POLICIES TO PROMOTE FISCAL DISCIPLINE[1]

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A. Introduction

The first public sector ombudsman office was set up in Sweden in 1890. A second country, Finland, did not follow for more than a hundred years. By 1962, all four Scandinavian countries had an ombudsman office, and by 1983 so did 23 mainly Commonwealth and European countries. However, the number of countries with ombudsman offices has increased from 27 to 110 in the last 20 years. This uneven pattern illustrates the way good ideas often spread, at first slowly, and mainly by following the examples of peers, and then more rapidly, as a response to some challenge. In the case of ombudsman offices, the recent trigger has been the transition to democracy in many parts of the world, and the recognition that having an office to deal with public complaints can contribute significantly to achieving accountability of democratic government.[2]

While new fiscal policy ideas do not come along too often, fiscal responsibility frameworks, incorporating either or both a commitment to fiscal transparency and adherence to fiscal rules, have become popular only in recent years. Yet transparency and rules are not new ideas. Certainly rules have been around a long time. Indeed, Germany and Japan introduced rules shortly after the Second World War. Earlier commitments to transparency are less easy to pin down, but the consequences of nontransparent practices (even if they are not described

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[2] I am grateful to Murray Petrie for drawing this example of policy transfer to my attention.

as such) have long been understood, and are a source of fiscal illusion which features prominently in discussions of the political economy of fiscal policy. However, it is the more recent attention that has been focused on the need to establish fiscal discipline in many countries of the world that has raised the profile of fiscal responsibility frameworks.

B. The Case for Fiscal Discipline

There is a clear case to be made in favor of fiscal discipline, here defined as establishing and then maintaining prudent deficit and debt levels. First and foremost, fiscal discipline is desirable because sound government finances are a prerequisite for macroeconomic stability: aggregate demand pressures, and with them inflation and balance of payments problems, can be avoided; and there is scope for fiscal policy to counteract cyclical variations in output. Second, the effectiveness of monetary policy is not constrained by a need to offset the consequences of loose fiscal policy (fiscal dominance). Third, fiscal discipline allows policymakers to pay attention to the efficiency of the tax system and expenditure programs, which is good for resource allocation and growth. And fourth, room is provided to accommodate emerging fiscal pressures, both predictable (such as unfunded public pension liabilities) and unpredictable (such as contingent liabilities).

Recent financial crises in emerging market economies provide a clear context in which to appreciate the pay-off to fiscal discipline. This is most obviously so with debt crises, which are usually the consequence of market concerns about solvency and liquidity in countries that have run persistent fiscal imbalances. However, even currency and banking crises can have adverse fiscal implications, due to large devaluations and the cost of bail-outs, which are more manageable if the fiscal position is initially sound. Moreover, crises typically produce sharp recessions, which all other thing being equal argue for countercyclical fiscal loosening; but procyclical fiscal tightening is often dictated by a weak fiscal position that provides no room for maneuver.

More generally, fiscal discipline takes on greater significance in a globalized world economy, in that the benefits from open capital markets and free trade are contingent on sound policies. A lack of fiscal discipline can limit access to international capital, which constrains potential growth, and increases its volatility, which complicates macroeconomic management. It also usually goes hand in hand with market distortions that disrupt the free flow of goods, services and factors. To derive maximum benefit from globalization, not only are sound policies needed, but a good measure of policy compatibility across countries. Of course, this does not mean that efficiency is all that matters; globalization presents challenges, most notably in the form of increased risk as market forces produce large numbers gainers and losers. Insuring populations against this risk is the proper function of government, for example by expanding the welfare state, but it is a function that has to be performed without losing sight of the need for fiscal discipline and efficiency.

C. Fiscal Responsibility Frameworks

Fiscal responsibility frameworks have been implemented in many OECD countries and some emerging market economies in response to the need for fiscal discipline.[3] Promoting fiscal transparency and favoring rules over discretion in fiscal policy formulation has been a response to general and specific circumstances. The general circumstances relate not only to the adverse economic consequences of high deficits and debt noted above, but also the need to address underlying political economy problems that have a source of deficit bias (see below).

