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WHY DOES POLAND NEED A FISCAL COUNCIL?[1]

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Abstract

The EU's economic governance reform has led to institutional innovations in the Member States, particularly in the euro area. Although generally overlooked in legal scholarship and public debate, one of the most significant changes is the mandatory establishment of independent fiscal institutions to restore fiscal credibility and preserve sound public accounts. Through the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG), EU law has established certain requirements for Member States to make these fiscal institutions genuinely independent of fiscal authorities and increase transparency and consistency in fiscal policy decision-making. As the only EU Member State, Poland has not established a fiscal council so far. It is therefore worth asking why Poland needs a fiscal council especially now.

Keywords: fiscal council, independent fiscal institution, Supreme Audit Office, fiscal policy, transparency and consistency in fiscal policy

1. Introductory remarks

In the last decade, there has been a marked increase in interest in independent monitoring bodies for medium-term fiscal sustainability (so-called watchdog institutions). The Organization for Economic Cooperation and Development (OECD), the International Monetary Fund (IMF), and the European Commission confirm this trend. The importance of this solution has increased, especially in recent years in view of the deteriorating financial state and outlook of individual countries[2]. The ongoing debt crisis has been compounded by phenomena already identified, such as the tendency of politicians to increase budget deficits (deficit bias), the unsustainability of public debt despite good economic times (debt ratcheting), and the ageing population process. Consequently, the role of independent fiscal institutions, also known as fiscal councils, has increased in practice. The intensity of their

[2] Organization for Economic Co-operation and Development, Recommendation on Principles for Independent Fiscal Institutions, http://www.oecd.org/gov/budgeting/recommendation-on-principles-for-independent-fiscal-institutions.htm

establishment has increased especially in European countries, on which supranational criteria are imposed to fulfil annual general government deficit and debt-to-GDP ratios, but also medium-term objectives (MTO). Nowadays, an important rationale for establishing independent fiscal institutions in EU countries is the obligation to implement the directive's objectives on the budgetary framework of the Member States, which is one of the legal acts of the so-called *six-pack* budgetary reform implemented since 2012[3].

The OECD defines fiscal councils (IFIs) as institutions *established under public law, staffed by non-partisan professionals mandated to provide ongoing monitoring and/or advice on implementing fiscal policy. The mandate of such institutions is to increase pressure for fiscal discipline, enhance the quality of the debate on public finances and promote fiscal transparency and accountability*[4].

Fiscal councils are institutions designed to increase pressure for fiscal discipline, improve the quality of the debate on public finances and promote fiscal transparency. These institutions can effectively complement other fiscal institutions and contribute to the effectiveness of numerically set fiscal rules. However, in order for the establishment of a fiscal council to contribute to enhancing fiscal discipline, this institution should have strict operational and financial independence from the government and have legally guaranteed access to all public data necessary to assess the draft budget and the state of public finances, prepare independent macroeconomic analyses and forecasts, make recommendations on the desirable nature of fiscal policy, and be able to estimate the cost of individual government projects or the degree of the government's compliance with fiscal rules[5]. The choice of the type of independent institutions should be tailored to the nature of the country's fiscal problems and its political circumstances, including constitutional foundations, legislative traditions and political habits. Currently, 26 of the 27 EU countries have at least one fully functional independent fiscal institution. The only exception is

[3] M. Horvath, EU independent fiscal institutions: An assessment of potential effectiveness, *Journal of Common Market Studies* 2018, vol. 56(3), pp. 504–519.

[4] Organization for Economic Co-operation and Development, Draft Principles for Independent Fiscal Institutions: Background document No 3, https://www.oecd.org/gov/budgeting/49777912.pdf.

[5] C. Fasone, Do Independent Fiscal Institutions Enhance Parliamentary Accountability in the Eurozone?, *Politics and Governance* 2021, vol. 9 (3), pp. 135–144.

Poland, which does not count with an agency that can be described neither as independent nor as a proper fiscal agency. The European Commission, by the way, has noticed this situation, identifying Poland as the only country without an independent fiscal institution, signalling this issue on several occasions and recommending the creation of such an agency, e.g. in each of its assessments of the 2015-2019 convergence programmes and its country-specific recommendations. Poland has an institution, the Supreme Audit Office, which presents some characteristics of a fiscal agency. However, analysts widely agree that it cannot be considered an independent fiscal agency; therefore, most studies exclude it. It is also worth noting that in some Member States, more than one agency performs the tasks entrusted to independent fiscal institutions (e.g. Austria, Belgium, Germany). This is usually the case where a country already had one institution before the EU governance framework was developed, where there is an additional agency linked to the parliament or a sub-national agency. In these cases, the division of tasks and inter-institutional cooperation become important for assessing the effectiveness of these agencies[6].

