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11 Children of the crisis: Fiscal councils in Portugal, Spain and Ireland

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The adverse public finance implications of the global crisis spurred a wave of institutional reform in budgetary policy in the European Union. The Irish, Portuguese and Spanish independent fiscal watchdogs were created in circumstances in which the commitment of the national authorities to ensuring sustainability in public finances needed a dose of credibility. In this chapter, I study the strengths and the challenges of these 'children of the crisis'. Instances of exemplary compliance with the international institutional benchmarks defined in the OECD (2014) principles are highlighted. I argue that improved communication and better access to information, including from the EU level, could enhance the effectiveness of the watchdogs in performing their oversight function. Staff recruitment and retention is not without problems either. Where applicable, the mandates could be independently reviewed to reflect changing fiscal challenges.

The financial crisis left the Irish, Portuguese and Spanish public debt at substantially elevated levels. Whilst the reasons behind the dire public finance situation were country-specific, the need for authorities to project a credible path towards significantly lower debt levels eventually was common.

The solution in all three cases was seen in a combination of more medium-term orientation in budgeting, backed up by numerical fiscal rules, and overseen by an independent monitoring body. The complementarity between these different elements is thought to result in a visible improvement in fiscal performance over the medium term (see Nerlich and Reuter 2013, for some evidence).

As a part of broader packages of institutional changes, the Irish Fiscal Advisory Council (IFAC), the Portuguese Public Finance Council (CFP) and the Spanish Independent Authority for Fiscal Responsibility (AIReF) were established between 2011 and 2013.

The rationale behind and the potential channels of influence of independent fiscal institutions (IFIs) are set out in greater detail in Calmfors and Wren-Lewis (2011), IMF (2013) and Beetsma and Debrun (2017) as well as in Part I of this e-Book.

This chapter studies the experience of the above-mentioned three watchdogs. It paints an overwhelmingly positive picture of the three institutions, whilst highlighting important challenges. This reflects the conclusions from the more systematic assessment of the potential for effective scrutiny of these institutions as evaluated comparatively across EU IFIs in Horvath (2017), formal external evaluations such as Jonung *et al.* (2015) as well as judgment based on publicly observable output and personal interaction with the institutions within the Network of EU IFIs.

The cornerstones of effectiveness

The idea of introducing independent fiscal oversight at the national level enjoyed broad political support in all three countries. Commitments towards outside bodies clearly played a role in all cases, whether as a part of conditionality under programmes of official financial assistance or as a part of institutional reform at the European level. The need for reform was, however, recognised internally at the national level and enjoyed cross-party support (see OECD 2016 a,b,c). Hence, ownership, a key principle that should underpin any potentially effective independent monitoring body according to the OECD (2014), was fulfilled. Discussions about the exact nature of political skirmishes surrounding the establishment or early functioning in some of the cases should not devalue the importance of the consensus around the idea of the need for independent oversight. Understanding the preconditions for the emergence of this consensus is an interesting ongoing research agenda (see Beetsma *et al.* 2017, for an insightful political-economy inquiry).

All three bodies are clearly non-partisan, operating independently with their leadership appointed on the bases of merit and competence. The Portuguese council, whose

members are not exclusively Portuguese by nationality, is also a good example of embracing international expertise to the benefit of national public governance.

The core of the tasks of the IFIs, in line with EU legislation, is the evaluation of the fulfilment of numerical fiscal rules, and the endorsement of official macroeconomic and fiscal projections. The execution of this mandate to a high standard requires advanced analytical and specialist skills. In addition to full-time hiring, the IFAC as well as the AIReF have been recruiting their staff from other independent public bodies through secondments, particularly in the early stages of their existence. This is a neat way of addressing the commonly seen shortage of readily available experienced staff in the area of fiscal policy analysis for young institutions, which has wider benefits to the local community of experts.

In spite of broad similarity in mandates, the three councils operate with significantly different resources. The IFAC has to make ends meet with €800,000 and a staff of five, whilst the AIReF operates with a budget of €4.5 million and 35 staff members. The CFP lies in between with a budget of around €2.5 million and a staff of close to 20. Importantly, however, funding is adequately safeguarded in all three cases.

