

**THE ROLE OF INDEPENDENT FISCAL INSTITUTIONS – THE
CASE STUDY OF THE COUNCIL FOR BUDGET
RESPONSIBILITY OF THE SLOVAK REPUBLIC**

By
Katalin Molnárfi

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Department of Economics

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Supervisor: Professor Julius Horváth

Budapest, Hungary

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ABSTRACT

The increasing debt problems in the Economic and Monetary Union have increased the interest in fiscal watchdogs. Good fiscal institutions are a crucial condition to achieve disciplined fiscal performance. However, their existence in itself is not sufficient. The real question is how these fiscal institutions could strengthen the overall fiscal performance in practice. Their success and effectiveness are subject to several factors, including mandate, credibility and transparency, and nation-wide, strong, long-lasting political commitment. The thesis provides some guidance through the academic discussion, and a detailed case-study of the recently set up Council for Budget Responsibility (CBR) of the Slovak Republic.

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INTRODUCTION

The thesis focuses on what role independent fiscal institutions¹ should play, according to the academic discussion, and the European Commission's common principles. What task should they have? Should they only give positive analysis or should they offer normative policy recommendations as well? Should they only monitor fiscal rules, or operate rather like substitute, allowing a more discretionary approach? How should the independence from the political system be guaranteed? (Calmfors and Wren-Lewis, 2011). The thesis discusses these issues from a theoretical perspective and analyses the experience of the Council for Budget Responsibility (CBR) of the Slovak Republic, since its success amongst the existing fiscal institutions could be relevant and transferable to other countries as well.

The paper is structured as follows. As a background, Chapter 2 reviews the current academic discussion. Chapter 3 reflects on the existing fiscal councils. Chapter 4 considers the case study of the Slovak Republic and takes a practical look at how the CBR functions. Chapter 5 draws some conclusions on the role of fiscal watchdogs, and provides a policy advice.

¹ The term 'fiscal institutions' is used in a broad sense, including fiscal rules, transparency rules and budgetary procedures.

CHAPTER 2: THEORY

2.1 Background

The international financial crisis of 2008 has gradually changed into fiscal crises in a number of countries and caused severe weaknesses in the economic budgetary governance in the Economic and Monetary Union as a whole. The extent and potential consequences of the spillovers between euro area member states' economic and budgetary situations is now clearly evident (COM, 2012). The idea that budgetary rules shall be able to react to particularly severe situations has long been acknowledged in the union's surveillance framework. After the monetary policy integration, the fiscal and structural policies became the fundamental mechanisms to offset the consequences of external and internal shocks on the economy. (Stability Programme, 2013). The Treaty on the functioning of the European Union therefore requires the member states to consider their economic policies as a matter of common interest. Their budgetary policies have to be led by the goal for sound public finances.

From the early 1970s to the mid 1990s government debt rapidly increased in most OECD countries (Calmfors and Wren-Lewis, 2011). There was a strong need for fiscal rules in order to reduce the deficit bias. In the EU, the Stability and Growth Pact imposed ceilings on deficit as well as on debt. It also established MTOs, medium-term budget targets for the normal periods. According to the SGP, the budget deficit should be no more than 3 % of GDP, consolidated gross government debt should be equal or less than 60 % of GDP. If larger, it should be "sufficiently diminishing" and approaching the limit "at a satisfactory pace" (European Commission, n.d.). However, as the Stability Pact's escape clauses allowed temporary violations in the event of negative output growth, hence there has been a number of breaches. Before 2008, the majority of the breaches involved old member states.

Meanwhile, as Calmfors and Wren-Lewis note, several countries (the UK for instance) introduced national fiscal rules. However, it had to be soon recognized that the fiscal rules were not sufficient against the ever increasing government debt. There are several reasons for it. Firstly, the rules were not respected (Greece). Second, even when they were respected, fiscal outcomes laid too close to deficit ceilings (Portugal, France, UK). In other countries, such as in Ireland and Spain, the end of the booms caused budget deteriorations. As a consequence, new ways were needed to safeguard fiscal discipline.

Then came the idea of the independent fiscal watchdogs (Calmfors and Wren-Lewis, 2011): independent institutions which monitor the fiscal authorities' responsibility and transparency. The basic idea behind was that these councils' assessments might be strong enough to put the governments under pressure to make fiscally sustainable decisions due to fear to the potential criticism and damage to their reputation. The idea has been also promoted by the IMF, the OECD, the ECB as well as the European Commission. The EU inaugurated the van Rompuy Task Force in which it specified tasks for fiscal councils: providing independent analysis, sustainability assessments and fiscal forecasts. Also, an EU-IMF decision agreed that Ireland had to set up a fiscal council for the financial aid it got in December 2010.

The idea has been also advocated by various academic proposals in the mid 90s as well (Calmfors 2005). The basic idea was to design an independent institution in such a way that it is based on the good experiences of independent central banking. The proposals were of two types: 1) an independent fiscal institution which should make actual fiscal policy decisions. 2) a fiscal watchdog which does only forecasting, analysis, evaluation and advising. This watchdog type institution is labelled as fiscal council.

Institutions of the watchdog type have already existed before in some countries: the “Central Planning Bureau in the Netherlands, the Economic Council in Denmark, the Congressional Budget Office in the US and the Public Borrowing Requirement Section of the High Council of Finance in Belgium, and similar institutions have been established afterwards in Hungary, Canada, Slovenia and in the UK (Calmfors, Wren-Lewis, 2011).

2.2 Explanations for the deficit bias

For governments, the ideal time for consolidation is always tomorrow. However, discretionary policy making is always suboptimal comparing to policy rules. According to Calmfors and Wren-Lewis (2011), there are several political-economic reasons in the academic discussion for the deficit bias (which may also be interrelated): asymmetric information, time inconsistency, common-pool problems, impatience, electoral competition, and exploiting future generations.

Different reasons for deficit bias have different implications for the fiscal council. If, for example, the deficit bias results from informational problems between the elected government and its voters, then the adequate *form of delegation* could be a watchdog function that restores imbalance. On the contrary, if it is due to the current generation which deliberately exploits future generations, a delegation of actual fiscal decisions may be more desirable.