2. The role and tasks of fiscal councils in the Member States of the European Union

The key impetus for developing independent fiscal institutions has come primarily from legislative initiatives at EU level. Currently, the legal framework that sets out the requirements for independent fiscal institutions is contained in three pieces of legislation: EU Directive 2011/85, the Treaty on Stability, Cooperation and Governance (TSCG) and Regulation 473/2013. Despite the existence of some common basic requirements, this set of rules was deliberately open-ended in terms of organisation and structure. Thus, they allowed Member States to adapt existing institutions or design new agencies as they preferred, leading to much variation between countries regarding institutional

[6] See more C. Fasone, The Constitutional Role of Independent Fiscal Institutions in the Eurozone, „German Law Journal" 2022, vol. 23, pp. 257–279. https://doi.org/10.1017/glj.2022.13

structure, mandate and strength. The need for independent fiscal institutions in the European Union Member States stems from Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States. This directive is part of the so-called *six-pack*, six pieces of European Union legislation aimed at improving financial management in the Member States after the financial crisis. The Directive establishes detailed rules for the budgetary frameworks of the Member States, which in Article 2 include, among other things: budgetary accounting and statistical reporting systems, numerical fiscal rules and medium-term budgetary frameworks. The overarching aim of the solutions introduced by the Directive is to ensure compliance by Member States with their obligations under the Treaty on the Functioning of the European Union to avoid excessive government deficits. Article 5 requires Member States to incorporate numerical fiscal rules into their national legal orders intended to *effectively support, over a multi-annual horizon, the achievement by general government as a whole of Member States' obligations under the TFEU in budgetary policy*. However, the mere introduction of a numerical fiscal rule in the national legal order is insufficient to transpose the Directive. The Directive contains several references to the need or desirability for independent fiscal institutions to carry out, prepare forecasts or supervise compliance with fiscal rules. Article 6 of the Directive also requires *effective and timely monitoring of compliance with the rules based on reliable and independent analysis carried out by independent bodies or bodies endowed with functional autonomy vis-à-vis the fiscal authorities of the Member States*. This provision therefore provides the basis for establishing independent fiscal institutions in the legal orders of Member States to monitor compliance with numerical fiscal rules. Independent fiscal institutions are non-partisan public bodies, other than the central bank, the government or the parliament, tasked with preparing macroeconomic forecasts for the budget, monitoring the progress of fiscal policy implementation and carrying out advisory tasks to public authorities. Considering the institutional models used in practice, independent fiscal institutions can be established: firstly, within specifically dedicated bodies (Fiscal Councils), secondly, at the parliamentary budget offices, and thirdly, at the State Audit Offices[7].

The second piece of EU legislation analysed, the Treaty on Stability, Co-operation and Governance, is *de jure* an intergovernmental treaty located outside the EU's regulatory structure, but *de facto a* key element of the EU's economic architecture. This treaty, which is binding on all eurozone countries and those Member States that voluntarily sign it, is designed to stiffen the rules laid down in the six-pack and sets out the fiscal rules that governments must follow. Concerning fiscal agencies, Article 3(2) prejudges that contracting parties implement the corrective mechanisms agreed in the treaty. Such implementation must be done *based on common principles to be put forward by the European Commission, concerning in particular the nature, scope and timetable of the corrective action to be taken (…) and the role and independence of the institutions responsible at national level for monitoring compliance with the principles contained in paragraph 1*[8]. The above principles are further developed in the European Commission Communication Common Principles on National Fiscal Correction Mechanisms (COM/2012/0342 final). This Communication is adopted in the framework of the implementation of the Stability Treaty, in the general interest of the Union and to contribute to the proper functioning of the Economic and Monetary Union. This document outlines the tasks to be assigned to the independent fiscal institutions and the organisational requirements to be fulfilled. An analysis of this document makes it possible to reconstruct the key principles underlying the model proposed by the Commission. According to principle No. 7 in the Annex, independent bodies or bodies with functional autonomy acting as monitoring institutions shall act for the credibility and transparency of the correction mechanism. These bodies would make a public assessment of: the occurrence of circumstances justifying the activation of the correction mechanism; whether the progress of the correction is under national rules and plans; and the occurrence

[7] C. Fasone, Corte dei Conti v. Ufficio parlamentare di bilancio?, Toruńskie Studia Polsko-Włoskie/Studi polacco italiani di Toruń 2013, vol. IX, pp. 171-200.

