

## MALİ KURALLAR VE BAĞIMSIZ MALİ KONSEYLERİN KARŞILAŞTIRMALI BİR ANALİZİ<sup>1</sup>

DOI NO: 10.5578/jeas.54064

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### ÖZET

Özellikle II. Dünya Savaşı'ndan sonra, artan kamu harcamaları ve bütçe açıkları ülkeleri kalıcı çözümler bulmaya yöneltti. Stagflasyon ve bütçe açığı kaynaklı krizler ile bu ihtiyaç şiddetlendi. Önce, mali kurallar teorisi ortaya çıktı ve birçok ülkede uygulanmaya başlandı. Bunu takiben istikrarlı bir kamu mali yönetimi ve sürdürülebilir borç ve açıkların sağlanabilmesi için bağımsız mali kurumlar gündeme geldi. Her iki metodunda artıları ve eksileri var. Bu çalışmanın amacı bu iki metodu karşılaştırarak bir analiz ortaya koymak ve ülkelerin uzun dönem makro-fiskal dinamiklerini istikrara kavuşturma anlamında yararlı bir strateji geliştirmektir.

**Anahtar Kelimeler:** Mali Kurallar, Mali Kurumlar, Kurumsal İktisat.

**JEL Kodları:** E02, H10, H63, H69.

### A COMPARATIVE ANALYSIS OF FISCAL RULES AND INDEPENDENT FISCAL AGENCIES

#### ABSTRACT

Especially after the World War II, increasing public expenditures and budget deficits lead countries to seek for permanent solutions. With stagflation and budget-deficit oriented crises this need escalated. Firstly, the theory of fiscal rules emerged and started to be implemented in several countries. After that, independent fiscal agencies came to the fore in order to have a stable public financial management and sustainable debts and deficits. Both method have pros and cons. The aim of this study is to propose an analysis by comparing these two methods and devise a useful strategy in the sense that it helps countries to stabilize their long-term macro-fiscal dynamics.

**Keywords:** Fiscal Rules, Fiscal Institutions, Institutional Economics.

**JEL Codes:** E02, H10, H63, H69.

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<sup>1</sup> Geliş Tarihi: 04.03.2017 - Kabul Tarihi: 27.10.2017.

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## INTRODUCTION

After the World War-II, budget deficits in many countries rose sharply due to increasing public expenditures. Some of these countries experienced severe economic crises. Therefore, they started to seek permanent solutions. Especially after the stagflation in 1970s this need was started to be felt deeply. Also, the last economic crisis in 2009 again brought the fiscal rules and fiscal agencies on the agenda.

The premises of Keynesian Theory which was proposed after the Great Depression did not find solutions to new economic matters in 1970s. According to the theory, recession periods should be welcomed by tax cuts and increasing public expenditures, on the other hand in inflationary times government should impose more tax or raise the existing tax rates and reduce the public expenditures. But, public expenditure increased during the recession period in the 1970s did not decrease with the economic revival. Also politicians that desire to be elected again reduced tax rates and increased public expenditures. Consequently, rising budget deficits were tried to be funded by imposing new taxes or increasing tax rates. Increased tax and debt burden due to lack of fiscal discipline has negative consequences on total savings, investments and work endeavors, affects economic growth negatively and causes tax evasion, also leads to the expansion of the informal economy (Aktan and others, 2010: 99; Edizdoğan and Çetinkaya, 2013).

Two of the solutions put forward and widely implemented for these problems are fiscal rules and independent fiscal institutions. They were simply expected to stabilize the macro-fiscal dynamics of the countries and become permanent solutions to the deficit and debt problems.

In this context, fiscal rules and independent fiscal agencies are applied to curb the deficits and debt, and depoliticize the budgetary process. Fiscal rules in nature are either very strict measures against the political decisions since they require a legal framework for budgetary processes or very flexible. Moreover, their institutional backgrounds are also generally crude (Wyplosz, 2005: 65). On the other hand, fiscal institutions may appear in a variety of forms: They can be advising, monitoring, auditing bodies. In some countries their decisions can be binding for governments' macro-fiscal policies. Both methods have advantages and disadvantages for governments. In this study these two methods are compared, pros and cons of the two approaches are analyzed and it is tried to devise a strategy for a country to have a permanent solution for rising debt stock and budget deficits.

