

# Fiscal Institutions for Stability and Economic Growth

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”Economic Governance and Sustained Growth in the Balkans”, organised by  
DG ECFIN/European Commission and  
Joint Vienna Institute  
Vienna, 15 March 2007  
Dr Per Molander, Mapsec



Mapsec  
Managing the Public Sector

## *Main building-blocks*

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0. Well-defined role of the state
  1. Strong fiscal institutions at all levels of the public sector
  2. Clear division of labour between different levels of the public sector
  3. Competent and accountable administration
  4. Links to WB countries
  5. Well-designed reform strategy
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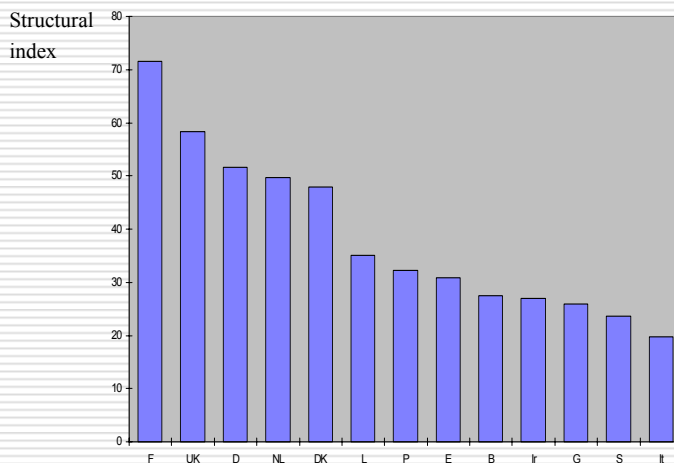
## *1. Institutions matter to fiscal policy*

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- Macro level:
    - Presidential vs. parliamentary systems
    - Majoritarian vs. proportional systems
    - Fiscal federalism
  - Intermediate level
    - Administrative tradition
    - Transparency
    - Audit institutions
  - Micro level
    - Budget process
    - Accounting, information systems
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## *Swedish budget process, 1992*

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## *Principles underlying Swedish reform*

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- Fiscal policy restrictions should be self-assumed
  - Micro-rules should reflect overall fiscal policy goals
  - Parliamentary fiscal powers should be actively exercised
  - Restrictions should be independent of the technical form of economic commitments
  - Budget decisions should be covering
  - Long-term consideration should be fostered
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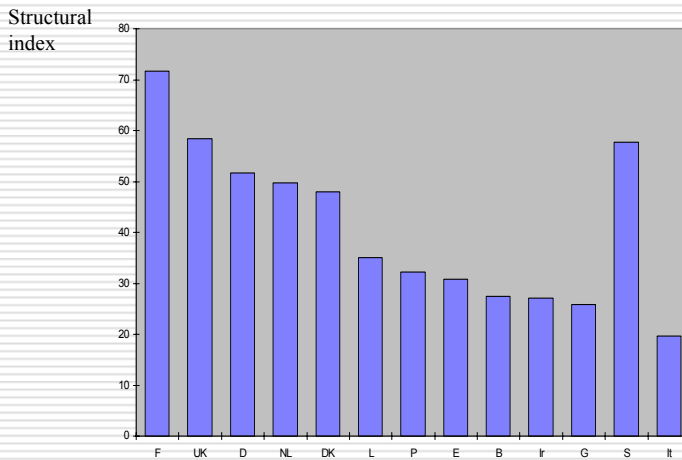
## *Reform components*

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- Top-down approach
  - Tri-annual, nominal, covering expenditure ceiling (excl. interest on central govt. debt)
  - Gross budgeting
  - Tax-expenditure account
  - Open-ended appropriations abolished
  - Budget margin
  - In-year monitoring
  - Up-grading of forecasts
  - Measures on account of audit reports
  - Economic-management rating of agencies
  - Improved budget cycle (centre of gravity in spring)
  - Organic budget act
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## *Swedish budget process, 1996*

