POLICY BRIEF

Financial and Fiscal Commission (2022)

Independent fiscal institutions and their effectiveness: Cross-country evidence, common features and policy lessons for South Africa

Executive Summary

Fiscal governance has emerged as a prospective solution to weak fiscal performances. The role of independent fiscal institutions (IFIs) in improving fiscal performance is particularly gaining traction. Institutional reforms are fundamental in modifying the decision calculus of policymakers to improve the prospects of fiscal policy in supporting macroeconomic stability. IFIs and fiscal rules have become the backbone of public financial management. Robust fiscal governance implementation, therefore offers a critical intervention and implications for improving fiscal performance.

This study assesses if and how IFIs influence fiscal outcomes using cross-country evidence in seven international case studies. The case studies consist of the following IFIs: the High Council of Finance (Belgium), the Parliamentary Budget Officer (Canada), the National Assembly Budget Office (Korea), the Council for Budget Responsibility (Slovakia), the Congressional Budget Office (USA), the Office for Budget Responsibility (UK) and the Parliamentary Budget Office (Uganda). The Financial and Fiscal Commission and the South African Budget Parliamentary Office (SAPBO) case study compares South Africa with the international IFIs assessed.

The paper's findings reveal that most IFIs examined are mandated to assess macroeconomic and budgetary forecasts, undertake independent macroeconomic and fiscal variable forecasts, prepare and provide recommendations to fiscal authorities on budgets and related assumptions, and conduct the costing of policy and legislation. Most IFIs assessed enjoy legal independence and operational autonomy with regard to independence. The results also show that most of the IFIs assessed have academics as senior members, and their institutional models are such that most of them are parliamentary budget offices. The assessment of the IFIs shows that they have been able to relatively influence fiscal outcomes, which is subject to their design, resourcing and mandates.

FINANCIAL AND FISCAL COMMISSION

THE FINANCIAL AND FISCAL COMMISSION

The Financial and Fiscal Commission is a body that makes recommendations and gives advice to organs of state on financial and fiscal matters. As an institution created in the Constitution of the Republic of South Africa, it is an independent juristic person subject only to the Constitution itself, the Financial and Fiscal Commission Act, 1997 (Act No. 99 of 1997) (as amended) and relevant legislative prescripts. It may perform its functions on its own initiative or at the request of an organ of state.

The vision of the Commission is to provide influential advice for equitable, efficient and sustainable intergovernmental fiscal relations between national, provincial and local spheres of government. This relates to the equitable division of government revenue among three spheres of government and to the related service delivery of public services to South Africans.

Through focused research, the Commission aims to provide proactive, expert and independent advice on promoting the intergovernmental fiscal relations system using evidence-based policy analysis to ensure the realisation of constitutional values. The Commission reports directly to both Parliament and the provincial legislatures, who hold government institutions to account. Government must respond to the Commission's recommendations and the extent to which they will be implemented at the tabling of the annual national budget in February each year.

The Commission consists of commissioners appointed by the President: the Chairperson and Deputy Chairperson, three representatives of provinces, two representatives of organised local government and two other persons. The Commission pledges its commitment to the betterment of South Africa and South Africans in the execution of its duties.

Hence, the Commission recommends that SAPBO and the Commission should endorse government macroeconomic and fiscal forecasts, cost all government policies or legislation that impact on fiscal policy, and monitor compliance with the fiscal rules or objectives. Government should establish a process of periodically reviewing the operational independence of SAPBO and the Commission. The Commission and SAPBO should also be provided with timely and comprehensive access to relevant information, including the methodologies, assumptions and data used by National Treasury in budgetary planning. The legal basis for the compliance and explanation of deviance from the recommendation principle for the Commission must be strengthened and extended to cover SAPBO, and the Commission and SAPBO should be formally consulted on budget formulation and execution.

.

