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Comment on Charles Wyplosz: Fiscal policy councils—unlovable or just unloved?

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Charles Wyplosz has written a very fine survey of the discussion around fiscal policy councils: the potential fiscal problems they should help to alleviate, various ways of setting up such councils and whether they can both work and be loved.

I have developed my general views on fiscal policy councils elsewhere and I shall not repeat them here.[1] Instead, I shall focus my comments on the newly established Swedish Fiscal Policy Council and how its construction is related to the general discussion about such councils.

The existing academic proposals on fiscal policy councils can be classified into three main categories:

- A *hard* option where such a council takes on a direct decision-making role regarding budget outcomes.
- A *soft* version where such a council gives the government authoritative *recommendations* on future policy.
- An even *softer* version, according to which the government should be obliged to base its budget proposal on forecasts made by an independent committee in order to avoid an *optimism bias* in forecasts which could be used to justify lax budgetary policy.[2]

The Swedish version of a fiscal policy council differs from earlier proposals in two respects. On the one hand, it is much softer than even the softest of these proposals, since the task is not to make ex ante recommendations but instead an ex post evaluation of past policy. And the Swedish council will certainly not have any decision-making power except, of course, regarding its own work. But, on the other hand, the policy area to be covered is much broader than in the standard proposals.

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[1] See EEAG (2003) and Calmfors (2003a,b, 2005 and 2006).

[2] See Jonung and Larch (2006).

According to its instruction, the council is to evaluate:

1. The extent to which the government's fiscal-policy objectives are achieved. The objectives include long-run sustainability, the budget surplus target, the expenditure ceiling and that the fiscal policy stance squares with the cyclical situation.
2. Whether developments are in line with healthy long-run growth and long-run sustainable high employment.
3. The clarity of the government budget proposals and the stated grounds for policy measures.
4. Government economic forecasts and the models used to generate them.

In addition, the council should try to stimulate the public debate on economic policy. The findings of the council are to be published in an annual report.

This remit is thus wider than in most earlier proposals on fiscal policy councils in two respects: it includes an evaluation of to what extent policy contributes to growth and employment and also an evaluation of stated grounds for policy measures as well as of the quality of forecasts and their model underpinnings.

How are we going to solve our task?

- In a first report it is natural to focus on basic issues of principle. One issue is, of course, what should be meant by long-run sustainability of public finances and how the current budget objectives square with this overriding goal: the current one-per-cent-of-GDP budget surplus target over the cycle is motivated by future demographic concerns: so a natural question is then for how long the objective should apply.
- Another unclear issue is how fiscal policy should be adjusted over the cycle. There is a general presumption that fiscal policy should be countercyclical but no clear view in the government budget documents on the exact relative roles that should be played by monetary and fiscal policy when it comes to stabilisation of the business cycle.
- A third issue is what principles should guide fiscal policy in a situation such as the present one where there is huge uncertainty about the effects of labour market reforms. This links up with the issue of whether the current fiscal policy stance represents the right trade-off between long-run budget objectives and cyclical considerations.

- It would be an enormous task to evaluate both growth and employment policies in general. Given the emphasis of the government on employment, it seems reasonable that we at least initially focus our evaluation on that aspect. This means that we will also be analysing specific labour market reforms.
- We will put a large effort into evaluating the analytical basis for various government tax proposals. Here the analytical basis for the reform of the real estate tax and the abolition of the wealth tax appears much less satisfactory than for many of the labour market reforms. One can also look more deeply into the methods used to estimate variables such as equilibrium employment, potential output, output gaps and the cyclically adjusted budget balance.

As we see it, the purpose of our work is to give both the parliament and the public at large a better basis for forming informed judgements on the government's economic policy. So, the ultimate objective is to increase the accountability of policy makers. The Finance Committee in Parliament will be using our report as an input in their deliberations.

How much can the council contribute to the policy debate by making an ex post evaluation? Even if we will not give direct recommendations on future policy, judgements of past measures (and comparisons with alternatives) can be very useful for the future. It is also natural that we comment on announcements of future policy measures in the budget proposals, even if the measures have not yet been fully worked out.

What reactions were there to the establishment of the council? I think there were three main types of criticism:

1. That there are so many others doing the same thing that a fiscal policy council represents nothing new and is therefore unnecessary.
2. That the establishment of a fiscal policy council is a threat to democracy: it is more or less a *coup d'état*, with economists taking over power.
3. That the council will not be independent enough and will work more or less as cheer leaders for the current government.

Points one and two are often voiced by the same people, but both propositions cannot possibly hold at the same time. Regarding the first point, my view is that institutional arrangements do matter. So, the regular publishing of a report on government fiscal policy could become an event contributing to a more structured public discussion. Regarding the second point: a better basis for economic policy discussions should strengthen democracy and not the other way around.

It could be seen as a potential weakness that the council is appointed directly by the government. It is, of course, theoretically possible that the council's evaluations could be influenced by a desire on the part of the members to be re-appointed by the government. However, one has tried to reduce this risk by stipulating in our instruction that future appointments—like with the Economic Council in Denmark—are to be made on proposals by the council itself.

In practice, the risk that the council members would be unduly influenced by a desire to be re-appointed is probably small. For one thing, the ratio between work input and pay is quite unfavourable, so one has to be somewhat of a philanthropist to take on a task like this. All members also have their main occupation elsewhere, so we are not dependent on this assignment for our living: it is rather the other way around. But the main guarantee for independence is, of course, the loss of reputation that the council members would suffer if we were to be seen to act in a political way—in academic circles that would be absolutely devastating for one's reputation.

In fact, one would expect the political opposition to potentially benefit more from the work of the council than the government. One reason for this is that the opposition will always have much less of analytical capacity available than the government and therefore has to rely more on analyses of others. Another reason is that the focus of the reports will be a critical assessment of policy documents from the government: it would be rather pointless if the council could not find things to criticise that ought to be improved.

If the Fiscal Policy Council is to gain long-run legitimacy, then we must earn a reputation for impartiality and independence. So, there is obviously a very strong incentive for us to act in this way. But it is up to us to prove in our future work that we can achieve this.

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