In this context, in section one historical approaches on stabilization policies are revealed, in section two main components of the concept fiscal discipline is mentioned, in section three and section four fiscal rules and independent fiscal agencies are analyzed respectively, section five indicates some cross-country cases in terms of fiscal rules and fiscal councils, section six reveals a comparison of the two method and section seven proposes a policy implication.

## 1. HISTORICAL APPROACHES TO STABILIZATION POLICIES

The historical approaches proposed many policies on fiscal policies, role of a state, functions of government budget and fiscal discipline. One of these approaches is Classical approach. Classical approach advocates a small sized and neutral budget, budget should be balanced, there should not be budget deficit or surplus, governments should not intervene in the free-market economy, public expenditures and taxes also should not have an impact on the economy. In short, the concept of neutral state is the fundamental component of the Classical approach. New Classicals also advocate the small and balanced budget. On the other hand, according to the Keynesian approach, market economy is unstable in nature. Therefore, governments should intervene in the economy actively. In Keynesian view, budget is regarded as fiscal policy tools for governments. In recession government should increase public expenditures and in economic boom periods decrease them. Also in economic stagnation governments can and should have budget deficits but in expansionary period governments should adopt a budget surplus policy. According to Monetarists the free market economy is stable in nature and real source of unstable economic situations is wrongly implemented monetary policies, governments should only take necessary measures to make sure free-market economy functions well and fiscal policies are not effective since they may cause the crowding-out effect. On the other hand, Constitutional Economic view states that the discretionary fiscal policies should be restricted by constitutions (Özdurak, 2014). This approach also is the base of the theory of fiscal rules.

## 2. THE CONCEPT OF FISCAL DISCIPLINE

Fiscal discipline means that public revenues and public expenditures are equal. It covers not only a balanced central budget but also the balance of all public revenues and public expenditures (Edizdoğan & Çetinkaya, 2013: 148). Another definition of fiscal discipline is "establishing and then maintaining prudent deficit and debt levels" (Hemming, 2003: 2). In this definition prudence of the fiscal policies is emphasized and sharp boundaries are not drawn. Consequently, in the

broadest definition of fiscal discipline, we can state that a government is able to finance the public expenditure by public revenues within a fiscal year. However, country implementations show that even in the most developed countries, periods when the budget revenues and expenditures are equal are fairly rare (Günay, 2007: 6).

According to Hemming (2003) establishment of fiscal discipline is particularly important in terms of four factors. We can list these elements in the following way: Firstly, fiscal discipline is desirable for governments since sound public financial management is a must for macroeconomic stability. Thus aggregate demand pressures and problems regarding balance of payment and inflation can be avoided. Secondly, monetary policy effectiveness is not restricted by a need to compensate for the consequences of loose fiscal policy; thirdly, thanks to fiscal discipline political decision-makers pay attention to the effectiveness of the tax system and public expenditure programs which are necessary in terms of resource allocation and economic growth and lastly, fiscal discipline is important in terms of meeting predictable and unpredictable fiscal pressures (Hemming, 2003: 2).

The absence of fiscal discipline, in particular, limits the emerging national economies' access to international capital, which is a pressure on potential growth. This can increase the fluctuations in the economy and complicate the macroeconomic management. For this reason, in order to maximize the benefit of the globalization process, not only strong policy implementations, but also policy harmonization between countries is needed. In countries where is not a financial discipline, it is more difficult to realize these compliance policies (Günay, 2007: 8).

Governments tend to spend more in good conditions and consequently they may face debt sustainability problems and economic bottlenecks. Policy-makers also tend to focus on the short-term conclusions and overlook the mid- and long-term consequences. Therefore, budget policies should be in harmony with policies regarding macro-economic stability and economic growth/development. This is a vital factor for fiscal discipline. Thus, it can be guaranteed that governments will avoid excessive borrowing and debt accumulation. *"A key distortion underlying inadequate fiscal discipline arises from the tendency of governments to have shorter time horizons than voters"* (Debrun et al, 2009: 49). They are less anxious about fiscal discipline due to uncertainty about next elections. In time, this myopia causes increasing current deficits and future taxes also future expenditure cuts (Debrun et al, 2009).

Fiscal discipline is also affected by automatic stabilizers like a progressive taxation and unemployment payments. The financial policies carried out with automatic stabilizers enable countries to mitigate the impacts of the economic fluctuations. In this sense, it is assumed that fiscal rules on public expenditures allow the automatic stabilizers to work in almost all economic conditions (Anderson and Minarik, 2006: 193-194).