With the Fiscal Responsibility Act of 1994, New Zealand pioneered the approach to fiscal management which places an explicit emphasis on improving fiscal transparency. This was intended to consolidate government finances which had strengthened in the late 1980s and early 1990s, and was part of a broader reform agenda directed toward improving economic

[3] References to OECD countries in this paper are to industrial countries.

performance by rolling back the state. Heavily influenced by the New Zealand experience, and again with an emphasis on preserving improved fiscal positions, Australia and the United Kingdom adopted a similar approach to fiscal management. The Charter for Budget Honesty was enacted in Australia in 1998, and in the same year the Finance Act in the United Kingdom introduced the Code for Fiscal Stability. The New Zealand, Australia, and United Kingdom frameworks share certain common elements. In particular, they have an explicit legal basis, they combine guiding principles for fiscal policy with a requirement that objectives are clearly stated, they emphasize the need for a longer-term focus to fiscal policy, and they set demanding requirements for fiscal reporting to the public. As such, they are widely seen to represent the state of the art as far as fiscal transparency is concerned.

The legislation in Australia and New Zealand does not contain explicit fiscal targets. However, balanced budget objectives, and a debt target in Australia, are specified in annual budgets. While not included in the Code for Fiscal Stability, two fiscal rules against which fiscal performance in the United Kingdom is judged are so closely associated with the Code as to be regarded part of it.[4] The golden rule requires that the government should borrow only to finance investment, and the sustainable investment rule requires that public sector net debt as a proportion of GDP should be held at a stable and prudent level (currently taken to be 40 percent of GDP). Both rules apply on average over the cycle. These rules are in part directed towards addressing a past bias against public investment which had left the United Kingdom with one of the smallest public capital stocks in Europe and well publicized infrastructure problems.

For euro area countries, the specific background has been the need to prevent fiscal profligacy disrupting initially the process of monetary union and subsequently monetary stability. This requires fiscal discipline in the euro area as a whole, and in individual member countries to the extent that loose fiscal policy in one country can raise the risk premium for

[4] The term fiscal rules is used in this paper to refer only to constraints on deficits and debt.

the area as a whole (the common pool problem). To these ends, the Maastricht Treaty required that, as a condition for joining the monetary union, fiscal deficits should be a maximum of 3 percent of GDP, and that government debt should be a maximum of 60 percent of GDP or progress in reducing debt to this level should be satisfactory. The Stability and Growth Pact (SGP) of 1997 requires countries to maintain medium-term fiscal positions close to balance or in surplus, although deficits still cannot exceed 3 percent of GDP. The principal intent of the Maastricht/SGP fiscal rules is to maintain an appropriate balance between the need for fiscal discipline over the medium term and the need for flexibility to undertake fiscal stabilization in response to normal cyclical fluctuations, which is important given the loss of monetary policy autonomy in the euro area.

Some European countries, including Finland, the Netherlands, and Sweden impose expenditure ceilings. In euro area countries (Finland and the Netherlands), these are intended to help meet the Maastricht/SGP rules. New Zealand and the United Kingdom have also adopted expenditure ceilings, but these are not the central focus of the respective fiscal policy frameworks. In the United States, the 1997 Balanced Budget Act required that the balanced budget target for 2002 be achieved through spending limits set out in the 1990 Budget Enforcement Act. The latter, which applied only to on-budget accounts (social security and Medicare are excluded), set nominal expenditure ceilings for discretionary spending, required that new expenditure and revenue measures impose no net cost (i.e., that they be financed on a pay-as-you-go, or PAYGO, basis), and included sequestration procedures which were triggered if these requirements were not met. These provisions have expired and have thus far not been replaced.

Almost all U.S. states are required to balance their current budget (although they can build up rainy day funds in good years to cover temporary deficits), while their investment is financed by market borrowing and their revenues are constrained by tax competition.[5] Similar

[5] The nature of the balanced budget constraint is not uniform across states. Only in 34 states is the governor required to sign a balanced budget. In other states, the governor has to present a balanced budget and in most of these the legislature has to pass a balanced budget.

provisions govern the finances of most provinces and territories in Canada. In principle, this means that national fiscal policy can be set at the federal level, but in practice this is not always easy. In Australia, states and territories specify fiscal objectives (such as maintaining a budget surplus, keeping taxes low, or reducing debt) and many have introduced fiscal responsibility legislation to underpin these objectives. Some euro area countries also have internal stability pacts to ensure that the finances of subnational governments are consistent with the Maastricht/SGP rules, which apply to government as a whole.