(1) Asymmetric information: the idea behind the asymmetric information story is that had the voters full information, they would discipline governments which allow deficit bias. But this cannot happen due to the lack of information. The over-optimistic forecasts (both from the side of the government and of the electorate) about future growth could result in deficit bias as future tax revenues will be less than hoped. Calmfors and Wren-Lewis suggest (2011) that the delegation of the forecasting process could be sufficient to restore sound public finances. Alesina et al. (1998) found evidence that successful fiscal adjustments do not jeopardise the

popularity of the government because if the voters are made aware of the fiscal plans, they are more willing to accept short-term costs for long-term gains.

(2) Impatience. Another explanation for deficit bias is impatience. It comes up both at the level of individuals and the government. An example of the first: Laibson (1997) suggests that when individuals have hyperbolic discount functions instead of conventional exponential ones, they tend to be much more impatient as choices are closer to the shorter term. (Bertelsmann and Rogoff (2010) use the idea of time inconsistency of the preferences to explain deficit bias. A simple analogy is a real-life example: an overweight man (high budget deficit) who is on a slimming diet, but spots a tempting cake (tax cut/ more spending today) at a restaurant. But a partner (a fiscal council) could urge him to change his decision. If there is no strong obligation, it is very easy to keep the old, bad habits. Parallely, a fiscal council could have an impact on the electorate to resist to short-term temptations today for a benefit of tomorrow.

The government could equally play this role. Though it does not, due to fear of popularity loss before the upcoming elections, and the fear of to be get voted out of office. In contrast, a fiscal council does not have the same interest, and could give an impartial advice. It should also be noted though that voters will not discipline impatient fiscal policy makers by throwing them out of office at elections because they vote over various issues of which fiscal policy represents only one, so it may not be enough (Calmfors and Wren-Lewis, 2011). A more general explanation for why impatience could result in deficit bias: the governments discount at a higher rate relative to the electorate. If fiscal policy shows more impatience than the private sector, a steady increase in debt could follow an adverse shock.

(3) Exploiting future generations: increasing debt allows the current generation to behave in a myopic way and exploit future generations (Musgrave, 1988). Maskin and Tirole (2004) examine the idea of delegating decisions to unelected representatives which could help minorities (the children and the unborn) not to be exploited. The exploitation may be direct, if taxes are cut today and paid for tomorrow by future generations. Indirect, if additional debt crowds out capital. Maskin and Tirole (2004) also suggest that it is possible that officials do care about future generations' interest because they want to leave a legacy. But as their legacy is multi-faceted, any particular aspect has only limited impact. Which is not true for the fiscal council.

(4) Electoral competition: competing parties and political business cycles also result in deficit bias and do significant harm to social welfare through cyclical changes in inflation and the level of output. In Alesina and Tabellini (1990) and Persson and Svensson (1989)'s model competing parties are different in preferences over types of public goods and over the size of the government, and perfectly reflect the preferences of their voters. The current government does not care about the cost of debt since it will be the opposing party who will pay it if not re-elected. It may even be advantageous to further increase debt to constrain the future government. In contrast, they were not such myopic would they be certain that they would stay in power forever. Though it should also be noted that this short-sighted behaviour fully reflects the preferences of the voters they represent.

(5) Common-pool theory: there is a direct link between the interest of certain groups and the size of deficit bias. Small groups may lobby for tax cuts or public projects which are favourable for them without regard to total future budgetary costs. Also, the policy makers themselves may insufficiently internalise the total costs of additional spending and debt (Calmfors, Wren-Lewis, 2011). Tornell and Lane (1999) find that this effect is likely to be stronger in "good times", thus deficit bias is linked with pro-cyclical fiscal policies.

More fragmented government coalitions are likely to have larger deficits. Roubini and Sachs (1989), Besley and Case (2003) also found evidence: political fragmentation is subject to more common-pool problems than the a system based on majority rule. Persson and Tabellini (2004) further suggest that majority rule comes with greater fiscal discipline. If there are ideologically dispersed coalitions, multi-year targets could increase discipline in public finances. There is strong empirical evidence that common-pool problems lead to deficit bias, but institutional set-up do matter as well. A strong finance ministry may decrease deficit bias (Hallenberg and von Hagen (1999)). However, for example, in the UK Gordon Brown had a very strong political power and imposed fiscal rules, within a government of majoritarian rule, though could not reduce the deficit bias. The recommendations of a fiscal watchdog could strengthen the position of a finance ministry, and could also serve as a basis of negotiations between political actors in a fragmented political system (Calmfors, Wren-Lewis, 2011).

(6) Inflation bias: is the deficit bias related to inflation bias? Leith and Wren-Lewis (2007) suggest that “the random-walk long-run debt policy is time inconsistent, if either debt is nominal or prices are sticky”. It is due to the forward-looking Phillips curve, hence it may as well hold for inflation bias.

2.3 Complementarity between fiscal rules and councils

The increase in the number of fiscal councils reflects a failure of fiscal rules to discipline public finances? According to Calmfors, and Wren-Lewis (2011) the answer is no. In most cases they should operate alongside. The establishment of a fiscal council does not negate the need for the rules: a council rather evaluates whether the rules are respected and whether the

goals are likely to be achieved, suggesting when a breach is allowed to happen, as well as proposing improvements to the rules. If the fiscal rule is complex and is not easy to monitor, a fiscal council could provide independent monitoring service. If the rule is simple, the council could judge whether a departure from this rule is justified. Besides, it also could provide independent advice on improving the rule, on how quickly the excess debt should be diminished, contrary to the government's opportunistic suggestions. While evaluating the government's fiscal decisions, a fiscal council could also effectively stimulates academic research.

CHAPTER 3: OVERVIEW OF EXISTING FISCAL COUNCILS

This Chapter discusses² how the various theoretical trade-offs mentioned in Chapter 2 are being tackled by existing fiscal councils. There are several institutions performing fiscal analysis in various countries, though not all of them could be classified as fiscal councils. According to Calmfors and Wren-Lewis (2011), the requirements that have to be fulfilled are: (1) the institution must have a clear fiscal watchdog function, conducting public research or forecasting is insufficient in itself. (2) Macroeconomic competence is required, in other words, pure auditing institutions are excluded. (3) The institution's independence must be respected, which means that it must not be only part of the ordinary government administration.

