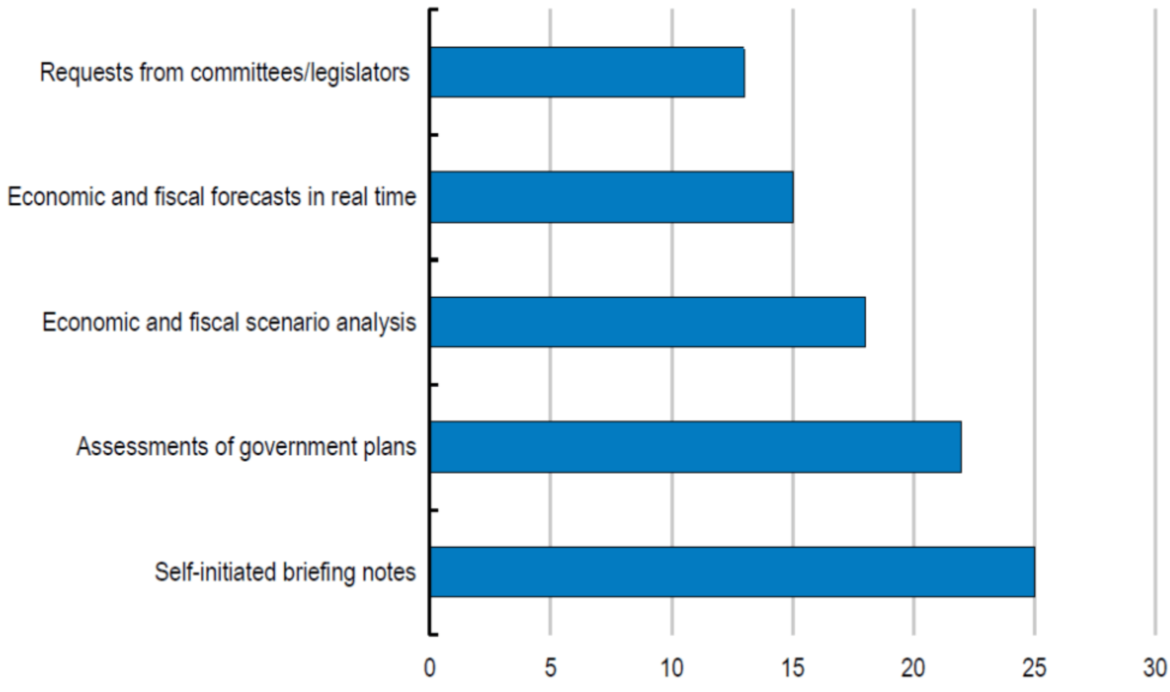
- ***Monitoring compliance with rules***. The Irish Fiscal Advisory Council is required to confirm the government's compliance with the domestic implementation of the EU fiscal rules. To do so, it developed innovative methods to estimate Irish potential GDP and the output gap, which are notoriously volatile in Ireland under the EU's commonly agreed methodology, owing to distortions from capital flows and activity related to foreign-owned multinational enterprises (OECD, 2021b).
- ***Costing of policies***. The US Congressional Budget Office played a pivotal role in informing debate on the multi-trillion dollar Coronavirus Aid, Relief and Economic Security (CARES) Act. It published a preliminary costing of the Act and responded to subsequent requests from Congress to evaluate other aspects of the economic impact of the Act (OECD, 2020). In the Netherlands, the CPB assesses the fiscal and economic effects of parties' election platforms and the coalition agreements after the elections. These analyses have raised awareness of the need, at a political level, for prudent and sustainable budget policies (von Trapp, Lienert and Wehner, 2016).

IFIs during the pandemic

For IFIs established following the GFC, the COVID-19 pandemic was their first major test. As traditional channels of parliamentary oversight faced operational constraints and emergency legislative protocols, IFIs stepped in to provide independent scrutiny of emergency spending programmes and real-time forecasts of the rapidly evolving economy and public finances (OECD, 2020). Over 90% of national IFIs in the OECD published rapid analyses of the economic and budgetary impact of the pandemic (see Figure 2 for a breakdown). They were an important source of analysis, with government either focused on fast responses or reluctant to publish analysis given the high degree of uncertainty. IFIs thus contributed to an open and democratic debate about public finance issues. They also supported governments activating escape clauses to suspend fiscal rules to ensure much-needed support to households and businesses through a transitory and unprecedented stress. The crisis showed that IFIs' varied mandates allowed them to respond in a meaningful way and to influence public debate. IFIs will continue to be critical partners during recovery as governments seek to restore sustainable and resilient public finances.

Figure 2. Breakdown of rapid analyses by IFIs during the Covid-19 pandemic

Number of IFIs



Note: The dataset includes 40 IFIs, covering institutions within the OECD (including two sub-national IFIs and one

independent advisory body established at the European level) and Brazil.
Source: OECD (2020).

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