Among emerging market economies, Brazil introduced the 2000 Fiscal Responsibility Law in response to the 1998 crisis. The law sets out fiscal rules aimed at ensuring medium-term fiscal sustainability and specifies stringent fiscal transparency requirements. A similar approach, or at least key elements of it, have been adopted in Argentina, Colombia, and Peru. With a view to addressing weak government finances in India, which crowd out private investment and hold back growth, the 2000 Fiscal Responsibility and Budget Management Bill combines rules and transparency requirements. Certainly the decision to take this route in Brazil and India was influenced by the OECD experience. Finally, it is more common for emerging market economies, and developing countries, to rely on limits on borrowing by the government, either domestically or more usually from the central bank, to exercise fiscal discipline, quite often unsuccessfully.

D. Fiscal Adjustment Experience

The spread of fiscal responsibility frameworks is based largely on a combination of need and imitation: certainly, it cannot yet be convincingly defended by reference to hard evidence that they work. Since the early- to mid-1990s, fiscal adjustment has occurred in most OECD countries. However, fiscal developments before then also had a large common element. Thus there was a period of mainly revenue-based fiscal adjustment during 1982–89; a period of expenditure-led fiscal expansion during 1989–93; and a period of expenditure-based adjustment during 1993–2000 which saw fiscal surpluses emerge in many countries (International Monetary Fund, 2001). Given the near universal picture of recent fiscal

adjustment, which has been mainly the result of a reduction in noncyclical primary spending and has thus been very much discretionary in nature, it could be argued that transparency and rules have not contributed in any obvious way to fiscal adjustment. Indeed, looking at Australia, New Zealand, and the United Kingdom, countries which have most emphasized transparency, and the euro area countries, with the strongest rules-based approach to fiscal policy, fiscal developments have a very similar pattern to that for the OECD area as a whole. Only Japan, where expansionary fiscal policy has been used over a prolonged period in an effort to stimulate a stagnant economy, is a clear outlier.[6]

Part of the problem, of course, is that it is difficult to provide clear conclusions about the role of transparency and rules in the absence of a counterfactual. For example, could New Zealand, where there had been a history of poor fiscal performance, have consolidated its fiscal adjustment without a new fiscal framework? Or could European countries with very high debt ratios by the mid-1990s have adjusted without the discipline imposed by the Maastricht Treaty? Certainly, a lack of transparency in Italy, in conjunction with other weaknesses of the fiscal management system, was a recognized obstacle to imposing fiscal discipline, and it does indeed seem unlikely that fiscal adjustment could have been achieved in the absence of a major institutional change.[7] Moreover, several studies (including Poterba 1997 and Schick, 2000) have concluded that the Budget Enforcement Act played a significant role in reducing expenditure in the United States.

There is also some econometric evidence on transparency and rules, particularly for E.U. countries. Thus von Hagen and Harden (1994) found that countries with more transparent budget procedures exhibited greater fiscal discipline in the 1980s and early 1990s, but this was before the recent emphasis on transparency. More recently,

[6] There have been some differences between countries, especially in the euro area. Fiscal deficits persisted in major euro area countries in 2000 (France, Germany, and Italy) despite strong cyclical positions, while the debt ratio in three countries (Belgium, Greece and Italy) has remained around 100 percent of GDP.

[7] See Chiorazzo and Spaventa (1999).

von Hagen, Hughes-Hallett, and Strausch (2000) find that fiscal policy has been associated with stronger fiscal performance, and has been less reactive to cyclical fluctuations and monetary policy changes, in the 1990s than previously, which is attributed in part to Maastricht. However, such results have to be regarded cautiously, for a variety of reasons. At best, they can provide analytical verification of conclusions in favor of fiscal responsibility frameworks, but to convince policymakers these conclusions probably have to be obvious to the casual observer. In other words, countries with fiscal responsibility frameworks have to be seen to have a better record of fiscal discipline(and the analysis can then confirm causality).