Given these assumptions, before the case-study of Chapter 4, this Section analyses five “old” European fiscal watchdogs, the Bureau for Economic Policy Analysis³ (CPB) from the Netherlands, the Economic Council from Denmark, the Council of Economic Experts (CEE) from Germany, the Government Debt Committee from Austria, the Public Sector Borrowing Requirement Section of the High Council of Finance from Belgium, and three others, only recently set up, the Fiscal Policy Council (FPC) from Sweden, the Fiscal Council from Slovenia and the Office for Budget Responsibility (OBR) from the UK. Finally, the original⁴ Fiscal Council from Hungary, which served as a model in the design of the Slovak Council for Budget Responsibility will be briefly presented.

In practice, these councils differ in various aspects. As shown in Chapter 2, one explanation for this diversity is provided by the literature for deficit bias. The Office for Budget Responsibility (UK) for instance, as Chote (2013) notes, was set up because of over-optimistic

² This chapter is principally built on the joint work of Calmfors and Wren-Lewis (2011).

³ Calmfors and Wren-Lewis (2011) refer to the CPB, as “Central Planning Bureau”. However, this name is misleading since the CPB has never performed economic planning (Centraal Planbureau, n.d.).

⁴ The original analytical body has been recently replaced for reasons of political convenience in 2010 despite being an institution under the Parliament, after that it had criticized the government's budget (Calmfors and Wren-Lewis, 2011).

government forecasts, and moving-targets syndrome (*time-inconsistency*). Additionally, there have already been independent bodies scrutinizing public finances, however, without access to all information available (*asymmetric information*). In contrast, behind the Swedish Fiscal Policy Council's establishment was rather a national tradition to involve academics in the economic policy debate (Calmfors, 2010).

Calmfors and Wren-Lewis (2011) suggest that this diversity may also reflect differences in national political structures. The case of the Bureau for Economic Policy Analysis in the Netherlands reflects typical Dutch circumstances indeed: one of the most best-known tasks of the council is its macroeconomic and budget estimates which represents the base of the coalition negotiations (Bos and Teulings, 2012). Before the general elections, political parties may turn to the council to evaluate the economic consequences of their programs. Though participation is voluntary, all major parties participate. However, the council does only provide positive analysis: it makes a clear demarcation of its own role and the role of political parties; it does not aim to convince voters to support one policy instead of another. Apart from this, enjoys a cross-parties support, and its independent position since World War II is also unique in the world.

There are some cases where the establishment of a fiscal council indicates the failure of existing fiscal rules, but in most cases councils are complements to such rules by monitoring the adherence towards fiscal targets (for example the Office of Budget Responsibility in the UK offering fiscal forecasts) or by advising whether the rules may be temporary breached (the Fiscal Policy Council in Sweden), or even proposing improvements to the rules.

3.1 Tasks and remit of the fiscal councils

As we have seen in Chapter 2, there is no academic consensus about in what tasks the fiscal councils should engage, hence there is great diversity in the tasks performed in practice

(Calmfors and Wren-Lewis, 2011). They could include forecasting, costing of policy initiatives, evaluation of fiscal transparency, ex-ante and ex-post evaluation of fiscal policy, evaluation of sustainability, normative recommendations and analysis of broader issues. The specific tasks of the above mentioned councils are summarized in the following two tables.

Table 1 Tasks of fiscal councils

	Forecasting	Costing of policy initiatives	Evaluation of fiscal transparency	Ex-post evaluation of fiscal policy
Austria (1997 ⁵)	√			√
Belgium (1989)				√
Denmark (1962)	√			√
Germany (1963)	√			
Hungary (2008)	√	√	√	√
The Netherlands (1947) ⁶	√	√	√	√
Slovenia (2010)	√		√	√
Slovak Republic (2012)	√		√	√
Sweden (2007)	√		√	√
UK (2010)	√			√

	Ex-ante evaluation of fiscal policy	Complement to fiscal rules	Evaluation of sustainability	Normative recommendations	Analysis of broader issues
Austria (1997)	√	√	√	√	
Belgium (1989)	√	√	√	√	
Denmark (1962)	√		√	√	√
Germany (1963)	√	√	√	√	√
Hungary (2008)	√	√	√		

⁵ The year in the brackets indicate when the council in question was set up.

⁶ The CPB is the world's oldest fiscal watchdog (Bos and Teulings, 2012).

The Netherlands (1947)	√	√	√		√
Slovenia (2010)	√	√	√		√
Slovak Republic (2012)	√	√	√		√
Sweden (2007)	√	√	√	√	√
UK (2010)	√		√		√

(Source: Calmfors and Wren-Lewis, 2011).

As the tables illustrate, the councils all perform the core activities of both ex-post and ex-ante evaluation of fiscal policy as well as the monitoring of fiscal sustainability. The main question (discussed also in more detail in Chapter 2) is whether a fiscal council should be a substitute for fiscal rules (allowing a more discretionary approach) or rather a complement (monitoring the adherence to the rules).

The tables show that generally fiscal councils in practice act as complements to rules, as governments are usually not likely to tolerate potential criticism of their fiscal policy. According to Calmfors and Wren-Lewis (2011), there are two exceptions: the Swedish and the Slovenian council explicitly examine whether the medium-term objectives are consistent with the more fundamental, long-term ones. This task is explicitly specified in the Slovenian's council's mandate, while in Sweden, it is the council's own interpretation concerning its remit.

The Swedish, the Slovenian, the Dutch and to some extent the German council evaluate fiscal transparency. Not all of them make their own macroeconomic forecasts. This is the case in Austria, Denmark, and in the UK. Also, in the German, Slovenian and Swedish councils “only broad-based judgements of foreseeable developments are made” (Calmfors and Wren-Lewis, 2011). Whether or not macroeconomic forecasting is the task of a fiscal council depends on the existence of other independent institutions responsible for forecasting. In the Slovak Republic, for instance, the Council for Budget Responsibility does not give macroeconomic

forecasting, as it is the task of two other committees (which will be discussed in Chapter 4 in the case study).