As stated before in this study, fiscal discipline is a key for macroeconomic stability. The increasing use of public expenditures by governments, the arbitrary use of taxation authority, and the lack of restrictions on internal and external borrowing cause the lack of fiscal discipline. In order to achieve fiscal discipline public revenues and especially public expenditures should be kept under control. On the other hand, the increase in the total debt burden pushes the state towards interest swamp. It causes the contraction of the production economy and the expansion of the rent economy.

### 3. FISCAL RULES

The 1970s were a period of time when stagflation emerged on the basis of high inflation and stagnation, and fiscal policies were inadequate to solve this problem. This situation simply triggered the re-discovery of fiscal rules. In this section the theory, emergence, application of fiscal rules are revealed.

#### 3.1. Emergence of Fiscal Rules

*"Fiscal rules which dating back to ancient times have begun to rely on a legal and constitutional basis over the past 150 years"* (Günaydın and Eser, 2009: 53). In this context, we can propose three main periods in the emergence of the fiscal rules in the modern world. In the first period, some sub-national governments in countries like US and Sweden adopted golden rule and also declared an obligation to have a balanced budget. In the second period, after the World War II a number of industrialized countries including Germany, Italy, Japan, Netherlands adopted balanced budget rules in order to support their stabilization programs. These rules were similar to golden rule, however, other rules like funding the deficits from particular resources -mainly from central banks- were adopted in 1960s and there were developing countries Indonesia that introduced these rules. In the third period -which also can be called current period- the fiscal rules that include restrict balanced budget rules were adopted by several developed and developing countries. The distinction of these rules were that they mainly aimed transparency. And, finally New Zealand adopted the "Financial Liability Act" in 1994 to put inflation target into practice. Following this law,

many developed and developing countries have begun to set fiscal rules (Kopits, 2001).

In 1930's, Keynesian fiscal policies became popular. But after stagflation in 1970s, fiscal rules came to the fore again. In this context, in Europe, the fiscal rules entered into force in 1992 with the Maastricht Treaty. The number of countries implementing fiscal rules has increased considerably since the 1990s. In 1990 fiscal rules was applied only in 7 countries. These countries are Germany, France, USA, Luxembourg, Spain, Japan, Italy. Today, the number of countries implementing fiscal rules is close to 100.

Theoretical background of the concept 'fiscal rule' is mainly based on 'constitutional economic view'. The roots of the constitutional economic view traces back to 'public choice theory' and public choice theory has three basic assumptions: Methodological individualism, homo-economicus and political exchange. In other words, all economic and social decisions are based on not institutions but on individuals, an individual always seeks to maximize his utility and, politicians and individuals act just as they act in market economy-they want to maximize their utility and they practice a kind of vote trading-. Positive analysis of public choice theory is simply based on these three assumptions. On the other hand, we call the normative analysis of this theory as 'constitutional economics'. This theory simply proposes taking economic decisions of governments into constitutional protection (Yüksel, 2010).

### 3.2. The Theory of Fiscal Rules

The concept fiscal discipline has gained importance especially in the last half-century and one of the methods to have a fiscal discipline is the theory of fiscal rules. In this context, rule-based economic policies have been widely implemented in the last 20-25 years, in many developed and developing countries (Karakurt and Akdemir, 2010: 228). In 1990's many countries implemented inflation targeting. Following this attempt, control of budget deficits and debts via fiscal rules gained popularity. All these implementations have one in common: they were adopted to build credibility and take the discretionary policies under control. By doing so, the governments aimed to have a more predictable and foreseeable policy path (Kopits, 2001).

According to Demir and İnan (2011) "*it can be defined that the fiscal rules are practices that restrict and discipline closely fiscal policies imposing some quantitative restrictions on the size of the budget and stock of public debt*" (Demir & İnan, 2011: 25). Also another definition of fiscal rules is "... a statutory or constitutional restriction

*on fiscal policy that sets a specific limit on a fiscal indicator such as the budgetary balance, debt, spending, or taxation*" (Kennedy et al, 2001: 238). All these definitions have the following features in common: fiscal rules are some sort of legal restrictions upon fiscal indicators such as government debt, government spending or budgetary balance. In this context, fiscal rules are one of the main elements that are used to ensure fiscal discipline (Günay, 2007: 85). And, they also aim to achieve ensuring fiscal sustainability, predictability and macroeconomic stability.

