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MAKING FISCAL COUNCIL WORK FOR GHANA: COUNTRY EXPERIENCES AND BEST PRACTICE

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Summary

This paper provides some insights and operational guideposts on the design, scope and implementation of an effective fiscal council in Ghana for stemming fiscal indiscipline and improving fiscal performance. In particular, it looks at recent country experiences with fiscal councils and best practice across the globe that have been successful in reducing fiscal deficits, provides key lessons from those experiences, and synthesizes the evidence on public policies that can make fiscal council in a way that bolsters fiscal discipline and fiscal balance in a sustainable manner for Ghana. The paper concludes that the effectiveness and the long-term survival of the proposed fiscal council for Ghana will hinge on factors that include having a full legal and operational autonomy within the scope of its mandate, sufficient financial and human resources, active and unfettered access to information and dissemination of its analysis, and their credibility as well as a high level of political commitment to a medium-term fiscal goal. It then proceeds to propose a structure and how a fiscal council in Ghana should look like based on best practice.

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Introduction

Ghana has had a long period of fiscal indiscipline often resulting in large fiscal deficits and mounting public debt stock. The challenge with fiscal indiscipline dates back to several decades ago but has worsened over the last few years. This has often been occasioned by reckless election-linked public expenditure increases without recourse to the budget. For instance, the deficit-to-GDP ratio moved from a low of 1.8 percent of GDP in 2005 to a high of 8.5 percent in 2008 which happened to be an election year. It then fell again in the subsequent years until 2012 when it increased sharply to 10.1 percent, also in an election year. In three consecutive years (2012-2014), the country recorded a double-digit budget deficit. These persistence large budget deficits culminated into ballooning public debt and huge interest payments. In fact, the debt stock and interest payments as percentage of GDP increased from 25.4 percent and 2.1 percent to 73 percent and 7.3 percent respectively over a decade (2006-2016).

This fiscal malaise had often forced governments to go in for an IMF program often with very severe austerity measures and conditionalities including frontloaded fiscal consolidation policies to restore macroeconomic stability. However, the situation has become more or less like a rollercoaster –we go in and achieve some stability then we out, but immediately thereafter, the fiscal mess even becomes worse than the pre-IMF program era. Sometimes, not even the presence of an IMF program could restrain government from indulging in fiscal indiscipline and wanton expenditure overruns. In 2016, for example, also an election year, despite the 3-year IMF External Credit Facility Program, the deficit outturn for the year was 8.7 percent as against the program target of 5.3 percent.

Clearly, the tendency for incumbent policymakers to create fiscal illusion by engaging in off-budget expenditures or over spending despite revenue shortfalls, particularly in an election year, just to enhance their chances of re-election, does not seem to go away. The lack of monitoring and enforcement institutions to safeguard fiscal discipline and enforce adherence to fiscal rule is missing.

Motivated by this, the IEA few years ago commissioned a study that looked at the role of fiscal policy rule in improving fiscal management in Ghana and recommended the need for a fiscal council (FC) for Ghana in order to stem the persistent fiscal indiscipline. The government appears to have responded positively by passing a fiscal management act with some fiscal rules in 2016, known as the Public Financial Management Act (PFMA), (Act 921) to regulate the financial management of the public sector and to have a framework that support a sound fiscal policy. However, the Act in its current state does not only lack numerical targets or quantitative limits on debts, deficits, or spending, but also no specific provision is provided for a monitoring and enforcement framework to ensure adherence to the fiscal rules and better fiscal performance. In response to this gap in the fiscal management framework, the new government in its maiden 2017 Budget Statement, made a strong commitment to fiscal discipline by indicating its intention to initiate the process towards the establishment of a Fiscal Council that will adopt and implement rules to anchor fiscal policy implementation and to ensure compliance to fiscal rules in Ghana.

While the government is yet to make good its promise, this paper thinks that the nature, structure and mandate of such a council are as important as its establishment/existence. This paper therefore provides some insights and operational guideposts on the design, scope and implementation of an effective fiscal council for improving fiscal performance based on the available literature and the range of best practice across the globe.