The mandate of the AIReF involves extensive coverage of subnational budgets and the social security administration, which explains a lot of the difference in size between AIReF and the rest. It is also a peculiarity of AIReF that it charges a fee for the scrutiny it does at various public institutions and also for specific tasks it is asked to carry out. While this introduces an element of uncertainty into its funding, it also establishes a transparent link between its tasks and resources. Conflict of interest like the one associated with private-sector rating agencies could be a cause for concern but has not been an issue in practice.

Early impact

A key strength of the AIReF is derived from its extensive legal powers to issue recommendations in a wide range of areas to the different institutions of the public sector both at the national and subnational levels. The European Fiscal Compact envisages a comply-or-explain-type arrangement specifically in the context of medium-term convergence of the budget balance to an aggregate target.

AIReF's powers in this regard, however, extend into questions of fiscal transparency or budgetary targets at the regional level, for example. Although the legislation is vague with regards to the expected timing and the content of the responses by the relevant authorities, the practical application of the provisions *vis-à-vis* regional governments in the area of fiscal transparency has been encouraging, following steps by AIReF to increase the reputational costs of untimeliness or evasiveness. There were, however, cases when calls from AIReF for regional authorities to introduce preventive or corrective measures to deal with (risks of) deviations from fiscal targets were left without a response.

The CFP has contributed to transparency in public finances in Portugal by publishing a detailed list of one-off and temporary revenue and expenditure operations from early on. Diligent reporting of such operations adds a lot of useful knowledge about the true state of public finances relative to relying on headline indicators only. It also gives politicians the right incentives in both policy design and reporting. There is little guidance in law or non-legal text in this area, and the EU Commission publishes aggregate figures only, which leaves an IFI with an important gap to fill.

IFAC's advantage relative to its peers is the position it occupies in the debates about fiscal policy in Ireland. Its engagement with the specialist public, and presence in the reporting by the media is comparatively extensive. Data on online searches suggest the general public interest in the nation's budget seems to be waning as the memory of the crisis fades. Yet, the IFAC continues to appear in the media frequently. Publicity is important as the influence of fiscal watchdogs on budgetary policy is indirect and operates mainly through increasing transparency in the debates. Given that the leadership of the IFAC consists of part-time appointments, and they are assisted by only a small secretariat, good public relations are also a testimony to the commitment and coordination at IFAC. Its concentration on a relatively narrow set of issues concerning the Irish budget, the state of the macro-economy and compliance with fiscal rules appears to work well, although may well be a virtue out of necessity. Weak response to reports or lack thereof from governments and lack of interest from legislatures is a common experience of EU IFIs, and the IFAC stands out as one of the better examples in this regard too. This is due to the relatively clear legislation in place that guides such interactions.

Challenges

Timely and adequate access to data and qualitative information is a significant limitation on the effectiveness of the scrutiny IFIs carry out in many countries. The three examined institutions are no exception. Getting detailed information about the costing of measures proposed and implemented by national governments is a general problem. The work of at least two of the institutions examined is, however, rather adversely affected by the nature of information flows between the EU and the national level too. In Ireland as well as Portugal, the national numerical fiscal rules are the rules defined at the EU level, and so the task of the IFIs is *de facto* to mimic the evaluation conducted by the EU Commission. Numerical as well as qualitative input into the analysis from the EU level, however, often arrives incomplete and with a significant delay. The IFIs concerned would need timely and complete information on the latest Commission assumptions underlying its estimate of the cyclical position of their economies, its assessment of the outlook for potential growth, transparency in what it considers discretionary revenue measures and one-off/temporary budgetary items, and more clarity in (an increasing number of) areas where qualitative judgment is applied in Commission evaluations. The absence of such information may lead to a cacophony of policy messages, and, in one important instance, ultimately led to the questioning of the authority of the IFI by the executive (Jankovics and Sherwood 2017).