It is to be noted here that there is a serious risk of political interference following a fiscal council's potential criticism about the government forecasting. Bos and Teulings (2012) note that the CPB in the Netherlands and the OBR in the UK have been several times exposed to political pressure to adjust their forecasts. In the latter, the fiscal council was accused of being overly benign to the government.

The scope of a fiscal council's remit also varies substantially across countries (Calmfors and Wren-Lewis, 2011). It is limited to only fiscal policy evaluation in Austria, Belgium, and in the UK. Yet in other cases, the councils engage in other, additional activities as well, which are not necessarily included in their core mandate. The Slovenian fiscal council though performs other activities, these activities represent a relatively small share of the overall activity. In contrast, in Denmark, in the Netherlands, and in Sweden, these issues, such as evolution of the labour market and other structural policies play a greater role. The Dutch Bureau for Economic Policy Analysis, for instance, provides a cost-benefit analyses of various types of policy proposals, from tax policy, education to infrastructure. Bos and Teulings (2012) are of the opinion that the broad scope of activities, instead of being restricted only to fiscal policy analysis is one of the crucial factors for a success of the Dutch council since it contributes to the public understanding of relevant policy trade-offs. The Slovak council also has recently undertaken an extensive analysis about retirement- and health care reforms, which will be represented in more detail in Chapter 4. The Swedish fiscal council stands apart: it is officially instructed to evaluate the government's explanations behind certain policies as well.

The practice of providing normative recommendations also varies. It is explicit policy for some of the councils to strictly attach to only positive analysis instead of normative recommendations (Calmfors and Wren-Lewis, 2011). An example is the Dutch council, which

specifies on its website that “the result of an analysis will never be a straight recommendation on a particular course of action”, their task is only about describing a potential trade-offs. In the UK, the Office for Budget Responsibility is officially restrained from evaluating policy alternatives. In contrast, the councils in Austria, Denmark, Belgium and Sweden do provide normative recommendations. The German fiscal council is somewhere in the middle: although the Council of Economic Experts is officially forbidden from normative recommendations about particular policies, it gives them nevertheless.

In practice, there are various combinations of these tasks, as the tables illustrate. The Swedish Fiscal Policy Council for example does not make own forecasts, but has a relatively broad remit and provides normative recommendations as well. In contrast, the Office for Budget Responsibility in the UK offers although has a relatively narrow remit restricted only to fiscal policy, provides own forecasts.

3.2. Independence, resources, composition and impact

The guarantee the independence of fiscal councils is far more fragile than is for central banks. Open conflicts with the government could easily jeopardize the work of the council (Calmfors and Wren-Lewis, 2011). Periods of office are also generally shorter than for the members of monetary policy committees. It ranges from three years (Denmark, Sweden⁷) to five years (Belgium, Germany, Slovenia, UK). According to Calmfors and Wren-Lewis (2011), in most cases, the periods of office are allowed to be renewed. However, it is not always the case: Chote (2013) adds that appointments could be the strongest political pressure points indeed: in Belgium, the High Council of Finance was left in an undefined state and thus made

⁷ The period of office was recently reduced to only one year (Calmfors and Wren-Lewis, 2011).

unable to properly operate for several years after the Finance Minister did not renew the mandate of existing council members, nor appointed new ones.

Moreover, council members may formally be fired by political will. The Council for Budget Responsibility in Slovakia is therefore represents an exemption with its non-renewable 7-years long term⁸, where the members could only be recalled by the absolute majority of the National Council.

Independence could also be undermined if the staff is provided by the Ministry of Finance (Belgium, Slovenia) (Calmfors and Wren-Lewis, 2011). For Austria`s Government Debt Committee, the Central Bank provides staff, which also raises concerns: on the one hand, independence from the Ministry of Finance is guaranteed, but on the other, is being also threatened by a too close relationship between these institutions. For example the Office for Budget Responsibility (UK) works in a too close relationship with the Treasury⁹, which may undermine its perceived and actual independence. As Bos and Teulings (2012) highlight, as the Dutch council is also part of the Ministry of Economic Affairs, a trade-off is emerging: the daily policy making process is easier on the one hand, however, on the other, the perceived/actual independence is much more difficult to sustain.

Chote (2013) adds that making a fiscal council formally responsible to Parliament, instead of the Executive, does not necessarily protect it from political interference, as happened in Hungary: after only two years of operation, it was transformed into a powerless body. The Office for Budget Responsibility in the UK (which is officially part of the Treasury) could potentially be put under a similar squeeze. If a council is perceived to be a providing support for the government (as was the case of the Office for Budget Responsibility in the UK after its

⁸ The term is non-renewable.

⁹ As Chote (2013) writes, the OBR is “non-departmental public body under the aegis of the Treasury, but (..) also formally accountable to Parliament via the Treasury Select Committee (TSC) of the House of Commons.

first post-budget forecast was criticized), it could quickly lose its reputation. Calmfors and Wren-Lewis (2011) consider that in order to possibly counteract this effect, fiscal councils should be allowed to assess different policy options as well.

Those councils which lack formal safeguards to sufficiently guarantee their independence should rely on building up a reputation by providing impartial and sound analysis, even if it takes a lot of time. This has been the case of the Bureau for Economic Policy Analysis (The Netherlands) and the Economic Council (Denmark) (Debrun et al, 2009 and Calmfors, 2010b). For the Bureau for Economic Policy Analysis, building up a reputation took time, but according to Bos and Teulings (2012) now holds a uniquely solid, and accepted position in Dutch policy-making. Von Hagen (2010) shows that there are negative models as well: although the German Council of Economic Experts is an old institution, lacks respect from both the government and from professional peers. It could thus be reasonable for a fiscal council to have an advisory board, as it could mediate between the government and the council, while protecting its independence. Besides the Bureau for Economic Policy Analysis (The Netherlands), the Slovak Council for Budget Responsibility also has an advisory board¹⁰.

¹⁰ Of which one of the most important member is Mr. Gyorgy Kopits, who previously has been the head of the Hungarian Fiscal Council.