In this connection, the acid test will be the ability of fiscal responsibility frameworks to contain the loosening of fiscal policy that began in 2001 as growth slowed, and has since intensified as the global economy has remained weak and security-related spending has increased, and then to subsequently reestablish sound fiscal positions. At the current time, with the Maastricht deficit limit having been reached by the largest euro area member countries and pressure being mounted to reinterpret or reformulate the SGP to provide more room for fiscal policy maneuver, with the U.S. federal deficit widening alarmingly and state finances deteriorating sharply (both because of the growth slowdown and widening pension deficits), and with concerns being expressed about government finances in other OECD countries, prospects look distinctly shaky. And in emerging market economies, while fiscal responsibility legislation helped Brazil contain the fiscal impact of contagion from recent crises in Latin America, Argentina had to abandon the fiscal commitments made in its 1999 fiscal responsibility legislation and 2001 zero deficit plan, while legislation in India is having a rough passage through Parliament, where it has been stuck for the last two years.

E. Promoting Transparency

While there may be some doubt about the resilience of fiscal responsibility frameworks, and in particular fiscal rules, the effort to promote fiscal transparency has it own momentum in

the form of the IMF *Code of Good Practices on Fiscal Transparency*.[8] The Code provides a benchmark for assessing fiscal transparency, and as such represents a standard of fiscal transparency to which all countries should aspire. The Code is organized around four general principles that reflect essential elements of fiscal transparency and a number of specific principles that expand upon each of the general principles. The Code also contains detailed good practices of fiscal management. These good practices do not reflect only what happens in New Zealand, Australia, and the United Kingdom, where the fiscal frameworks are examples of best practice and do not represent a standard that is appropriate for all countries.[9]

The Code is grounded firmly in an approach to economic and financial management that recognizes the importance of adhering to standards as a means of strengthening the international financial system, reducing vulnerabilities, and providing for more effective crisis prevention and management. In this connection, the IMF publishes assessments against various standards and codes in Reports on the Observance of Standards and Codes (ROSCs). These cover transparency standards (for data, fiscal policy, and monetary and financial policy), financial sector standards (banking supervision, securities, insurance, payment systems, and AML/CFT), and market-based standards (corporate governance, accounting, auditing, and insolvency and creditor rights). Participation in the ROSC process is voluntary, and 243 ROSC modules had been published as of end-2002, including 48 fiscal transparency modules. ROSC modules are increasingly being used by market participants to inform investment and credit decisions, and the clear message from fund managers and rating agencies is that the private sector invests more in transparent countries, and they also get more favorable credit ratings. The implication is that there are clear market-based incentives to strengthen fiscal transparency.

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[8] The original Code was published in 1998. A revised version was published in May 2001.

[9] Best practices are discussed in the IMF *Manual on Fiscal Transparency*, a revised version of which was also published in May 2001. The OECD has also produced guidelines on *Best Practices for Budget Transparency*.

F. Improving Rules

It is difficult to find people who will argue against transparency, since the underlying principle is unassailable and the detail of the various codes attracts widespread support. The same is not true of rules, in part because the principle is less clear cut. The fact that favoring rules over discretion is in vogue does not diminish the case that judgment is preferable if it can be effectively tailored to individual circumstance. The problem in the case of fiscal policy is that discretion has a bad track record. It has been a source of deficit bias, reflecting deep-seated political economy problems. Most notably the electoral system, the political process, and fiscal institutions combine to increase spending in good times but to only partially rein in spending in bad times. This not only produces expenditure-led deficit bias, discretionary fiscal policy ends up being procyclical. Moreover, even when countercyclical fiscal policy is pursued, the fiscal response often comes too late and cannot be quickly reversed. Overall, discretionary fiscal policy ends up increasing cyclical volatility (Fatas and Mihov, 2001).