What is a Fiscal Council?

A fiscal council, which is also commonly referred to as independent fiscal institution or independent fiscal council has several meaning depending on its remit, mandate, tasks, and institutional forms. However, at its most basic level, a fiscal council can be defined as a publicly-funded entity staffed by non-elected professionals mandated to provide nonpartisan oversight of fiscal performance and/or advice and guidance on key aspects of fiscal policy. On the other hand, and more broadly, fiscal councils have been defined as 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.

While fiscal councils vary across countries in several forms and often have different mandates and functions depending on countries specific factors. Fiscal Councils can be grouped into two main functional bodies/categories; that are, FCs with positive mandates and FCs with normative mandates.

An IMF report observes that while the vast majority of fiscal councils continue to perform positive analyses, evaluate long-term sustainability issues, and prepare or assess macroeconomic forecasts, newly created ones have broader remits. For instance, the Netherlands Bureau for Economic Planning Analysis performs extensive forecasting and costing functions. However, it does not make judgments on the appropriateness of the government's budgetary plans. In contrast, the Swedish Fiscal Policy Council and the Irish Fiscal Advisory Council engage in normative analysis, but do not produce their own forecasts or costing.

However, several other institutions perform both functions. In Denmark Demark, for example, its FC, known as Economic Council is an advisory body that not only provides macroeconomic forecasts but also undertakes analyses of a variety of fiscal policy issues related to the functioning of the public sector, the tax system, fiscal sustainability and the fiscal stance, on the basis of which it issues policy recommendations. The council is also charged with monitoring compliance with current fiscal rules, issuing recommendations as needed to ensure compliance.

How can Ghana benefit from a Fiscal Council?

Fiscal councils have generally been found to contribute to improved fiscal performance by improving policymakers' incentives to opt for sound fiscal policies. However, there is also an acknowledgement that FCs are no *"silver bullet"* for securing and maintaining fiscal discipline – certain key characteristics are required. Empirical studies suggest that while certain characteristics of fiscal councils are associated with stronger fiscal performance, the mere existence of a council is not. This notwithstanding, FC can generally benefit the country in several other ways as follows:

- By depoliticising various aspects of fiscal policy, whether related to formulation or monitoring,
- fiscal councils can better inform voters on the actual state of fiscal policy and raise the political costs of fiscal indiscipline;
- by fostering transparency over the political cycle and allowing people to make ex-ante inputs into the budget cycle—thereby closing technical loopholes that allow governments to circumvent numerical fiscal rules' including the tendency to overestimate expected revenues, underestimate planned expenditure, or unduly exploit escape clauses.

What Key Functional Features are required?

The literature on fiscal council has identified some stylized characteristics that ensure the success of these institutions. These elements include the mandate of the institution, functional independence and involvement in the budgeting processes.

The mandate: The mandate should be clear and unambiguous, specifying the tasks assigned to the institution and the scope of its activities, and backed by strong legal provisions. The mandate should ensure that the tasks assigned to the institution will be carried out on a regular basis and not only occasionally. Forecasts, monitoring tasks and assessments should be comprehensive and not limited to partial aspects.

Functional independence: A high degree of autonomy and functional independence vis-à-vis fiscal authorities are important preconditions to ensuring the institution is not hampered by political interference. This can be ensured by:

- Public financing, preferably stipulated in a legal text.
- Specific appointment procedures, particularly for the governing board, ensuring its functional independence.

Functional or operational and legal independence without political interference is particularly crucial for the sustainability and long-term effectiveness of an FC. There is evidence to show that FCs with legal independence without operational independence tend not to survive or become ineffective in their operations. A case in point is Hungary which established a fiscal council in 2009 to strengthen historically-weak fiscal policy formulation and implementation. However, the council was effectively disbanded in late 2010, following elections that swept into office a new government which strongly opposed to the independent body's legal authorities.