The main rationale behind the implementation of most fiscal rules is that current and future governments are either not willing to implement disciplined fiscal policy measures or lack the ability to implement them. (Mihaljek and Tissot, 2003:22). Fiscal rules are simply built on three bases: (I) determination of what will be targeted or limited and the determination of the numerical values of these targets or their limitations. For example: The target ratio of debt stock to GDP is set at 60%, (II) clarification of sanctions if policy-makers do not implement applications for specified objectives and (III) good surveillance and application method.

### 3.3. On Applicability of Fiscal Rules

In order to analyze the theory of fiscal rules, above all, the premises of the constitutional economic theory should be questioned. Are all the decisions really taken at the individual base? Obviously not. On the contrary, individual decisions are mostly directed by the institutional decisions. For example, an individual cannot decide to start a war against another country. On the other hand, not all the people are homo-economicus. For many people national interests may come before the individual interests. Again, for many politicians their ideology may come before their political interests (Yüksel, 2010).

On the other hand, it is usually a matter of uncertainty how the sanctions will be imposed in case of the deviations from fiscal rules. Furthermore, do they really work in crisis time? It can be seen that fiscal rules cannot prevent the negative impact of external shocks on the budget in the last global crisis. This explains why fiscal rules are put into practice in post-crisis periods and are not implemented in the period of economic contraction. There is also no strong evidence that the fiscal rules lower the perceived risk premium in the economy and no empirical conclusion that the tax burden in the economy falls with the debt stock (Özlale, 2010: 5). Especially in undeveloped countries and emerging economies, increasing the incomes for one or more times in order to comply with the fiscal rule may worsen the already negative tax composition

and reduce the potential growth rate (Özlale, 2010).

Moreover, the economic problems that each country has to deal with and, consequently, the policy measures that need to be implemented are different. Also, the only problem the country's economy focuses on is not the implementation of a macroeconomic system in which uncertainties are reduced. There are other important problems like unemployment, unfair income distribution and insufficient effective demand etc. Fiscal rules also save the political power from the political responsibility (Gürkan and Karahanoğulları: 2010). This is not ethical.

In this context, the IMF's Evaluations on implementation of fiscal rule are following (IMF, 2009: 14-15):

- *"Fiscal rules often take place in an environment where there is not enough political support*
- *Rules are often enforced without pre-requisite.*
- *They have a character that will increase economic instability because they reduce the effectiveness of discretionary decisions.*
- *Because they are silent about the composition of financial harmony, they have led to the reduction of social investments with high returns."*

For a successful application of fiscal rules, above all, an appropriate economic and political environment is required. They are also expected to be simple, flexible and growth-oriented. According to the IMF (2009), the conditions necessary for a successful fiscal rule implementation are as follows (IMF, 2009: 11-13):

- I) Adequate public financial management system*
- II) There must be reliable data.*
- III) Budgetary aggregates need to be predictable*
- IV) Budget reporting systems should be comprehensive*
- V) In accordance with a pre-announced schedule, it must be released and allow for external control."*

#### **4. INDEPENDENT FISCAL AGENCIES**

The recent economic crisis revealed the necessity of the fiscal discipline, transparency and responsible fiscal policies in the countries which cannot implement sound fiscal policies. As a consequence, the countries began to look for permanent institutional solutions. As mentioned before, most of the country's fiscal management is simply characterized by lack of fiscal discipline. Therefore, many countries which cannot implement sound fiscal policies suffer from the huge amount of debts and also financial crises. For

this reason, the financial system should be able to punish or block poor fiscal management. In this context, independent fiscal institutions are also a measure against non-transparency and excessive politicization of budgetary processes. In other words, fiscal institutions, just as fiscal rules, are proposed as a means of depoliticization of the fiscal policy. In this section the emergence, theory, application of independent fiscal agencies are mentioned.

#### **4.1. Emergence of Independent Fiscal Agencies**

The first independent fiscal agency which is a sort of fiscal institution in Europe was founded in 1945, in the Netherlands under the name Central Planning Bureau (CPB). Following this attempt, Congressional Budget Office established in USA in 1975; its function is simply making objective analyses regarding budget and macro-economy for the Congress.