Background

The aptitude of policymakers to constantly adjust policy levers to fulfil well-defined objectives is a two-edged sword. On the one hand, it enables auspicious reactions to unpredicted events. On the other, it rescinds optimum, but time-inconsistent obligations and allows distorted incentives to be translated into damaging policy biases. The manifestation of excessive government deficits and escalating public debts, dating back to as early as the 1970s, is testimony that unrestrained fiscal discretion could translate into detrimental economic consequences. An emerging body of literature shows the prospective benefits of restricting control over and above standard democratic constraints, and how it could be accomplished (Beetsma and Debrun, 2018)[1].

The failure of rules-based monetary policy, resulting from the financial innovations of the 1980s, necessitated the delegation of monetary policy to non-elected experts who established independent central banks. The official restrictions on fiscal discretion through fiscal rules followed after that. Initially, only a few countries subjected fiscal policy to quantitative limitation. However, the phenomenon quickly gained momentum and the unprecedented proliferation of fiscal rules followed. Presently, the International Monetary Fund (IMF) has data on approximately 80 countries that implement fiscal policy within an official framework consisting of some fiscal rules (IMF, 2017)[2].

The natural progression, given this context, is that the institutions embraced for monetary policy could and should be adopted for fiscal policy as well. IFIs can play a similar role as independent fiscal institutions. In any case, the frustration with the planning and function of rules-based fiscal frameworks is translating into an increasing number of countries establishing IFIs. IFIs are self-governing public institutions with a remit to objectively evaluate and offer non-partisan advice on fiscal policy and performance. These institutions are responsible for enhancing sound fiscal policy and sustainable public finances in conjunction with fiscal rules.

Research findings

The findings of this paper are categorised into four main sections: mandates and functions, independence, composition and institutional models, and compliance and impact.

1. Mandates and functions

The results show that almost three-quarters (five out of seven) of the IFIs examined are mandated to assess macroeconomic and budgetary forecasts. In contrast, over half (four out of seven) are mandated to undertake independent macroeconomic and fiscal variable forecasts. Less than half (three out of seven) are responsible for monitoring compliance with fiscal rules. More than half (four out of seven) prepare and provide recommendations to fiscal authorities on budgets and related assumptions. All IFIs assessed are obligated to publish public reports on their findings. More than half (four out of seven) conduct the costing of policy and legislation.

[1] Beetsma, R. M. W. J and Debrun, X. 2018. I*ndependent fiscal councils: Watchdogs or lapdogs?*. London, UK: Centre for Economic Policy Research (CEPR) Press.

[2] IMF. 2017. *Fiscal Rule Dataset 1985–2015*, Washington: IMF.

The results also show that the South African Parliamentary Budget Office conducts normative analysis, offers recommendations, and issues public reports. It is not mandated to assess budgetary forecasts or undertake independent forecasts of budgetary variables like most of the IFIs assessed. It also does not monitor fiscal rules, nor does it conduct costing of legislation and policy.

2. Independence

The results show that almost three-quarters (five out of seven) of the IFIs assessed enjoy legal independence, while nearly all (six out of seven) enjoy operational autonomy. Nearly three-quarters (five out of seven) of the IFIs can safeguard their budgets, almost all (six out of seven) can hire their staff, and all (seven out of seven) have adequate staff to fulfil their mandates and perform their duties. Almost all (six out of seven) have access to the information required to accomplish their objectives.

The results also show that SAPBO and the Commission enjoy high independence. Their independence is guaranteed in legislation. They can safeguard their budgets, hire their staff, and have adequate staff to perform their duties and access the information required to achieve their goals. However, the Commission and SAPBO do not have complete operational independence because they are under the executive and legislature, respectively. This means that a procedure of continually evaluating the independence of these IFIs is required. This mechanism will be crucial in detecting any changes impeding the effectiveness and independence of these IFIs in the form of a set of minimum standards.

The analysis further shows that the Commission and SAPBO enjoy a relatively good flow of information from the national government. However, the data on budgetary procedures at state-owned entities is still scarce. The same goes for the methodological details on how the government performs the costing of its policy measures.

