# Political commitment to budgetary discipline

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# Determinants of fiscal outcomes

Fiscal outcomes:

- Level of net expenditures;
- Level of tax revenues;
- Budget balance (deficit or surplus);
- Public debt.

Determinants of fiscal outcomes:

- Exogenous macro-economic factors (GDP, inflation, oil-price, etc.);
- Fiscal institutions (fiscal rules, budgetary procedures, etc. );
- Political commitment to strict fiscal policy.

# What is budgetary discipline ?

- *Institutional* budgetary discipline:
  - ➢ Strong fiscal institutions;
  - ➢ Compliance with the rules (fiscal institutions) that have been adopted.
- *Discretionary* budgetary discipline:
  - ➢ strict fiscal policy.
- Institutional budgetary discipline is <u>sufficient</u> for sustainable fiscal outcomes (low deficit, high surplus, low debt) but not <u>necessary</u> (Australia, Luxembourg).
- To the extent that institutional budgetary discipline is <u>stronger</u>, sustainable fiscal outcomes are <u>less dependent</u> on political commitment to strict fiscal policy.

# Rules versus discretion

Arguments for rules:

- Effectiveness (targets will be achieved, preclude decisions motivated by political expediency, Ulysses and the Sirens);
- Predictability (conducive to fiscal and sectoral planning).

Arguments for discretion:

- Need for flexibility: rules can never entirely substitute for discretion;
- Rules can be controversial (growth versus austerity debate).

# Optimal fiscal institutions

- Rules can be proposed for good reasons (effectiveness, predictability) and bad reasons (to impose a view on fiscal policy that may be wrong).
- Discretion can be proposed for good reasons (flexibility) and bad reasons (political expediency).
- Optimal rules are conducive to effectiveness and predictability, do not impose a wrong fiscal policy and strike a balance between coercion and flexibility.

# Example: Multi-annual expenditure frameworks (MTEF's)

- Most CESEE and OECD countries nowadays have MTEF's anchored in a fiscal rule;
- From the point of view of "rules versus discretion" the basic choices are:
  - fixed versus flexible framework;
  - number of out-years of the framework;
  - size of the deficit fluctuation margin that triggers revision;
  - anchoring in a an expenditure/revenue rule or in a trend based balance rule.

# Relevant considerations

- Better a less demanding framework that is complied with, than a more demanding framework that is not upheld;
- A fixed framework only to be considered if experience with a flexible framework (top-down budgeting) is satisfactory;
- Number of out-years of a fixed framework can gradually be extended;
- The size of the deficit fluctuation band should not be too small, otherwise the MTEF will be subject to permanent revision;
- Countries with a relatively small general government sector (underdeveloped social security arrangements) should not go for expenditure or revenue rules that hold down the level of expenditures.

# Compliance is essential

- Stronger fiscal institutions lead to better fiscal outcomes (lower deficit, higher surplus, lower debt), but only if the rules are complied with;
- If specific rules are not complied with, not only the aims of these rules are jeopardized, but the credibility of all rules is undermined.
- Fiscal institutions must be adapted to the circumstances of the country (volatility of GDP, capacity of the line ministries, development of ICT in budget preparation and execution, etc.): *basics first.*

# Strengthening fiscal institutions and enhancing compliance

*National fiscal institutions can be strengthened and compliance enhanced by:*

- Fiscal Transparency (IMF Code of Good Practices on Fiscal Transparency 1998, 1999a, 2001; OECD Principles of Fiscal Transparency 2000);
- Independent Fiscal Institutions that monitor and report on compliance (OECD draft principles for Independent Fiscal Institutions 2012);
- Law and best practice guidelines by international financial institutions and the EU.

# Conclusions

- Budgetary discipline is dependent on fiscal institutions, compliance and political commitment to strict fiscal policy;
- To the extent that fiscal institutions are stronger and compliance is better ensured, fiscal outcomes are less dependent on political commitment to strict fiscal policy;
- Fiscal institutions can never entirely substitute for political commitment; there will always be a role for discretionary policy;
- The strengthening of fiscal institutions is a long term process; the role of political commitment to strict fiscal policy is therefore more important in transition countries and countries with relatively weak fiscal institutions than in countries with strong fiscal institutions.