Independent fiscal agency is a very new concept. *"At its most basic level, a fiscal council is a publicly-funded entity staffed by non-elected professionals mandated to provide nonpartisan oversight of fiscal performance and/or advice and guidance - from either a positive or normative perspective - on key aspects of fiscal policy"* (Hagemann, 2011: 76). Another definition is that: *"Fiscal councils are independent public institutions aimed at promoting sustainable public finances through various functions, including public assessments of fiscal plans and performance, and the evaluation or provision of macroeconomic and budgetary forecasts"* (IMF, 2013: 1). They should not be confused with the auditing institutions. The auditing institutions have been existed for a long time in approximately 150 countries. They are independent, too. However, they do not make ex-ante analyses and assessment (Dziemianowicz, 2014: 66). In this context, non-partisan fiscal agencies are not decision makers but facilitators of sound macro-fiscal public finance.

#### **4.2. The Theory of Independent Fiscal agencies**

There are two types of independent fiscal agencies: independent fiscal authorities and fiscal councils. Independent fiscal authorities are simply responsible for setting long-term objectives, targets and adjusting some predetermined tax and expenditure packages. On the other hand, fiscal councils are liable for providing objective analysis of fiscal policies, independent budget forecasts and normative assessment and recommendations (Dziemianowicz, 2014: 64). Kopits (2011) also states that the main function of a fiscal council is to analyze and assess the macro-fiscal consequences of budget and other fiscal legislation.

The other two main functions of fiscal agencies are advising and auditing fiscal plans and performance. In some countries independent fiscal agencies directly involve in forecasting processes. Fiscal councils promote fiscal discipline by auditing, advising and forecasting. They also increase the country's credibility and level of institutionalization.

*"It should be clearly emphasized that without sufficient institutionalization of the widely understood budget process, one cannot speak about efficient functioning of the public finance sector"* (Dziemianowicz, 2014: 62). Thus, we can say that institutionalization is a pre-condition for a good fiscal management. Targets of creation of independent fiscal agencies are the same as fiscal rules: decreasing budget deficits, curbing the politicization of macro-fiscal decisions, transparency and enhancing the quality of fiscal policies.

On the other hand, the independent fiscal agencies must be independent in the real sense. If designed properly and managed effectively, they have a significant impact on the economy by ensuring fiscal discipline and building credibility. In this context, effectiveness of independent fiscal institutions depends on many factor. First of all, their scope of authority should be well-defined. They should be included in the budgetary process and their evaluations should be taken into account by the government. Secondly, as stated before in this work, they should be fully independent. Also, members of this bodies should be selected among scientists. These members should be experts in their fields and capable of making sound decisions and analyze the economy efficiently (Dziemianowicz, 2014: 65-66).

#### **4.3. On Applicability of Independent Fiscal Agencies**

*"Previous studies indicate that the fiscal councils having wider powers have greater impact on fiscal discipline and improve the quality of fiscal policy"* (Dziemianowicz, 2014: 68). However, their effectiveness mainly depends on the authority given to them and to their independence. On the other hand, the European Commission's studies indicate that the budget deficit in the countries, which have independent fiscal agency, is significantly lower in comparison to countries without such institutions (Dziemianowicz, 2014: 68).

First of all, the independent fiscal agency and related legal framework should be designed in comply with the political and economic features of the country. Different fiscal agencies have different features. By doing so, they can be capable of meeting the needs of countries and function in an effective way.

They are also flexible. By technical assistance, they allow governments to follow independent fiscal policies. Therefore, they can be institutional solutions of excessive deficits. They also enjoy the legal protections against intervention and pressure from politicians. Thus they can curb the manipulation of the politicians on the budgetary process.

In the absence of transparency, a well-functioning fiscal council can help to improve accountability and discourage opportunistic political decisions in the fiscal policy. Also these institutions can raise public awareness by independent scrutiny and taking on a mission to be an independent watchdog of the public financial decisions.

On the other hand, they can provide the government with technical assistance in the budgetary process. Econometric findings in this area support that they have more correct forecasts. *"The quality of government forecasts improved after the establishment of fiscal councils in Canada and Sweden."* (IMF, 2013: 39) In this context, they can curb the over-optimistic revenue forecasts and unrealistic expenditure estimations. They also help country to insulate public financial decisions from excessive partisan influence.

Good statistical governance is a must for the effectiveness of fiscal councils. Also, availability of reliable data is a key to a well-functioning fiscal council. This is again related to institutionalization. In an economic environment where only poor data are available further arrangements are required. On the other hand, tasks and the mission of fiscal agencies should be clear and implementable. At a minimum, a fiscal agency should have a role of watchdog.

The functions of fiscal agencies may vary from country to county. In short, fiscal councils should be a stand-alone and fully independent institutions. Their policy proposals should be in harmony with long-term economic objectives of the government. They also should monitor governments' fiscal performance-plan and policies, develop macro-economic projections, advice decision-makers on policy options.