Rules are the response to deficit bias and procyclicality, but they have their own weaknesses. They embody targets which are essentially arbitrary, since economic theory provides little guidance on the deficit/surplus and debt levels that might be regarded as in some sense 'optimal.' Relying on automatic stabilizers, as many rules do, is also a concern. Certainly they are quick acting and reversible, and should reduce cyclical volatility. But they too are fairly arbitrary, in the sense that their size, composition, and impact derives from the tax and spending decisions taken over a very long period of time with little if any reference to stabilization needs. What is close to becoming a fiscal policy mantra in countries with and without rules, 'let automatic stabilizers work', relies very much on a wing and prayer. Finally, while fiscal rules require transparency if they are to work well, the truth is that there is a strong disincentive to maintain or even create elements of nontransparency that allow unintended flexibility to be imparted to rules through creative accounting.

Certainly rules can be improved, and the call to do so in the euro area is motivated by legitimate concerns about the rigidity of the Maastricht/SGP rules. As noted above, the SGP is intended to provide room for automatic stabilizers to work in the euro area in the event of output volatility without compromising fiscal policy credibility. However, it was recognized from the outset that the cyclical response of fiscal policy varies across countries, and that in principle there need to be country-specific medium-term targets to ensure that the Maastricht 3 percent deficit rule is not violated (Artis and Buti, 2000). In setting a common and fairly ambitious target, the need for some countries to supplement their relatively weak automatic stabilizers with discretionary fiscal measures is one of the things being taken into account.[10] But this is clearly intended to be the exception.

Perhaps there should be more scope for discretionary policy.[11] While it may be quite reasonable to argue that automatic stabilizers can be relied on to provide any needed support to monetary policy in response to area-wide cyclical variations in output, and maybe even milder country specific shocks, discretionary fiscal policy is likely to be needed to respond to

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[10] On average, it is estimated that a structural deficit of about 1 percent of GDP (and ranging between ½ and 1½ percent of GDP for individual countries) provides sufficient room for automatic stabilizers to work and to remain within the 3 percent of GDP Maastricht deficit target in the event of a cyclical downturn matching in size any of those in recent history (International Monetary Fund, 1998). In addition to the need to compensate for weak automatic stabilizers, the possibility of historically large output shocks, the still high debt ratios in some countries (and the resulting exposure to interest rate shocks), likely reductions in support from E.U. structural funds in some countries (especially Ireland, Portugal, and Spain), and the potential fiscal costs of population aging justify a more ambitious target.

[11] This whole discussion is of course based on assumptions about the effectiveness of fiscal policy in influencing output in the short term which largely reflect Keynesian orthodoxy. However, fiscal multipliers can be quite low if the impact of fiscal policy is offset by the savings responses of Ricardian households and in the presence of debt sustainability problems, and can even turn negative, as evidenced by the expansionary fiscal contractions identified in certain European countries (Alesina and Ardagna, 1998). But for euro area countries, the negative effects of Ricardian behavior and high debt in some countries on fiscal multipliers are counteracted by the more limited scope for crowding out through the interest rate and the exchange rate in a monetary union and the beneficial effects of the Maastricht/SGP framework on fiscal policy credibility.

sharper or longer-lasting shocks, and certainly to address medium-term fiscal issues (e.g., the fiscal consequences of population aging). A particular criticism is that there is little justification for depriving countries with relatively low debt of the opportunity to take advantage of discretionary fiscal policy where it can help. The problem of course is that modifying the current Maastricht/SGP rules when they are proving to bind for the largest euro area countries risks damaging their credibility, and in the process diminishes the prospects for maintaining fiscal discipline. This then raises an issue as to whether a different approach may work better in the euro area, and perhaps elsewhere. This could continue to be rules-based. For example, there could be a switch to a golden rule for countries with relatively low debt. This would provide more scope for fiscal stabilization, and at the same time such a rule may be suited to the situation of current euro area countries (Ireland, for example) and the E.U. accession countries needing to increase public investment. The United Kingdom might also be expected to push for adoption of the golden rule if it joins the euro area. An alternative is a completely new institutional approach.

G. Independent Fiscal Authorities

The success with granting independence to central banks in conducting monetary policy has naturally suggested to some that a similar idea—namely, the creation of an independent fiscal authority (IFA) with the power to set or constrain some fiscal variable(s)—can be extended to fiscal policy with similar benefits. Specifically, by making fiscal policy decisions less political, implementation lags would be reduced, which would increase the flexibility to respond to short-term stabilization needs. If fiscal policy is at the same time anchored by a clear medium-term objective, fiscal discipline, and with it fiscal policy credibility, will be preserved.

