

Comment on Charles Wyplosz: Fiscal Policy Councils –
Unlovable or Just Unloved?

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I think Charles made 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 shall not comment directly on Charles' presentation. Instead, I shall take this opportunity to talk about the Swedish Fiscal Policy Council, which was set up on the 1 August this year, and how I see its role. But the idea is, of course, to highlight the issues Charles brought up.

I would classify the existing academic proposals on Fiscal Policy Councils 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.
- These were the two types of proposals Charles focused on. There exists also 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.

The set-up of the Swedish Fiscal Policy Council differs in two important respects from these proposals.

- First, the Swedish version 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 we will certainly not have any decision-making power except of course regarding our own work.
- Second, the remit of the Swedish Fiscal Policy Council is wider than according to most earlier proposals in a sense that I will come to soon.

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 balance objective, the expenditure ceiling and that the fiscal policy stance squares with the cyclical situation.
2. Whether developments are in line with long-run sustainable growth and long-run sustainable 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 wider than in most earlier proposals in two respects: it includes evaluation of to what extent policy contributes to growth and employment and also 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? We are still contemplating this, but I could give a few indications:

- In a first report it is natural to discuss some 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 objective 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 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 fiscal policy stance in the current boom 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 we will be analysing also specific labour market reforms.
- We will put down a large effort on evaluating the analytical basis for various government tax proposals. Here one can suspect that the analytical basis for proposals such as the changes of the property and wealth taxes is much less satisfactory than for several other proposals. We shall 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 accountability of policy makers. The idea is that the Finance Committee in Parliament should be able to use our report as an important input in their deliberations.

How much will we 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 are not yet fully worked out.

What reactions have the council met so far? I think we have seen 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 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, I do think institutional forms matter. So a regular publishing of a report on government fiscal policy could become an event contributing to a more structured public discussion. I have already implicitly commented on the second point: a better basis for economic policy discussions should strengthen democracy and not the other way around.

One could see it 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 – as 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 for us 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 preoccupation 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 we 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 is that the opposition will always have much less of analytical capacity available than the government and therefore has to rely more on other analyses. Another reason is that the likely focus of the reports will be a critical assessment of policy documents from the government: it would be rather pointless if we could not find things to criticise and that ought to be improved.

Let me conclude by saying that we are very well aware that if the Fiscal Policy Council is to gain long-run legitimacy, then we must earn a reputation for impartiality and independence. So, we have very strong incentives to act in this way. I end there and hope I have been able to complement Charles' discussion with some more practical considerations.