Box 1. Fiscal Council of Hungary

The Hungarian Fiscal Council is a very illustrative example of how fragile a fiscal council independence could be. After only two years of operation, its members have been replaced by political will and its secretariat has been taken away. The most likely reason behind is that the council had previously criticized the government's budget, stating that it was not sufficiently transparent and had overoptimistic assumptions. The council currently does not have any staff, and composed of only three members, according to the new legislation, a head nominated by the President of the Republic, a second member nominated by the Central Bank governor, and a third member, nominated by the director of the National Audit Office. According to Ódor (2014), whether or not it could be classified as a *fiscal council* today, depends on how we define a fiscal council: if we define it as an analytical body, fully independent from the government, and with an appropriate staff do conduct its analyses, then it is not a fiscal council, but officially, by law, it is indeed a fiscal council. The members have even a veto right for the budget.

However, the original form of the council served as role model for the design of the Slovak Council of Budget Responsibility (Interview Ódor, May 2014).

The amount of resources of the councils also substantially differs across countries. There are some extreme examples: the Fiscal Council in Slovenia has no staff, however, has the right to use the resources of the government, the secretariat of the Fiscal Policy Council in Sweden consists of only four persons. In contrast, the Bureau for Economic Policy Analysis in the Netherlands has a staff of 170 persons. (There is an even more extreme example: the staff

of the Congressional Budget Office in United States count 230 persons). However, in the majority of councils, an average staff size is 15-40 persons.

Calmfors and Wren-Lewis (2011) suggest that there is no obvious link between how broad the remit is and how big is the staff of a council. No matter how small the secretariat of the Fiscal Policy's secretariat is in Sweden, it has one of the broadest remit. It seems that generally fiscal councils need a bigger staff when engage also in the cost-benefit analyses of particular government initiatives and in macroeconomic forecasting. The size of this staff then depends on how detailed analyses are made.

The number of members of the council varies greatly as well. It may range from a minimal 3-4 (Hungary, UK) to 7-8 (Sweden, Slovenia) or 12-14 persons (Belgium, Austria) or to around 250 staff (The Congressional Budget Office in the United States). The composition of the councils may also differ. Members may consist only of academics, or academics may dominate amongst them (Netherlands, Germany, UK¹¹, Hungary¹²). In the Bureau for Economic Policy Analysis (Netherlands) for example, the heads of the members have traditionally been academics. However, having public-finance experts from governmental administration amongst the members is also a viable way. In Austria and Belgium for instance, the academic share is much smaller. Calmfors and Wren-Lewis (2011) explain this with the fact that these councils are not only watchdogs, but provide normative policy advice as well. In the case of those councils which restrict themselves to positive analysis, academic members may be more suitable (The Netherlands, Slovakia). In the Slovak Republic, all three members are coming from the academics sphere.

¹¹ This was not true for the OBR operating between May and October 2010.

¹² In the original council.

When analyzing the impact of a fiscal council, causality raises questions. Calmfors and Wren-Lewis (2011) note that it is difficult to determine whether the fiscal council's operation *alters* budget performance, or whether both of them are *caused* by another third factor. Additionally, if a council has no direct influence on the budget, it still can influence policy outcomes by fostering public debate. However, it could trigger open conflicts with the government. On the other hand, it may improve the council's perceived credibility for independent analysis.

3.3 Summary and lessons

Existing fiscal councils are very diverse. They vary in size and in their remit, and could choose between different methods trying to influence the government's fiscal policy, since there is no accepted general pattern in the academic on how to design an optimal remit of a fiscal council. Hence, in practice, there are councils which give normative recommendations (the Economic Council in Denmark), and there are others which are restricted to engage only in positive analysis (the Bureau for Economic Policy Analysis in the Netherlands and the Office for Budget Responsibility in the UK). Some of them limit their mandate to fiscal policy (OBR in the UK), while others examine broader issues as well (the Fiscal Policy Council in Sweden, and the Economic Council in Denmark, and the Bureau for Economic Policy Analysis in the Netherlands) or analyze the ups and downs of alternative policies. Some focus on sustainability analysis and on macroeconomic fiscal assessment, while others also cost individual policy projects (Calmfors and Wren-Lewis, 2011). However, a striking common feature is they are only advisory institutions and do not have actual power to determine the size of deficits.

Calmfors and Wren-Lewis (2011) suggest the differences in the fiscal council's design could be principally explained by the different situations in which they were set-up: apart from the societal and institutional framework, whether they were created in the middle of an acute

fiscal crisis (for example in time of a de facto breach of the fiscal rules) or only by theoretical considerations, have they been an addition to an already existing fiscal framework or not. The authors also note that although a relatively broad remit could lessen the actual impact of the council's fiscal policy analysis, it could also help to build up an impartial reputation.

As we have seen, the danger of political pressure coming from the government is obvious, as the examples of the Hungarian Fiscal Council and the Swedish Fiscal Policy council show. Calmfors and Wren-Lewis (2011) suggest to draw lessons from central banks to better ensure independence (for example prohibition of firing the staff by political force). It could be even more advisable for countries where the fiscal councils have only recently been introduced. To further highlight how fiscal councils operate in practice, Chapter 4 presents the case study of the Council of Budget Responsibility of the Slovak Republic.

CHAPTER 4: CASE-STUDY OF THE COUNCIL FOR BUDGET

RESPONSIBILITY OF THE SLOVAK REPUBLIC

The aim of this chapter to reflect on the Slovak Council's two-year experience and to provide critical analysis: why it was created, what were its role models, what are its core activities, and what it has contributed to fiscal policymaking in Slovakia. This Chapter is basically built on the interview with one council member, Ľudovít Ódor¹³, and on E-mail correspondence with another, Michael Horváth¹⁴ as well as an OECD working paper (OECD, 2012) which provided independent assessment of the council and on the relevant legislation.

Section 1 discusses the background and the establishment of the fiscal council, Section 2 presents the mandate, remit and tasks of the council, Section 3 discusses its access to information and its transparency, Section 4 presents its membership, staff and budget, Section 5 reflects on the potential room for improvement, and Section 6 draws lessons of the council's first two years of operation and briefly concludes.