[8] C. Fasone, D. Fromage, Fiscal Councils: Threat or Opportunity for Democracy in the Post-Crisis Economic and Monetary Union?, In Democracy in the EMU in the Aftermath Of The Crisis, eds. L. Daniele, P. Simone, R. Cisotta, Springer 2017, pp. 161-178.

of circumstances justifying the activation, extension and termination of the exemption clauses. The Member State concerned is obliged to follow the assessment of the bodies mentioned above and, if it does not, to publicly explain the reasons for not complying with the assessment findings. The above bodies *structure considers the existing institutional environment and the country-specific administrative structure. The above bodies are governed by national laws ensuring a high degree of functional autonomy, including: i) a legally mandated statutory system; ii) non-interference in that the above bodies do not take orders and can make information public on time; iii) appointment procedures based on criteria of experience and competence; iv) adequacy of resources and adequate access to information to perform their tasks. In the light of the document analysed, independent fiscal institutions would therefore be expected to assess the functioning of correction mechanisms, compliance with fiscal rules and to provide a public assessment of the circumstances that trigger such mechanisms (or the application of exceptions). In order to guarantee their impact, the Commission proposes to apply the „comply or explain* principle, which would mean that governments could not simply ignore recommendations or questions posed by these agencies. Finally, regarding organisation, the Commission's communication prejudges that institutions must be consistent with each country's existing institutional structure and administrative specificities, stresses the importance of guaranteeing functional autonomy and emphasises the need for good communication with citizens. While the responsibility for ensuring compliance with correction mechanisms lies primarily with fiscal authorities, national monitoring institutions would play a crucial role in promoting credibility and transparency. Following national rules, these bodies would be expected to assess the functioning of the correction mechanisms at the different stages of the correction's activation and implementation, including possible recourse to the escape clause. In turn, the independence of the functional autonomy of these bodies is an essential feature to enable them to play an effective role in the overall national fiscal policy. Principle 7 provides some guidance in this regard. First, their structure should align with the existing institutional setting and the country-specific administrative structure to better integrate the monitoring institutions. Secondly, several criteria guarantee a high degree of functional autonomy. The statutory system and these bodies' powers and responsibilities should be legally enshrined. Strict safeguards should also be taken concerning appointments and the adequacy of resources and access to information. These conditions are necessary to enable the monitoring bodies to carry out their activities effectively and ensure the mechanisms' transparency and credibility. Particularly important in this context is the ability to communicate freely with the public.

The third EU normative act, Regulation (EU) No 473/2013 of the European Parliament and of the Council of 21 May 2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficits in the euro area Member States (OJ L 140, 27.5.2013, p. 11-23), formulates most of the legal requirements and develops in more detail the role of independent fiscal institutions, extending the principles set out in the previous document. This regulation is part of the Two-Pack, which followed the line initiated by the Six-Pack and aimed to increase fiscal coordination and ensure appropriate oversight mechanisms. The standard lists some of the functions that independent fiscal agencies could perform, such as monitoring compliance with fiscal rules, assessing the functioning of corrective mechanisms or the occurrence of extraordinary circumstances, making (or validating) unbiased forecasts, engaging in technical dialogue. However, although this EU Regulation imposes legal requirements, it would only have implications for those Member States that are part of the euro area[9].

Regarding the institutional set-up, the regulation assumes that it should consider each Member State's specificities. For example, the state may equip an existing unit with the autonomy and resources necessary to perform the required tasks. The regulations are therefore quite open in terms of institutional requirements. Some states even have more than one fiscal council due to the pre-existence of a multi-agency framework, the creation of a parliamentary office to act as an additional fiscal council or the presence of a regional or sub-national office. Although Regulation 473/2013 accepts that more than one institution may be responsible for some of the tasks assigned to fiscal agencies,

[9] C. Fasone, E. Griglio, Can Fiscal Councils Enhance the Role of National Parliaments in the European Union? A Comparative Analysis, In The Euro Crisis and the State of European Democracy, eds. B. de Witte, A. Héritier, A. H. Trechsel, Florence 2013, pp. 266-305.

the standard does not favour this option. The regulation explicitly states that excessive institutional fragmentation should be avoided. Such ambiguity was intentional and allowed for considerable variation across countries, as we will explore later in this article. Notwithstanding these differences, the binding norm must grant all institutions a high degree of autonomy, create competency-based appointment procedures, and count on adequate resources[10].