The IFIs also face notable human resource challenges. Succession planning at the top is obviously of paramount importance but there are also aching day-to-day problems. There is undue ministerial control over hiring at the AIReF and the IFAC. According to OECD (2016a, c), hiring at IFAC is subject to "prior consent of the Minister following consultation with the Minister for Public Expenditure and Reform", whilst the Spanish Ministry of Finance and Public Administrations retains control over the number and type of positions as well as overall staff costs at AIReF. More flexibility in recruitment and remuneration would, among other things, be desirable in order for the institutions to be able to hire professionals with rare skills. As regards staff already in house, given the lean nature of the IFIs, there is not much in terms of career progression the institutions can offer to motivate their usually young and ambitious staff. Diversity in tasks can go a long way to complement monetary incentives (often limited within the public sector). This may include work of an academic nature, as recommended also in Jonung *et al.* (2015), which would raise the profile of both the individual and the institution.

Looking ahead

Periodic reviews of the mandate of watchdogs could establish if changes are needed, since the main challenges that the public budgets face may also be changing as the economies gradually emerge from the post-crisis period.

In the case of the IFAC, for example, recognising more explicitly the importance of studying the long-term challenges for fiscal solvency in the watchdog's mandate would bring the institution closer to the industry best practice. The lack of information about individual policy measures could be addressed by developing capacities for such costing exercises within the three IFIs. Whenever a change in the (practical interpretation of the) mandate is considered, it is important to consider the adequacy of resources for such an enlarged role.

Enhancing the effectiveness of communication should be high on the agenda as it is a key precondition of impact for bodies without significant decision making powers. The IFIs should devote adequate resources and attention to making their communication more professional and tailored to the relevant audiences. In all three cases studied here, the target audience involves the broad public, and this should be borne in mind when presenting publications.

The broader EU context: The orphans of the crisis

The positive experiences of the CFP, AIReF and IFAC should be studied in the broader context of institution building in EU member states. All EU member states, except Poland and the Czech Republic, now have an independent body appointed to monitor public finance developments. All countries nominally satisfy the requirement of legal transposition of EU law and the Fiscal Compact (European Commission 2017). The practical implementation at times, however, falls well short of the spirit of the legislation. As documented in Horvath (2017), all EU IFIs score well on legally granted independence and competence of their leadership. This is, however, where convergence to best practice ends.

There are IFIs across the EU whose potential effectiveness is severely constrained by lack of staff, finances, access to information or engagement by other authorities.

The cases of the Cypriot, German, Estonian, Finnish, Latvian, Luxembourg and Maltese IFI – to name a few from the euro area – would deserve a closer scrutiny. Whilst being cautious when drawing strong inferences from a small sample, one common theme in all cases seems to be that the bodies are seen as somewhat alien elements in the national institutional framework.

The cases of Portugal, Spain and Ireland, however, demonstrate that it is possible for local ownership of good governance to emerge, even if commitments towards external bodies play an important role in triggering institutional reform, given the right set of circumstances in the local political economy. This is not to argue that we have to wait for (a return of the) conditions of severe public finance strain to provide an impetus for further reform where it is needed. One way ahead from where we are would be to build on the existing legal basis, and make sure, through peer support or pressure from the EU level, that the basic pre-conditions for effective scrutiny by these bodies are in place. The reinforced institutions could then be left to build reputation locally, and jostle their way within the national institutional architecture by displaying concrete outcomes. The first shoots of such organic growth emboldened by peer support can be seen in Lithuania. Otherwise, in the absence of a stronger follow-up from peers or the EU level, these institutions may well be left – as orphans often are - unwanted by their adoptive families of national institutions, and seemingly not cared for by anybody else.

Summary

Portugal, Spain and Ireland took what many see as a significant step on the road to better fiscal performance when they decided to establish independent fiscal monitoring bodies whose setup complies with recommendations based on international best practice. Broad political consensus at the national level, instigated by the urgency to offer a credible way out from the post-crisis fiscal stress – largely absent in other countries – may have played a crucial role in these cases of positive institutional development. To build on their solid start and early impact, CFP, AIReF and IFAC should work on the effectiveness of their communication. At the same time, information flows should be improved both at the national level and from EU institutions. The adequacy of their mandates and their human resource needs could be independently reviewed over time.

Ensuring that capacities are commensurate to tasks through peer support or better enforcement of the legislation from the EU level could promote convergence among EU IFIs to the good practices displayed by these successful children of the crisis.

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