4.1 The establishment of the council

The public finance deficit has been steadily higher than its sustainable long-term value since Slovakia became an independent country (Horváth and Ódor, 2009). Also, not so long ago, the global economic turmoil deteriorated the Slovak fiscal policy from its path, and necessitated a large-scale fiscal consolidation effort. The crucial prerequisite for the stabilization became a credible medium-term consolidation plan ensuring stable growth, long-term sustainability of public finances, and convergence towards advanced EU member states (Stability Programme, 2013).

¹³ (Ódor, 2014). In-person interview conducted on 23 May, 2014, Bratislava.

¹⁴ (Horváth, 2014). E-mail correspondence on 3 June, 2014.

Since its EU adherence, Slovakia became subject of the requirements resulting from the Stability and Growth Pact (SGP). These fiscal rules are complex, but the best-known are the deficit limit of 3 % of GDP, and gross debt limit of 60 % of GDP. However, according to Horváth and Ódor (2009), the Stability and Growth Pact offered insufficient guarantee for transparent and responsible public finances. Hence, they recommended a whole new national fiscal framework with additional fiscal rules to complement the Pact. These additional rules consist the *upper limit for gross public debt*, the *expenditure ceilings*, *new rules for municipalities* and *transparency rules*. The overall aim of the new fiscal reform was to improve responsibility, transparency and efficiency in public finances, while improving the credibility of the Slovak exit strategy after the economic and financial downturn.

The idea of an independent fiscal authority monitoring fiscal processes and rules was also a part of their proposal (these two Slovak economists, Ódor and Horváth are currently members of the three-member authority). Their suggestion was also in line with the coordination of common policies, since the European Commission itself urges member states to introduce fiscal institutions to complement SGP at the national level (COM, 2012).

The negotiations resulting in the adoption of the legislation developed in the middle of a fundamental economic and sovereign debt crisis in Europe¹⁵. It has weakened Slovakia's fiscal policy, which resulted in rising debt levels, however still within the EU's official threshold of 60 % of GDP (OECD, 2012). Despite this, according to Ódor (2014), the idea of an independent fiscal watchdog was home-grown. Yet, the resulting legislation is in full

¹⁵ The economic crisis directly affected the national politics since Slovakia had to vote for the approval of the expansion of the European Financial Stability Fund in October 2011, which triggered a motion of confidence and new elections in March 2012 where the socialist Smer party won. Smer followed the previous government's policy of decreasing the deficit (OECD, 2012).

accordance with the new fiscal treaty, as it promotes national fiscal rules as well as independent fiscal institutions.

The idea of the council comes from a working paper by the National Bank of Slovakia (Horváth and Ódor, 2009). The paper intensified the discussions with the political parties just before the elections of June 2010. Horváth and Ódor wanted to persuade the political sphere that maybe some part of the whole framework could be implemented (Ódor, 2014). Finally, the proposal could find its way into the centre-right coalition's government programme which was published in August 2010. In 2011, a cross-party parliamentary committee elaborated the draft legislation, which was subsequently signed by every political party represented in the National Council. In December, the Constitutional Law on Budget Responsibility was passed, with provisions for the establishment of the Council, by a majority of 146 out of 147 votes (Ódor, 2012).

When designing the structure of the council, the founders looked at different kinds of fiscal councils. The experience of Hungary's Fiscal Council served as the principal comparative model for the Council for Budget Responsibility during the drafting of its provisions, since they thought that at that time (in 2009) it was functioning quite well. One of the current council members, Ódor visited Hungary several times to discuss with George Kopits¹⁶ the issues about the establishment of the CBR (Ódor, 2014). The original plan was to set-up a fiscal watchdog under the Parliament (with the aim to protect its independence). However, slightly afterwards, the Hungarian example very well illustrated that this was not a good idea, when the original Hungarian Fiscal Council was replaced with a much weaker analytical body in 2011. The Slovak council wanted to be fully independent, hence, it finally seemed wiser to protect the institutional independence from political interference with a budget coming from the central

¹⁶ At that time, Kopits was the head of the Hungarian Fiscal Council.

bank of Slovakia. According to the OECD (OECD, 2012), the latter institutional structure resembles more the one of Austria's Government Debt Committee (and to some extent the Portuguese Council on Public Finances, however this case did not have a principal role in the academic debate resulting in the set-up of the Council for Budget Responsibility. However, overall, the council's structure is kind of a mix of several country experiences. What is important to see, is that the establishment of the Council for Budget Responsibility was finally only part of a broader package including new national fiscal rules: constitutional debt limit, expenditure ceilings, strengthened fiscal rules for municipalities and enhanced fiscal transparency. The CBR itself became the watchdog to monitor the enforcement of these rules.

4.2. Mandate, remit, tasks and work programme

The structure and mandate of the Council for Budget Responsibility is laid down in legislation in the Constitutional Law on Budgetary Responsibility (Ústavný zákon o rozpočtovej zodpovednosti), under which it became a statutory body on 8 December 2011. (Legislation). According to Ódor (2014), direct comparisons are hard to make, but judged by international standards, the CBR has a pretty strong legal basis underpinning its independence. However, apart from formal safeguards, the council also has to rely on the legitimacy that it gains by building up a reputation for transparent, impartial, and rigorous analyses.

It was clear from the beginning that if the council really wants to have a long-lasting, constitutional basis, only positive analysis can be attached to the council, but not normative because the latter could become very easily political (Ódor, 2014). In other words, the council is not formulating an opinion about whether the government's consolidation pace is appropriate or not, it is stating only that the government is consolidating 0.5 or 0.8 per cent and how it compares to the fiscal rules, and identifies risks as well. It looks at not only an ex-post

assessment what was achieved in the past, but also an ex-ante risk evaluation of the budget. Hence, the risk assessment is maybe the most widely-debated of its reports (Ódor, 2014). These prospective analysis of fiscal sustainability and retrospective assessment of compliance with fiscal rules are prioritized in the council's legal mandate. According to Ódor (2014), the council members are certain that this relatively narrow remit and the focus on more specific tasks is more effective and could provide bigger value-added.