It should be emphasised that Member States have retained a considerable degree of freedom to design their independent fiscal institutions. Given that independent fiscal institutions in some Member States predates the legislative impetus at the European level in this area and recognising the diversity of national fiscal and administrative systems, no attempt has been made to impose a one-size-fits-all model in EU legislation. The aforementioned Common Principles of the Fiscal Compact, which were subsequently incorporated into the two-pack, set out only general minimum criteria, leaving Member States sufficient freedom to create or maintain institutions that suit their specific national circumstances. Member States retain considerable freedom with regard to the structure, mandate and resources of their international financial institutions, as long as the general requirements are respected.

In practice, the vast majority of IFIs were established in EU Member States only after the approval of the EU regulatory framework. Largely under the influence of the aforementioned legislative requirements, the number of IFIs has more than tripled in recent times: of the 35 IFIs that were present in EU Member States at the end of 2017, only 10 were operational in 2010. The shortest *seniority* in this group can be boasted by the Slovenian Fiscal Council, which started its activities in late spring 2017, and the Czech Fiscal Council, whose members were established in January 2018. It is also worth mentioning that 8 Member States (Austria, Belgium, Greece, Finland, Luxembourg, the Netherlands, Slovenia and Slovakia) have two institutions mandated to carry out the core functions of the IFI. In these cases, the division of tasks is usually organised so that there is a forecasting institution (responsible for providing the official macroeconomic forecasts used for budgetary planning)

[10] T. Tesche, Fiscal councils: A weapon against populism?, EUIdeas (20 June 2019), https://euideas.eui.eu/2019/06/20/fiscal-councils-a-weapon-against-populism/.

and a council with broader competences. This diversity of objectives is also reflected in how fiscal councils in the euro area have been designed and mandated. Indeed, the requirements set by EU law for their creation and reform have been implemented in different ways depending on the specifics of the constitutional system[11]. Some were originally designed to strengthen the executive (in Spain and Germany), some to strengthen parliaments (as in Austria and Italy), and some to strengthen the autonomy of already independent institutions (such as the Central Bank in Estonia and the Court of Auditors in France)[12].

3. Why does Poland need a fiscal council?

As emphasised in the literature, these institutions can contribute to increasing the transparency of the budget process, which is a prerequisite for increasing the degree of accountability of politicians and the political cost of irresponsible budget policy-making. One of the key challenges highlighted by the EU bodies in the context of the condition of Polish public finances is precisely the problem of the increasing scale of the Polish government's circumvention of the principles of pursuing an effective and transparent budgetary policy. For the first time, this significant problem was highlighted in the Council Recommendations of 9 July 2019 on Poland's National Reform Programme for 2019 and containing the Council's opinion on Poland's Convergence Programme for 2019 (2019/C 301/21). At that time, an increase in public expenditure as a proportion of GDP was noted. In doing so, it rightly pointed out that Poland's public finances will be exposed to upward spending pressures in the future, particularly to an ageing population. These factors reinforce the need to introduce new instruments to manage better expenditure, including regular assessment of its effectiveness and efficiency. Therefore, the Council recommended that the Polish government take further steps to

[11] European Commission, Report from the Commission presented under Article 8 of the TSCG, https://ec.europa.eu/commission/presscorner/detail/fr/DOC_12_2

[12] T. Tesche, The Troika is dead, long live the domestic troikas?': The Diffusion of National Fiscal Councils, Journal of Common Market Studies 2019, vol. 57(6), pp. 1211-1227.

increase the efficiency of public spending, including by improving the budget system[13]. The document also noted the need to establish a fiscal council in Poland (Fasone 2022). The Council recommendations of 12 July 2022 on Poland's national reform programme for 2022, containing the Council's opinion on Poland's convergence programme for 2022 (2022/C 334/21), reiterated that one of the major challenges facing the Polish government is to increase spending efficiency by addressing long-standing deficiencies in the budget process. These include complex and outdated budget classifications; sub-optimal recording of information; lack of viable medium-term planning and the fact that expenditure reviews do not directly affect the budget process. These factors increase the need for new tools to improve expenditure management, including regular evaluation of effectiveness and efficiency. The recommendations rightly point out that during the pandemic, most of the spending on COVID-19 measures was done through a special fund managed by the Bank of National Economy and through off-budget financial instruments. While this gave the government greater flexibility in managing crisis-related spending and avoided the risk of exceeding the constitutional level of public debt, it reduced parliamentary scrutiny of spending and public access to up-to-date information on public spending. For this reason, taking into account the level of central sector deficit outside parliamentary control, according to data collected by Eurostat, Poland ranked first among the large EU countries and second among all EU countries (behind Cyprus). By comparison, as many as 16 EU Member States do not have a deficit outside parliamentary control[14].

