Fiscal Policy
Moving towards Predictability

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CASE discussion panel at the Economic Forum in Krynica, Poland
(September 7, 2016, 15:35)

Successful Reform: Maximizes Well-Being

Information-Knowledge-Predictability => *Well-being*

Problem: Lack of Knowledge

knowledge generates transparency & *predictability*, which is the key to well-being

Reform must aim for enhancing Knowledge

(Fiscal Framework, Independent Institutions, External Supervision/Input)

Knowledge is the basis for Predictions

- A predictable future:
  - offers opportunities for a wide and deep gains
  - is essential for a stable and growing economy
- Fiscal predictability:
  - contributes to the knowledge of participants in the economy (economic agents)
- Fiscal framework improves predictability:
  - Informs citizens/stakeholders, improves knowledge
  - enshrined in ***budgetary rules*** provides a predictable path for guiding the economy towards its potential prosperity (output).

Budgetary Rules (Fiscal Framework)
A necessary Condition for Predictability

- For generating a **stable economic growth** path budgetary rules ***outperform*** budgetary discretions

- Budgetary rules are **information-rich:**

highlighting (***predicting***) the path of government activities to the future.

- Budgetary discretions induce more **uncertainty** (***shock***) than stability in the economy.

Fiscal predictability

- Fiscal predictability improves:
  - accuracy of expected **costs & benefits** of transactions
  - **efficiency** of interactions with the government

- Future is more predictable if the government has a known **fiscal framework (budgetary rules)**

Fiscal Framework (Budgetary Rules)

- An effective and efficient fiscal framework is:
  1) Simple
  2) Flexible
  3) Credible (predictability and enforcement)

  Examples:
  - Expenditure rule: Simple and responsive
  - Medium Term Framework: Predictable & accountable

Improving Fiscal Predictability

- Predictability requires **restraining the government's incentive** towards increasing Deficit, while improving its **transparency** & **objectivity**.

- **Fiscal framework** is a necessary, <u>but not</u> sufficient condition for fiscal predictability.

- There is a <u>**need**</u> for checking governments by '**Independent Institutions**' (Fiscal Councils).

  *In other words, something similar to an ***inter-jurisdictional competition*** (<u>regulatory competition</u>) may help.

Central Asian Republics, Albania, Egypt: Why Reform Fails?

1) Absence of political commitment & goals
2) Absence of a clear roadmap
3) Gradual piecemeal approach & lack of a known sequence for reforms
4) Persistence of the Soviet legacy
5) Nontransparent & predatory institutions (tax administration)
6) A large shadow economy
7) Accumulated contestable wealth by citizens & politicians
8) Donors' fatigue leading to localization/indigenous of supervision of (foreign) Technical Assistance (ignoring inherent incentive structures)
9) Paucity of independent institutions (regulatory or inter-jurisdictional competition)

Republic of Georgia:
Why Reform Succeeds?

1) Political Commitment: EU integration / meeting EU standards.
2) A sound MTEF and moving towards accrual base budgeting
3) A transparent & efficient tax administration.
4) Fiscal risk management system: risks emanating from macro shocks & public debt (and now a process for managing PPPs' contingent liabilities).
5) Fiscal rules that limit fiscal deficit and public debt are nested in "the Economic Liberty Act." Also, fiscal risk due to the debt guarantees are limited by the Law on Public Debt.
6) Independent fiscal institution: Parliamentary Budget Office (**PBO**) is a recognized ***fiscal council*.**

Regulatory Competition for Fiscal Predictability

Problem: Government's Incentive in Regulating Knowledge

- **Information:** Data Collection (quality?)
- **Knowledge:** Generating official and authoritative reports & guidelines (accuracy?)
- **Predictions:** Forecasting the path of the main economic variables (predictive failures?)

Solution: Regulatory Competition - Independent Institutions (Fiscal Councils).

Independent institutions providing **overlapping jurisdictions on knowledge** that could (endogenously) generate competitive outcomes (**quality accurate predictions**); & **Independent data sets**, information (e.g., surveys!).

European Commission: Independent Institutions

"Independent fiscal institutions* are defined as non partisan public bodies, other than the central bank, government or parliament that prepare macroeconomic forecasts for the budget, monitor fiscal performance and/or advise the government on fiscal policy matters. These institutions are primarily financed by public funds and are functionally independent vis-à-vis fiscal authorities. Courts of Auditors are included in this definition if their activities go beyond the accounting control and cover any of the tasks mentioned above."

IMF:
Fiscal Council

The following definition has been used to identify fiscal councils (IMF, 2013). "A fiscal council is a permanent agency with a statutory or executive mandate to assess publicly and independently from partisan influence government's fiscal policies, plans and performance against macroeconomic objectives related to the long-term sustainability of public finances, short-medium-term macroeconomic stability, and other official objectives. In addition, a fiscal council can also: (i) contribute to the use of unbiased macroeconomic and budgetary forecasts in budget preparation, (ii) facilitate the implementation of fiscal policy rules, (iii) cost new policy initiatives, and (iv) identify sensible fiscal policy options, and possibly, formulate recommendations."

Thank you!