While there are some similarities between monetary and fiscal policy, the usual counterargument is that the advantages of independent central banks do not carry over automatically to IFAs, because fiscal policy differs from monetary policy in fundamental ways. In particular, monetary policy in most cases has a single objective, the control of

inflation, while fiscal policy has its traditional stabilization, allocation, and distributional objectives. Moreover, monetary policy typically pursues its single objective with one basic instrument, a short-term interest rate, which can be easily and quickly adjusted; fiscal policy, in contrast, uses various tax and expenditure instruments with complicated interrelationships between them. The upshot is that fiscal policy formulation and implementation is more complicated, and by its very nature difficult to depoliticize.

Earlier IFA proposals did not fully respond to these concerns. Thus the Blinder (1997) proposal that the design of the tax structure be given over to an independent body, and the Seidman (2001) proposal that such a body should control the overall size but not the structure of the budget, would pretty much be nonstarters. The Ball (1997) and Gruen (1997) proposals which would give statutorily appointed, independent fiscal officials, in New Zealand and Australia respectively, some responsibility to make small across the board adjustments to tax rates are better. However, the von Hagen and Harden (1994) proposal for a National Debt Board for European Union countries in the run-up to monetary union, which would decide at the beginning of the budget process the maximum change in debt over the budget year, would probably impinge least on the size and structure of the budget, and therefore on the legitimate interests of the legislature. Eichengreen, Hausmann, and von Hagen (1999) suggest something very similar in a Latin American context.

While previous interest in IFAs barely registered with policymakers and the public, the recent concerns about the limitations of the Maastricht/SGP rules have not only reignited interest in IFAs, but have also seen a forceful case being made for them in the ongoing policy debate. Thus Wyplosz (2002) argues for national Fiscal Policy Committees which specify fiscal deficit/surplus targets to be included in the annual budget that are appropriately countercyclical and yet are consistent with achieving debt sustainability over some specified time period. Debt sustainability can be defined in terms of a specific target at which stability will be maintained, or a deficit/surplus target that guarantees that debt will fall. The important point is that the debt sustainability objective should be endorsed by the legislature. The committee would also be able amend the targets if economic conditions change

significantly within year. Other options, such as giving an IFA control over taxes, and most notably VAT, or rainy-day stabilization funds, have also been discussed (see CESifo, 2003).

With all such proposals, there would remain much detail to work out. But some big questions also remain unanswered. In the euro area, there is the problem of coordinating discretionary fiscal policies across countries so that they are consistent with area-wide fiscal policy objectives. Spillover effects can also create the opportunity for one country to take a free ride on another country's fiscal policies. A central fiscal authority could improve coordination in key areas, and in particular if: increasing economic and political integration leads to the emergence of regional public goods and new externalities that can only be dealt with centrally; a centralized solution is needed to deal with the effects of tax competition, given the more prominent role of tax policy in fostering competitiveness in the absence of monetary or exchange rate instruments; and the redistribution role of fiscal policy may need to be shifted from member states to the center as mobility increases (Cangiano and Mottu, 1998). But it is less clear whether a central fiscal authority, or a network of country fiscal authorities, could undertake coordinated stabilization. Most likely, overall goals, for example, debt sustainability objectives would have to be agreed centrally, as under the current arrangements, while peer pressure will be relied on to discipline IFAs.

A key issue concerns about the adoption of the Maastricht/SGP framework signaled that in IFAs, but have also seen a major change in this sense. If the concern is that too much power would be vested in an independent body, the IFA could be advisory; Wyplosz (2002) refers to this as a 'Wisepersons Council'. Such a council could also act as an independent scorekeeper, assessing and reporting on compliance with budget targets. If its advice and conclusions are made public, markets will take note of it and governments will be hard pressed to ignore it. But there would still remain the problem of getting political consensus among 12 euro area member countries (and maybe more E.U. and E.U. accession countries) about a new institutional set up without knowing whether it works better that the Maastricht/SGP rules. The prospects of this happening are probably not bright, although successful demonstration by one more adventurous country that an IFA can work in practice

could help. However, as with all experiments, this one may not work, and as one commentator on New Zealand's (allegedly failed) experiment with economic libertarianism noted: "Economists may be grateful for such experiments. But it is usually better not to live in the countries where they take place" (Kay, 2000). IFAs could be a good idea that never sees the light of day.