From a structural deficit perspective, Poland was already not well prepared before the pandemic crisis. The European Commission highlighted this in its 2022 report on Poland. According to the European Commission, public finances could have prepared better for the pandemic. Poland did not take advantage of the good economic situation before the COVID-19 pandemic to prepare its public finances for the downturn. The Polish economy was developing dynamically then, the labour market situation was the most favourable

[13] European Commission. Country report Poland 2019 (2019/C 301/21), https://eur-lex.europa.eu/legal-content/PL/TXT/PDF/?uri=CELEX:32019H0905(21)&from=EN.

[14] European Commission. Country report Poland 2022 (SWD(2022) 622 final). https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52022SC0622&qid=1647478307912

ever, and Poland's main trading partners were experiencing strong economic growth. Instead of preparing public finances for the downturn, Poland implemented costly policies that not only burdened its public finances in the short term, but also generated high long-term liabilities (e.g., income-independent social benefits for families with children and pensioners and reversal of earlier reforms, e.g., extending working lives)[15]. As a result, while most EU countries were generating surpluses before the pandemic, Poland was running budget deficits. Consequently, Poland was among the three countries (alongside Hungary and Romania) with the most worrying structural state of public finances. In its forecasts, the European Commission also highlighted a sharp increase in the average cost of servicing Polish debt. In 2023, according to European Commission forecasts, Poland's average debt servicing costs will be the second highest in the European Union, with only Hungary incurring higher costs. High debt servicing costs will also increase the public finance deficit by an additional 1% of GDP[16]. Obviously, the phenomena mentioned above affecting the transparency and efficiency of public spending are not exclusive to Poland, as they are faced both by the old (e.g. Spain, Portugal, Italy) and the new Member States (Cyprus, Romania or Hungary). However, given the fact that, according to estimates by the Institute for Responsible Finance, in 2022, the deficit not included in the state budget accounted for more than 80% of the real central sector deficit, the analysis of the Polish case should be of particular interest[17].

It is also worth noting that the recommendations issued for Poland under the European Semester on improving the efficiency of public spending and the budgetary process, were also taken into account within the National Recovery Plan (NRP)[18]. As a result, the NRP, as a so-called milestone, formulates the demand for a significant reform of the fiscal framework (reform A1.1).

[15] European Commission. Debt Sustainability Monitor 2022, https://economy-finance.ec.europa.eu/system/files/2023-06/ip199_en_UPD.pdf

[16] European Commission. Spring 2023 Economic Forecast: an improved outlook amid persistent challenges, https://economy-finance.ec.europa.eu/system/files/2023-05/ip200_en_1.pdf.

[17] M. Serowaniec, The Debudgetization of Public Finances in Poland After Covid-19 and the War in Ukraine, *Politics and Governance* 2023, Vol. 11 (4), https://doi.org/10.17645/pag.v11i4.7242.

[18] Recovery and Resilience Facility. Operational arrangements between the European Commission and Poland, https://commission.europa.eu/system/files/2022-12/Countersigned%20PL%20RRF%20OAs.pdf.

In the current version of the NRP, accepted by the European Commission, it is stated that *the overarching objective of the reform is to increase transparency and efficiency of public spending*. Undoubtedly, achieving this objective would be facilitated by establishing a fiscal council.

4. Summary

A growing body of empirical analysis in the literature confirms the effectiveness of fiscal councils in meeting expected fiscal targets. For example, OECD countries with fiscal councils showed primary budget surpluses and the rate of public debt reduction was faster than in the rest of the countries without an independent fiscal institution. The usefulness of independent fiscal councils for improving the quality of fiscal policy (mainly reducing its pro-cyclicality), reducing information asymmetries and improving the quality of government forecasts (the difference between planned and realised levels of fiscal volumes) is also confirmed by the conclusions of analyses using econometric models. However, it must be stressed that, in addition to the demonstrated and expected benefits associated with the introduction of fiscal councils, a drawback of this solution is the limitation of the influence of democratically elected representatives on the level and structure of budget expenditures and revenues, which is the most serious obstacle to delegating the mentioned tasks to such institutions.

Among the most important indications of the need for a fiscal council in Poland are the difficulties in maintaining budgetary discipline. These budget deficits have persisted since the beginning of the systemic transformation. Budget imbalances persist even in periods of economic prosperity, which testifies to the structural nature of the deficit. Moreover, this condition persists despite introducing fiscal rules and monitoring fiscal indicators at the supranational level. Another argument for establishing an independent fiscal council in Poland is the persistently low transparency of public finances, which will result in the need to stabilise public finances.

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