#### **5. COUNTRY EXPERIENCES ON FISCAL RULES AND INDEPENDENT FISCAL AGENCIES**

There are many countries have fiscal rules to stabilize their macro-fiscal dynamics. In this context, Germany is among the leading countries in terms of fiscal rules, for instance. Fiscal rules have been applied in Germany with constitutional restrictions since 1969. In 1969, an article added to the German Constitution and it became compulsory for the federal government to have a balanced budget. But Germany have had budget deficits in 16 years and budget surplus only in 4 years in the twenty-year period between 1995-

2015. Furthermore, when examined in terms of Maastricht criteria<sup>3</sup>, it is seen that Germany has not been able to fulfill the rule of debt since 2002. Since 2002, the *debt stock/GDP* ratio has remained above 60%. Another country experienced a sharp growth in the public sector as well as public debts in recent years is France. In this context, France is another country cannot meet the Maastricht Criteria for a long time. Its general public debt to GDP ratio has been well above the 60% for the last 20 years and it continues to increase. On the other hand, fiscal rule implementations in the UK began with the introduction of a series of reforms to public finance in 1997, as a result of high public deficits in the first half of the 1990s. The main aim of the law is to improve the efficiency of the fiscal policy by setting the basic principles to guide the policy making and implementation process (Kaya, 2010: 44). In this framework, UK is one of the countries that preferred to implement non-numeric fiscal rules. These are simply transparency, stability, responsibility, justice and efficiency in the public financial management. From 1997-2007, the British government was successful in terms of golden rule implementation. In this period, the current public balance had a surplus of 0.1 percent. But after 2008 to 2016 general government debt to GDP had an increasing trend reaching at 112.6 percent in the year 2015 which is again well above the Maastricht Criteria. On the other hand, in USA the first legal regulation to set an example for rule-based implementation at the federal level is the Liberty Bond Act of 24 April 1917. The law is aimed at restricting the government's discretionary lending authority during the First World War. In this framework, a nominal limit has been set at the legal level for the gross debt stock (Peach, 2001: 229). In the mid-1980s, the rapidly increasing public deficits brought about a new legal regulation: Gramm-Rudman-Hollings (GRH) Act<sup>4</sup> which was adopted in 1985. With this law, the deficit levels are nominally limited on a fiscal year basis, with the aim of ensuring the budget deficit from 1986 to 1991. In conclusion the difference between the targeted deficits and real deficits from 1986 to 1993 were respectively 49.3, 5.7, 47.2, 80.6, 185, 269.2, 262.4 and 255 billion dollars (Kaya, 2010: 53). That means the GRH system was not successful in practice. One of the reasons for the failure of the system was the wrong calculation of the growth rate (Daban et al,

2003: 37). This situation again indicates the importance of fiscal councils with qualified staff and these agencies' support to the implementation process of the fiscal rules. The other important matter about fiscal rules that they do not work in crises. *"During the crisis, many countries put their fiscal rules into abeyance"* (Schaechter et al, 2012: 25). Therefore, as stated before in this paper they should be flexible. In this context, during the 2008-2009 crisis many countries make amendments in their fiscal rules. The expenditure rule<sup>5</sup> was breached in 2009 and not implemented in 2010 and 2011 in Bulgaria, the ceiling for the structural balanced budget rule was decreased from 1 percent of GDP in 2007 to 0.5 percent of GDP in 2008 and to a budget balance (zero) in 2009 in Chile, from 2007 to 2009 the government of Finland targeted the structural surplus of 1 percent of GDP but in February 2009 the government stated that it can deviate from this target temporarily, for instance (Dede, 2010; Kaya, 2010; Schaechter et al, 2012 ). On the other hand, *"There is evidence to suggest that these agencies have made an effective contribution to fiscal discipline in their respective countries"* (Debrun et al: 2009, 67). The councils make more realistic estimations rather than making optimistic judgments about the budget, monitor the implementation of budget plans, make budgetary targets accountable and thus ensure that policy makers and the public have knowledge of the budget process (Kovancilar & Alparslan, 2011: 106). In this context, the table below indicates the empirical conclusions of the study run by Debrun and Kumar (2008).