3. Composition and institutional models

The results show that almost three-quarters (five out of seven) of the IFIs assessed have academics as senior members, nearly all (six out of seven) have policy experts as senior members, and almost three-quarters (five out of seven) have politicians as senior members, and nearly all (six out of seven) have civil servants as senior members. All the IFIs assessed have other senior members who do not fall squarely into the abovementioned categories. In terms of institutional models, the majority of the IFIs assessed (four out of seven) are parliamentary budget offices, the minority (two out of seven) are under the executive, and only one (one out of seven) is a stand-alone institution. The results also show that most senior members of SAPBO are academics, policy experts and civil servants. The analysis shows that SAPBO follows the best international practice in the constitution of its senior management teams.

4. Compliance and impact

The results show that less than a third (two out of seven) of the IFIs assessed produce macroeconomic and fiscal forecasts that are used in the budget, less than a third (two out of seven) require fiscal authorities to either comply or explain any deviations from the forecasts and recommendations of IFIs, while only one (one out of seven) is mandated to have formal consultations or hearings as part of the budget formulation to interact directly with the stakeholders responsible for budget preparation. None of the IFIs assessed were mandated to produce forecasts that are binding for fiscal policy. Similarly, none of the IFIs assessed were permitted to halt the budgetary process if it has serious reservations about it.

The results also show that SAPBO does not produce macroeconomic and fiscal forecasts that are used in the budget. It is also not mandated to make formal recommendations that require fiscal authorities to either comply or explain any deviations from them, nor is it mandated to have formal consultations or hearings as part of the budget formulation to interact directly with the stakeholders responsible for budget preparation. It is also not mandated to produce forecasts that are binding for fiscal policy, nor is it empowered to halt the budgetary process if it has serious reservations about it.

In South Africa, the comply or explain principle is only applicable to the Commission and not SAPBO. This highlights the need to extend it to cover SAPBO. There is also a need to strengthen the current comply or explain principle with regard to specific timelines, scope, degree of coverage and extent, as well as legal ramifications for contravention.

Conclusion

In contrast with independent central banks, who exercise complete discretion to establish designated policy instruments to attain their monetary policy goals, IFIs are fiscal watchdogs that cannot bite because they have no explicit mandate that directly affects fiscal policy. Therefore, their effectiveness is primarily determined by how loud and how quickly these fiscal watchdogs bark. Their efficacy relies on their ability to influence policymakers to choose sound fiscal policies by promoting fiscal transparency to improve accountability and inhibit devious shifts in fiscal policy, while highlighting consciousness regarding the ramifications of destructive fiscal policy paths. In practical terms, IFIs are effective if they execute specific functions to produce well-defined outputs, including fiscal policy analysis, recommendations, assessments and forecasts.

At the fundamental level, effective IFIs should be equipped with sufficient human and financial resources to enable them to execute specific functions and produce their respective outputs in support of their mandates, which are favourable to enhancing fiscal policy outcomes. The analysis of this study shows that the critical policy message is that, in reforming its IFIs, South Africa must ensure that it effectively contributes to formulating and executing more sustainable and stabilising fiscal policies.

Based on these findings, it is recommended that SAPBO and the Commission endorse government macro-economic and fiscal forecasts, cost all government policies or legislation that impact on fiscal policy, and monitor compliance with the fiscal rules or objectives. The Commission recommends that government should establish a process of periodically reviewing the operational independence of SAPBO and the Commission, and that the Commission and SAPBO should be provided with timely and comprehensive access to relevant information, including the methodologies, assumptions and data used by National Treasury in budgetary planning. The legal basis for the compliance and explanation of deviance from the recommendation principle for the Commission must be strengthened and extended to cover SAPBO. The Commission and SAPBO should be formally consulted on budget formulation and execution.

Enquiries:

Thando Ngozo
Thando.Ngozo@ffc.co.za

Sanele Simayile
Sanele.Simayile@ffc.co.za

Financial and Fiscal Commission
Montrose Place (2nd Floor), Bekker Street
Waterfall Park, Vorna Valley, Midrand

Private Bag X69, Halfway House, 1685

www.ffc.co.za

Midrand Office Telephone: +27 (0) 11 207 2300
Cape Town Office Telephone: +27 (0) 21 487 3780