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## *Summary of experiences*

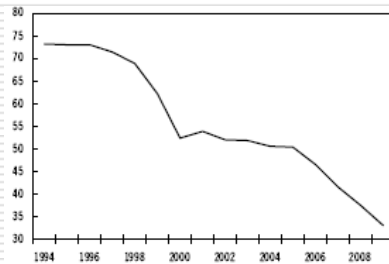
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- Stabilization of public finances
  - Stabilization of parliamentary budget process
  - Political stabilization
  - Democracy strengthened by increased transparency
  - Loop-holes – codify as much as possible
  - Very long-term issues difficult to integrate
  - Expenditure ceiling should be mandatory
  - Details are important
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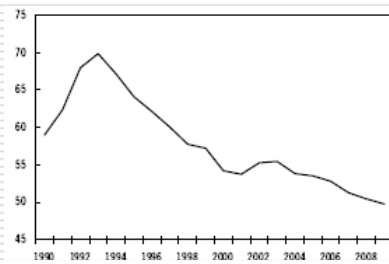
## *Consolidated debt ratio and expenditure ratio (% GDP)*

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Debt ratio



Expenditure ratio



## *2. State-local relationships: Arguments for and against local autonomy*

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### *For:*

- Freedom
- Community
- Part of the democratic infrastructure
- Efficiency – public expenditure level
- Efficiency – preferences
- Efficiency – local production conditions
- Experimentation

### *Against:*

- Human rights protection
  - Equity
  - Macroeconomic stability – bailout risk
  - Economies of scale
  - Administrative efficiency
  - Quality of financial management
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## *Sweden – some basic facts*

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- Population                    9 million
  - Municipalities                290
  - County councils            20
  - Municipal sector:
    - Share of GDP 25 %, share of employees 25 %
    - Size of municipalities: 2.600 – 750.000, median 16.000
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## *Tasks of the municipal sector*

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### *Regulated*

- basic education
- child care
- care for the elderly
- social assistance
- services to the disabled
- health care (mainly regional)
- physical planning
- rescue services

### *General*

- local infrastructure
  - public transport
  - cultural affairs
  - leisure activities
  - housing
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## *Financing*

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- Taxes on personal income - proportional
  - User fees
  - Grants – per capita
  - Equalization system: The implementation of nation-wide systems should be independent of local ability to pay.
  - Discretionary support
  
  - Financing principle – no unfunded mandates
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## *System of equalization*

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*Revenues:* guaranteed minimum tax base

*Expenditures:*

- 15-20 expenditure blocks
- Average costs
- Determination of structural factors
- Adjustment with respect to local values of structural factors

*Example of structural factors - basic schooling:*

- Proportion of school-age children (7–16),
  - Proportion of Finnish and non-Nordic children (7-16),
  - Sparse population
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## *Control mechanisms*

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- Local elections
  - Local press
  - Free access to information
  - Auditors
  - Right of appeal
  - Balanced-budget requirement
  - Budget, 3-year plan, fund management
  - Accounting standards
  - Monitoring by central agencies
  - Key indicators database
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## *Observations on state-local relationships*

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- A well-defined division of responsibilities based on first principles is necessary.
  - Control mechanisms at the different levels are more important than the general division of powers.
  - The state is responsible for the regulation and surveillance of the municipal sector.
  - An impartial arbitration mechanism between the national and the local level is recommended.
  - Transparency of the equalisation system is not a priority.
  - Decentralisation of powers is almost irreversible.
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### 3. Agencies – for and against

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#### *For:*

- Rule of law
- Impartiality
- Public access to documents
- Well-defined contracts of performance

#### *Against:*

- Lack of accountability
  - Principal-agent problem not satisfactorily solved
  - Marginalisation of the Government Offices
  - Risk of non-transparent appointment of directors
  - Poor repertoire of sanctions
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### 4. Links to WB countries

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Albania	Fiscal discipline, weak FDI
Bosnia & Herzegovina	Fiscal discipline, public sector management, governance
Croatia	High expenditure ratio, debt, public administration
FYR Macedonia	Public sector management, extra-budgetary funds, decentralization
Montenegro	Fiscal sustainability
Serbia	Fiscal sustainability, public sector management, governance

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## *5. Success factors in reform projects*

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### *Environment*

- Crisis
- Geometry of interest groups
- Empirical research

### *Design*

- Reform climate
  - Design principles
  - Fairness
  - Packaging
  - Entrepreneurs
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