Due to lack of data, there is currently a few cross-country analyses on independent fiscal agencies (Debrun et al, 2009:70). However there are exceptions: European Commission (2006) and Debrun and Kumar (2008). Both studies use the same data set that provided by the European Commission on the bases of a survey conducted in 25 European union member states. The contribution of the second study is to propose a quantitative indicator and summarizing the impact of fiscal councils on fiscal discipline (Debrun et al, 2009). In this framework, the figure-1 below indicates that there is a strong positive relationship between overall influence of fiscal councils and its perceived effect in fiscal performance.

<sup>3</sup> In accordance with Maastricht Treaty (1992) and the Stability and Growth Pact (SGP) (1997), European Union Member States' budget deficit to GDP ratio and general public debt to GDP ratio should be maximum 3 percent and 60 percent respectively.

<sup>4</sup> The real name of the law is "Balanced Budget and Emergency Deficit Control Act"

<sup>5</sup> This rule was a ceiling on the public expenditure/GDP ratio of 40 percent.

**Table 1:** Features and Perceived Impact of Fiscal Councils in the EU

	Number of Councils	Overall influence and independence	Overall Influence in the budget process	Impact of independent forecast	Formal Guarantees on Political independence	Perceived impact on fiscal discipline
Austria	1	1.3	0.8	0.2	1.7	1.5
Belgium	2	5.7	6.5	2.3	4.9	6.3
Denmark	1	3.5	2.4	0.0	4.6	0.8
Estonia	1	4.0	2.9	0.0	5.2	7.1
France	2	1.7	1.5	0.0	1.9	1.3
Germany	4	3.7	1.4	0.2	6.1	2.5
Greece	1	1.5	0.2	0.0	2.7	0.2
Hungary	1	4.2	4.6	0.0	3.8	3.3
Italy	1	1.9	1.1	0.0	2.7	2.5
Luxembourg	1	4.8	3.6	0.0	6.0	2.7
Netherlands	1	3.5	2.6	1.1	4.4	6.3
Portugal	1	4.1	2.5	0.0	5.6	1.5
Spain	2	5.5	5.0	0.0	6.1	7.1
UK	1	1.9	2.0	0.0	1.9	1.5
Average		3.4	2.7	0.3	4.1	3.2
Average Euro		3.4	2.5	0.4	4.2	3.2
Standard Deviation		1.5	1.8	0.7	1.6	2.4

**Source:** Debrun, X. and Kumar M. S. 2008. Fiscal Rules, Fiscal Councils and All That: Commitment Devices, Signaling Tools, or Smokescreen?, *Proceedings of Banca d'Italia Public Finance Workshop*, Rome: Banca d'Italia, 479-512. (Maximum Score is 10)

## 6. A COMPARISON OF FISCAL RULES AND INDEPENDENT FISCAL AGENCIES

Responsible fiscal policy is a pre-condition for effective usage of the public debt and budget deficits. Two of the methods applied to ensure that condition are fiscal rules and independent fiscal agencies. In the light of the analysis that put forward in this work it can be proposed that only application of fiscal rules without supportive fiscal agencies seem no logical for many reasons. First of all, necessity of the fiscal rules should be questioned. "...governments can commit credibly to fiscal discipline without any permanent rules." (Kopits, 2001: 6). This situation shows us that credibility is built not also by rules but also by reputation (Kopits, 2001). Another criticism to fiscal rules is that they are not effective enough. Because they enhance non-transparent behavior of politicians like accounting tricks or circumvention of the rules. Rules also impose excessive bureaucratic requirements. On the other hand, if a country does not have a strong institutional infrastructure, both method simply do not work. Moreover, inflexibility of fiscal rules can be quite dangerous for the countries especially in the crisis times. However, independent fiscal agencies consist of scientists and technocrats may be helpful for governments to overcome crises by consultation they provide. Indeed, inflexibility of fiscal rules played a major role in emergence of independent fiscal agencies. Also, fiscal rules restrict political aims. This means

restriction of social will (Gürkan & Karahanoğulları, 2010: 552). On the other hand, a well-established fiscal agency may help the government to achieve its goals both in the short- and long-term. A fiscal council generally direct the fiscal policy in an indirect way, they rarely have a direct impact on the public financial management of the government (IMF, 2013). Rules are also criticized since they impose unnecessary bureaucratic transactions. They also generally cannot impose heavy penalties. These are the other factors reduce the credibility of this approach (Kopits, 2001). Lastly, implementation of fiscal rules is quite hard for governments because of different economic cycles. The governments are to adopt fiscal policies according to the existing economic conditions. This can cause biases from the fiscal rules. But independent fiscal agencies can predict the economic conjunctures and help governments to adopt effective policies in order to overcome adverse situations successfully.