H. Institutional Reform

Fiscal responsibility frameworks require that they are supported by other fiscal policies and that the full range of properly functioning fiscal institutions are in place not only for policies to be effective, but also to ensure that they do not have the opposite effect to that intended. Thus, in addition to the tax system and expenditure structure being designed in accordance with the usual efficiency and equity criteria, they also have to well administered. This is an area where there is a good deal of experience about what works, and where technical assistance has played a role in promoting particular approaches. Two examples illustrate this.

In the tax administration area, there has been a increasing focus on segmenting the taxpayer population with a view to stabilizing revenue flows, and in particular by paying particular attention to large taxpayers. Building on the success of special audit units for large corporations that a number of OECD countries have had in place since the 1950s and 1960s, 55 countries (with a wide geographic spread) have large taxpayer units (LTUs) in their tax administrations. While in OECD countries the focus still tends to be on audit, in many other countries the LTU is responsible for the full range of tax administration functions—taxpayer services, collection, enforcement of arrears, and audit. In 40 of these countries, LTUs were established with technical assistance from the IMF, supported in some cases by bilateral assistance. In a number of countries, LTUs are a responsible for more than 80 percent of domestic revenue collection, although 40–60 percent is the norm.[12]

[12] Baer (2002) provides more detail.

In the financial management area, most OECD countries rely on treasury systems to manage public money. However, when the former Soviet Union broke up, there was no such system in place, and the development of such a system had to be designed and implemented in a manner consistent with the needs of economic transition more generally. Again, IMF technical assistance played a significant role, and has emphasized the development of a basic payments system ahead of more ambitious management information systems. In this case, other multilateral and bilateral providers of technical assistance were involved, all having bought into the treasury concept. It is also clear, and far more so than appears to be the case with LTUs, that in addition to the availability of technical assistance, IMF conditionality played a key role in hastening progress with treasury development, especially because it was tied in with improving fiscal policy monitoring and reporting.[13]

I. Conclusions

How have fiscal responsibility frameworks developed and spread? This paper points to a number of possibilities. Repeated failure to tackle persistent, common problems, most notably deficit bias and procyclicality, has been a challenge in many OECD countries and emerging market economies to which an emphasis on transparency and rules is a clear response. New needs which place a premium on fiscal discipline have also played a role. Monetary union in Europe is a specific case in point, while globalization provides a more general justification. For the most part, the policy transfer mainly reflects the sharing of ideas between countries facing similar problems and needs, rather than the response to an initiative that has been an obvious success. This is certainly the case for rules, which as presently implemented have clear shortcomings, and which have few unreserved advocates. This contrasts with transparency, which has its own momentum in the form of peer pressure exercised through a broader standards and codes initiative, as well as market incentives.

[13] Potter and Diamond (2000) provide more detail.

While transparency is an idea that will continue to spread, the outlook for rules is far less certain. Much depends on whether current shortcomings can be addressed, in the euro area in particular. But far more so than with transparency, the benefits of which are easy to appreciate in the abstract, rules probably also have to be seen to successfully provide the right combination of flexibility and fiscal discipline. It is a tall order, but is the key to rules initially being retained and eventually spreading to other countries, either individually or as part of a monetary union. If rules lose their appeal, either because they provide too little or too much fiscal discipline, then independent fiscal authorities may be an alternative that some country will try and succeed with, in which case others will surely follow.

The success of fiscal policy frameworks also depends on having well functioning fiscal institutions to support their implementation, and multilateral and bilateral providers of technical assistance have a clear contribution to make to institution building. Multilateral institutions and biliateral agencies can also play a role in promoting new ideas more generally through their surveillance operations, lending and aid programs, and less formal information exchange and advisory activities. In this connection, they need to leverage academic research which will inevitably be where many new ideas originate and are subjected to the most rigorous analysis.

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