Any Parliamentary party may also turn to the council to evaluate specific pieces of legislation, but it is up to the council whether it complies or not. The cost-benefit analysis of legislative proposals task is voluntary, since it is not included in the council's core mandate. Also, it is not very frequent yet, maybe before the elections, this task will be much more significant. Last year one of the political parties turned to the council to evaluate the government's proposal for pension reform, so the council did that (Ódor, 2014).

Ódor (2014) notes that when considering the size of the council during its design, the founders were certain that they did not want a *big* council, for example as big as those ones which are dealing with detailed cost-benefit analysis of every legislative proposal (like the Congressional Budget Office in the USA or the Parliamentary Budget Office in Canada). They wanted to focus more on the fiscal issues from the beginning, and left the macroeconomic forecasting to the Macroeconomic Forecasting Committee, which operates in the country since 2004. However, they definitely wanted an analytical body attached to the council.

How does this remit compare with the international examples? The CBR's mandate is also narrower in that sense than of some of its international counterparts that it restricts itself to positive analysis rather than giving normative policy recommendations. The Office for Budget Responsibility (UK) is the extreme case: it is officially instructed not even to examine the impact of alternative policy options. The other extreme case is the Bureau of Economic Policy Analysis (The Netherlands) which assesses the economic consequences of the parties'

programs prior to the general elections (Chote, 2013). It is an interesting question whether will be any demand for the Slovak council to examine alternative policies one it has established itself more firmly in its current role.

The council could determine its own work programme, unless it is in line with the requirements of its mandate (OECD, (2012). The work programme of the council determines two specific annual reporting deadlines: one for the report on fiscal sustainability (30 April), and the other for the report on the compliance with fiscal and transparency rules (31 August) to the National Council.

Box 2. Most problematic areas in the 2013 Budget of the Slovak Republic, according to the Council for Budget Responsibility

When the Council for Budget Responsibility evaluated the 2013 budget, wrote a fully-fledged analysis in November last year, and has updated all the risk factors just recently, as the size of the identified risks has increased (Addendum, 2013). On the revenue side of the budget, the dividend income was overestimated, on the expenditure side, especially the common expenditures of the municipalities and the health-care sector are the most problematic ones. Based on the no policy scenario, Slovakia will exit the target by 0.4-0.5 percentage points to GDP, therefore additional measures are needed (Evaluation, 2013). Yet the government did not specify appropriately its proposed measures. The Council for Budget Responsibility stated explicitly in its report that although part of the measures were specified, but the big part was very uncertain and general. However, it is positive that since the Slovak economy is approaching the constitutional debt limit and as more sanction mechanisms are in place, the government has to decrease the current expenditures in the budget by 3 % this year, based on the constitutional law, which could help to put the budget back on track.

4.3 Access to information and transparency

It is the council's duty to publish on its website the required reports prescribed by law and the relevant methodologies and assumptions (OECD, 2012). This transparency requirement is essential to build and maintain trust, but also, it is a useful source of self-discipline too: by publicating detailed forecasts, the council avoid the temptation to provide presentationally convenient judgements instead of what would be analytically sound. However, one potential disadvantage of presenting detailed forecasts is that it may de-emphasize the enormous uncertainty that lies around given the nature and complexity of public finances (Chote, 2013). The Council for Budget Responsibility nonetheless publishes a series of briefing papers in which it also explains the key features of the methodology used.

As we have seen in the previous chapter, a fiscal council's effectiveness could seriously be undermined by restricting the available sources. There is no specific restrictions with regard to the council's access the relevant data. The constitutional law gives the council the right of access to all government information which it may require for the performance of its duty. Thus, the council could not be denied of whichever data it believes it needs to perform its tasks in a proper way. Also, public entities must provide necessary assistance if the council requests it (Legislation).

4.4 Membership, staff and budget

The Council for Budget Responsibility has full freedom over its staffing decisions. It has a required complicated mechanism for nominating the members, which is defined in the constitutional law, the nominating procedure, the lengths and numbers of the terms are also clearly defined. The president, the governor, the government and the parliament all are included in the nomination process. The council consists of three members, one chair and two additional members. The chair should be voted by constitutional majority, and the two other members by

simple majority, but one is nominated (and recalled) by the National Bank governor, and the other is by the President of the Republic (Legislation).

The Council members have a non-renewable mandate for seven years. If the term expires, a member resigns, or becomes ineligible, the replacement should occur within one month. Membership is also incompatible with holding a position in any political party, in the National Bank of Slovakia, or in a company. Foreign nationals could be appointed, provided they have satisfactory knowledge of the Slovak economy (OECD country notes).

However, it is very important, that in the first term for the first council, for the approval of all three members, a constitutional majority was required. In other words, it was impossible to have council members without agreement between the coalition and opposition, since they wanted to have first council which is not politically sensitive. The three council members were thus elected by huge constitutional majority. However, parallelly, the council wanted to avoid all terms ending at the same time, which could have disrupted the continuous work. Therefore the council has a rolling period of seven years, but for not the first council: the first members mandate are for 3,5,7 years, and later on everybody will have a mandate of 7 (renewable) years (OECD, 2012).

The Council for Budget Responsibility is a mid-size council. Its staff is about 15-20 analysts and also has a panel¹⁷ of independent fiscal experts from all over the world. The advisory board holds a meeting once every year and based on specified topics, evaluates the council`s work. They also give a second opinion and mitigate between the council and politicians (Ódor, 2014).

¹⁷ George Kopits and Wren-Lewis are members of the advisory board, but also there are other, well-known people from the fiscal area (Council for Budget Responsibility, n.d.).

The CBR wanted to be fully independent, so by law, the primary financing for the council is coming from the National Bank of Slovakia, which must be reimbursed right away from the State Budget (however, the process must not obstruct monetary financing). The National Bank sets the limit of the overall spending, but the Council has the freedom to determine the allocation of funds. The Council was funded with approximately EUR 2 million in 2012 and its allocation has been linked to the nominal growth of the National Bank's budget (OECD, 2012). The funding of the Council is rather unique among the existing independent fiscal institutions, however, for example, the Government Debt Committee in Austria is also funded directly from the Austrian Central Bank's budget.