## 7. POLICY IMPLICATION

Recently, countries increasingly experience budget deficit-oriented financial crises and have started to take strict measures against this situation. The crisis in Greece is considered as a result of the public debt reaching significant levels, for instance. As a consequence, efforts to provide fiscal discipline increased significantly. In this context, the two proposed ways of establishing

fiscal discipline are fiscal rules and independent fiscal agencies.

Fiscal rules need some certain pre-conditions to work well. For example, above all, a country should achieve transparency in order to run a successful fiscal policy. But, regulations regarding transparency are circumvented through gimmicks. Therefore, according to Kopits (2001) first of all transparency<sup>6</sup> in institutional structure and functions should be achieved. Having multi-year macro budgetary policy is also essential for fiscal rules to function well. Because such a policy alerts the government as well as all the other economic agents on the policy adjustment that they may need. Establishment a contingency fund for prospective biases from the policies may also helpful for well implementation of fiscal rules. On the other hand, countries should establish an institutional authority for surveillance of the fiscal rules. The institutional structure, legal infrastructure and method of implementation of a good fiscal rule must be clearly defined. Exceptional circumstances must be provided in order to ensure flexibility in the rules against unexpected shocks and situations during implementation, and implementation and supervision of the rules should be done by impartial bodies. An optimal rule should also be transparent, simple, consistent and flexible. In addition, a good fiscal rule must be legible in terms of decisions, amendments and sanctions, which also expected to be appropriate for an effective implementation (post implementation and effective control) (Karakurt and Akdemir, 2010; Kopits, 2001).

Both theoretical and empirical literature put forward that there are the factors lack of fiscal discipline and poor fiscal management behind the excessive debt burden and budget deficits. (Debrun et al, 2009: 44) In this framework, first of all electoral system should be capable of punishing poor public finance management. On the other hand, independence of these authorities is a key for effectiveness. Fiscal councils also should be respected, have qualified staff and its mission should be articulated clearly.

Countries that have no institutional infrastructure need new institutions. Because lack of institutions hinders the functioning of not only the independent fiscal institutions but also fiscal rules. Also, if a country is determined to apply fiscal rules, commitment to fiscal policy rules is needed. In order to achieve this, committees should be established which are fully independent. Their decisions also should be binding to a certain extend. But the authority given them should not take the sovereign right from the government.

They should be able to determine the level of government debt, for instance. For this reason, these committees also should be accountable to the parliament.

Flexibility of fiscal rules is also a key factor for a well-functioning public financial system. This necessity is more important especially in crises since the rules restricted the discretionary fiscal policies. Therefore, many countries try to block or circumvent the rules in extraordinary times for a short time until they stabilize their economic dynamics again.

Both fiscal rules and independent fiscal agencies have also the potential to facilitate the implementation of discretionary policies. Pre-conditions for such a policy proposal are fiscal rules should be flexible, transparency in general fiscal policies should be achieved and implementation of the rules should be supported by fully independent fiscal agencies.

### CONCLUDING REMARKS

As stated before, the fiscal structures of many countries is generally characterized by lack of fiscal discipline. And according to Hemming (2013) this has three main consequences: increasing budget deficits, pro-cyclicality and expenditure inefficiency. This situation also hinders the economic development and macroeconomic stability. Therefore, this aspect of the matter indicates the importance of sound public finance management.

After the World War II, many countries tried to develop solutions to their rising debt stock and budget deficits. The two of this solutions are fiscal rules and fiscal agencies. In short, the comparative analysis of these two methods simply indicates that the implementation of fiscal rules is not effective in many countries. Also it should be noted that it is not logical to force every political power to comply with the same rules. Such an approach may remove differences and public choice.

On the other hand, well-established fiscal agencies can be really helpful for governments. They help governments make sound public financial decisions by providing them with technical assistance. But they should be fully independent, this independence should have legal protection and their decisions should be binding for governments to some extent. These are basic requirements for them to help to improve fiscal performance of a country. Consequently, for countries want to take more sound fiscal decisions it seems to more logical to found a well-designed fiscal agency with capable employees. Or, if a country is determined to apply fiscal rules, this

<sup>6</sup> Which is also a non-numeric fiscal rule.

implementation definitely should be backed up by fully independent fiscal agencies especially by fiscal councils.

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