Involvement in the budget process: The involvement of the institution in the budget process emerges as the most crucial element determining its influence on the conduct of fiscal policy. The arrangements in some EU countries have proved to be effective in conveying the policy messages issued by independent bodies.

Principles and Best Practice for Institutional Set-up

The Principles provide guidance on issues to consider in the design and governance of independent fiscal institutions codifying lessons learned and good practices. The first consideration is the kind of institutional model the state wish to have - whether it wants to have a stand-alone institution that is completely established outside the organs of government or to have it within the existing independent government institutions. While there are many examples of both across countries, an IMF study reports that when setting up a new fiscal council, a stand-alone institution should be preferred to alternative models. This is because the stand-alone format offers the best guarantees of legal and functional independence. Examples of countries with a stand-alone FC are UK, Ireland, Sweden, Portugal, Romania, Cyprus while bodies with functional autonomy hosted within an existing institution (such as Parliament, Court of Auditors, Central Bank) are France, Finland, Germany, Italy, Lithuania, the Netherlands.

Modalities and Key Principles required

From the foregoing, and reviewing the extant literature particularly from the OECD and the IMF studies on principles and best practice of setting-up independent FCs, the following summarises the key features and good practice for setting-up an effective and independent FC:

i. Statutory regime grounded in **constitutional provisions (or other superior law)** and implementing legislation
ii. **Explicit legal references** to freedom from any interference, right to communicate freely and privileged access to information
iii. Strong **safeguards for the members** (fairly long mandates, strict conditions for removal from office)
iv. Demanding **conditions for membership** (relevant background, incompatibilities)
v. **Nominations** originating from several institutions (government, parliament, central bank, academia, etc.)
vi. Endowment with **specialised support staff** (economists)
vii. Sufficient **financial resources**, commensurate with the size and mandate of the entity (including funds for outsourced expertise)
viii. Own **corporate identity** and own website
ix. Access to **relevant information** facilitated through agreements with key stakeholders (especially Ministry of Finance)
x. Capacity to **communicate and** disseminate publicly its analysis and recommendations.

Conclusion Remarks and Recommendations

The foregoing discussion suggests that the features of fiscal council are as much important as the establishment of the institution itself. Therefore, while this paper is in support of government government's intention to initiate the process towards the establishment of a Fiscal Council, it observes that establishment of fiscal council alone is not a silver bullet to ensuring better fiscal performance and sustainability. Certain key ingredients will be required to make it effective. The paper thereby makes the following recommendations.

- Ghana has recently passed the Public Financial Management Act (PFMA), 2016 (Act 921) which this paper believes is a positive step towards prudent fiscal management that may stem the persistent fiscal indiscipline. However, the paper notes that a fiscal policy framework like the PFMA does not function in isolation but requires effective supporting and monitoring institutions. Government should therefore move expeditiously on its promise by making sure that the establishment of this fiscal council becomes a reality at least by the end of its four year term in office.
- In order to kick start the set-up of the council, the paper urges government to first constitute a technical bi-

partisan committee that will ensure that the necessary amendments to the PFMA (Act 921) is effected and the operational guideposts for its design, establishment and implementation are not only done with the best practice, but also receive the popular support and buy-in of all Ghanaians.

- ❖ Government should take immediate steps to amend the PFMA Act in order to incorporate numerical limits to the fiscal rules in order to reduce fiscal discretion and time inconsistency problems.

- ❖ Given the human capacity requirement and the need for nonpartisanship, the paper recommends a stand-alone institution that will offer the best guarantee of legal and functional independence with the necessary expertise to deliver on its remit.

In conclusion, we stress that the effectiveness and the long-term survival of the proposed fiscal council will hinge on factors that include having a full legal and operational autonomy within the scope of its mandate, sufficient financial and human resources, active and unfettered access to information and dissemination of its analysis, and their credibility as well as high level of political commitment to a medium-term fiscal goal.

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