Up to now, there has been no open political conflict, neither the government nor the political parties did not criticize publicly the council. As it has a real back in the constitution, and with a primary financing from the central bank, it is not very likely that it will end up like the Hungarian one. Generally speaking, Ódor (2014) believes that now the huge risk in CEE countries is not that the government will abolish the council, since the legislation requires, but the major issue for these fiscal councils is the nomination process. That is a far more important risk than abolishing the institution. But up to now, the Council for Budget Responsibility was respected by all political parties.

4.5 Room for improvements

There is still room for improvement, of course. The council is still working on some of the methodologies it uses. According to Ódor (2014), there are two areas where the council could definitely improve its work. The first one is communication to the public. In the first two years the council has been such busy with building up an appropriate toolkit to analyze the budget in a very complex way, that it had less time to focus on the public and the communication of its findings. The second one is communication with the Parliament: Ódor

(2014) suggests a more systematic communication with MPs, or at least with the Budget Committee. It is important, since as was discussed in Chapter 2, it may be theoretically questioned whether a fiscal council could be truly independent, given its informal interactions with officials and politicians. Therefore, the council should be as transparent as it could about its interactions with the government during the forecast process.

Moreover, the council is also very active internationally (Ódor, 2014): it is in the process to setting up a European Network of Independent Fiscal Institutions. The first period of discussions, before they formalize the network, will last until the fall next year. In the meantime they work on an informal basis.

Box 3. The plan of the European Fiscal Network¹⁸

The idea of establishing a European Network of Independent Fiscal Institutions arose shortly after the establishment of the Council for Budget Responsibility, however, active work on the project began only in spring last year. Since then, there have been an initial informal meeting in Bratislava in October 2013 and a meeting on the margins of the OECD PBO Working Group in Jerusalem in April 2014. In Jerusalem, the network has decided to function temporarily as an informal body with the Council for Budget Responsibility as a coordinator until autumn 2015. Decisions about the permanent institutional structure for the network will be made only at that time. As we can see, the network is still in its early stage. According to Horváth (2014), the areas where joint action could be advisable both for national councils and EU-level policy making:

(1) Relations with EU institutions. Given their position in the European fiscal framework, it is of outmost importance that national fiscal councils are consulted on issues in connection with both the implementation and design of EU macroeconomic policy. Although formal links between the EU institutions and national governmental institutions do exist, no such relations are established with independent fiscal councils.

(2) Peer review. The independence of the fiscal councils is based to a large extent on the appropriate application of the newest standards and analytical techniques. In order to ensure it, a formal peer review process could be introduced to assess the methodologies used by councils when performing their core mandate.

¹⁸ (Horváth, 2014). E-mail correspondence on 3 June, 2014.

(3) Exchange of best practices. A proper supervision requires a lot of technical expertise. It could be therefore mutually beneficial if such knowledge was shared through conferences, workshops, and technical assistance.

(4) Policy coordination. National fiscal policy could have substantial spill-over effects that must be considered in European policy-making. Coordination in this area could therefore be welfare improving.

4.6 Concluding remarks and lessons of the first two years

The founders of the Council for Budget Responsibility (its current members) were concerned that it is not advisable to rely only on EU rules, since they are relaxed, and not sufficiently binding. Hence, they felt the urge to concentrate more on the domestic fiscal situation to avoid fiscal crises in the future (Ódor, 2014) It is important to notice, that the new fiscal framework as well as the Budget for Fiscal Responsibility were not set up due to outside pressure, they were rather based on theoretical considerations. The council was created in 2012 as an independent body to monitor and evaluate the fiscal performance of the Slovak Republic. Three persons have been appointed as members, staff and a small secretariat were added.

The establishment of the council was based on lessons from international experience and on a unique consensus that brought together all political parties in support of the new legal framework. This approach has led to a solid legitimacy and statutory basis thanks to which the council the council could operate alongside future governments of every political color. Also, funding from the Central Bank is likely to allow the Council to meet the requirements of its mandate (OECD, 2012). The council is also fully transparent about its methodology, and the way it reaches its conclusions. One of its main responsibility is towards the general public, to give its best judgement whether or not politicians like it or not, since one ultimate goal of a

fiscal council is to help people understand better the forecasting process as well as its limitations. One of the biggest contribution the CBR made to fiscal policy and debate was that it significantly increased the transparency of fiscal forecasts and analysis.

Basically the important lesson is that a fiscal council's reputation is built on the quality of its professional work. If it is not professional enough, then everybody can easily criticize it. Hence in order to gain credibility, it is of outmost importance to adapt the standard methodologies, and operate in an open and transparent way. It was a good decision of the council that it also publishes risk assessment of the budget (from the beginning of its operation) which is not clearly in the legislation, but the council does nevertheless because the monitoring function is there. As Ódor (2014) said, "every commercial bank analyst can look at the revenue side of the budget but almost nobody understands the expenditure side. They have no capacity to look into details, or capacity to find out creative accounting practices and the council could quickly show to the public that this is an important issue".

CHAPTER 5: CONCLUSION

It is important to notice that creation of the CBR concerned not only one single law, but a whole fiscal framework was introduced, including fiscal rules, and rules for transparency. The CBR is a home-grown institution, and was not forced by external bodies like the IMF, or the European Commission. It serves as a fiscal watchdog: the nature of its work is positive, or descriptive, but it has no mandate to express explicit policy recommendations.

If we examine the broader picture, there has been a rapid growth in the number of independent fiscal watchdogs emerging in the EU over the recent years, since the obligation to establish such institutions is now an integral part of the Treaty on Stability, Coordination and Governance. In addition, it is likely that their role in the policy making will gain importance as well. European regulation and international experience suggests that these fiscal institutions should be implemented in such a way which respects the national institutional set-up. Hence the emerging fiscal councils are heterogeneous in nature in addition to the diverse group that already operates. However, there are common functions that these establishments perform, such as costing of budgetary measures, the monitoring of national fiscal rules and the assessment of sustainability forecasts. Given this background, the Slovak fiscal council, the Council for Budget Responsibility, which the thesis examined in detail, aims to establish a formal network of European independent fiscal institutions to the mutual benefit of all.

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