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Councils in the Western Balkans

## **Fiscal Rules and Fiscal Councils in the Western Balkans: EU Scorecard**

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# Outline

- DG-ECFIN methodology for the scorecard on fiscal rules, councils and medium-term frameworks
- Assessing the strength of rules, councils and medium-term frameworks in the Western Balkans using this methodology
- Preliminary analysis of effects

# Methodology for Fiscal Rules Strength Index

- For each fiscal rule:  $FRSI = \sum_{i=1}^5 \frac{Cr_i}{MV_i} w_i$ 
  - $Cr_i$  is the score of each criterion;
  - $MV_i$  is the theoretical maximum score for each criterion; and
  - $w_i$  is the weight of each criterion (equal weighting scheme).

## Criteria:

1. Statutory/legal base of the rule	3c. Nature of the body in charge of monitoring the correction mechanism in case of deviation from the rule
2. Room for setting or revising objectives	3d. Independent body providing/endorsing macro/budgetary forecasts
3a. Nature of the body in charge of rule monitoring and the correction mechanism	4. Correction mechanisms in case of deviation from the rule
3b. Real-time monitoring	5. Resilience to shocks or events outside the control of the government

## Scoring pattern, ex.:

	Criterion 2: Room for setting or revising objectives
	The target of the rule, as defined in its establishing act, cannot be changed or temporarily suspended by the Government except in well - defined situations
3	
	Subject to parliamentary approval, the Government can either temporarily change the target or it is mandated to decide on the target
1	
	The government can change the target of the rule at any time without parliamentary approval
0	

## Country Fiscal Rules Strength Index

- For each country:  $C - FRSI = \sum_{j=1}^N 10 \cdot FRSI_j \cdot Cv_j \cdot \frac{1}{IR_j}$ 
  - $N$  is the number of all fiscal rules in the country;
  - $FRSI_j$  is the index value of the  $j$ -th fiscal rule in the country;
  - $Cv_j$  represents its coverage of general government (GG) finances; and
  - $IR_j$  represents its ranking of the fiscal rules

# Methodology for Scope Index of Fiscal Institutions

■ 
$$SIFI = \sum_{i=1}^5 \frac{T_i}{MV_i} L_i w_i$$

- $T_i$  represent the score of each task;
- $MV_i$  is the theoretical maximum score for each criteria;
- $L_i$  is the legal force coefficient for each criteria; and
- $w_i$  is the weight of each criteria (EU-oriented weighting scheme)

## Tasks:

1. Monitoring compliance with fiscal rules	4. Analysis of long-run sustainability of public finances
2. Macroeconomic forecasting	5. Active promotion of fiscal transparency
3. Budgetary forecasting and policy costing	6. Normative recommendations on fiscal policy

## Legal force coefficient:

1	Tasks stipulated in legal remit
0.5	Own-initiative tasks – proven and regular output
0	Own-initiative tasks – sporadic output

## Scoring pattern, ex.:

	Task 1: Monitoring compliance with fiscal rules
2	Monitoring both ex-ante and ex-post
1	Monitoring either ex-ante or ex-post
0	Monitoring neither ex-ante nor ex-post
0.5 or 0	<i>Bonus: Correction mechanism</i>
0.5 or 0	<i>Bonus: Monitoring of all general government rules</i>

# Methodology for Medium-Term Budgetary Frameworks Index

■ 
$$MTBF = \sum_{i=1}^5 \frac{Cr_i}{MV_i} w_i$$

- $Cr_i$  represent the score of each criteria;
- $MV_i$  is the theoretical maximum score for each criteria; and
- $w_i$  is the weight of each criteria (equal weighting scheme)

## Criteria:

1A: Coverage of the targets/ceilings included in the national medium-term fiscal plans	2C: there are well-defined actions to be taken in case of deviations from plans
1B: Coordination between sub-levels of government	3. Involvement of national parliament or use of a coalition agreement in the preparation of the national medium-term fiscal plans
2A: Connectedness between the targets/ceilings included in the national medium-term fiscal plans and the annual budgets	4. Involvement of independent fiscal institutions in the preparation of the national medium-term fiscal plans
2B: Objectives/ceilings are fixed in advance for a number of years and are not changed	5. Level of detail included in the national medium-term fiscal plans

## Scoring pattern, ex.:

	1A: Coverage of the targets/ceilings included in the national medium-term fiscal plans
3	It covers more than 90% of the general government
2	It covers between 70% and 90% of the general government
1	It covers between 50% and 70% of the general government
0	It covers less than 50% of the general government

# Fiscal Rule Strength Index for the public debt rule

WB6 countries and the EU member states from Central, East and Southeast Europe



Note: Rules for MK and RS should become effective in 2025. Rule for BA refers only to Institutions of BA, covering 5% of GG finance.

Source: DC-ECFIN for EU member states, authors' calculations for WB6

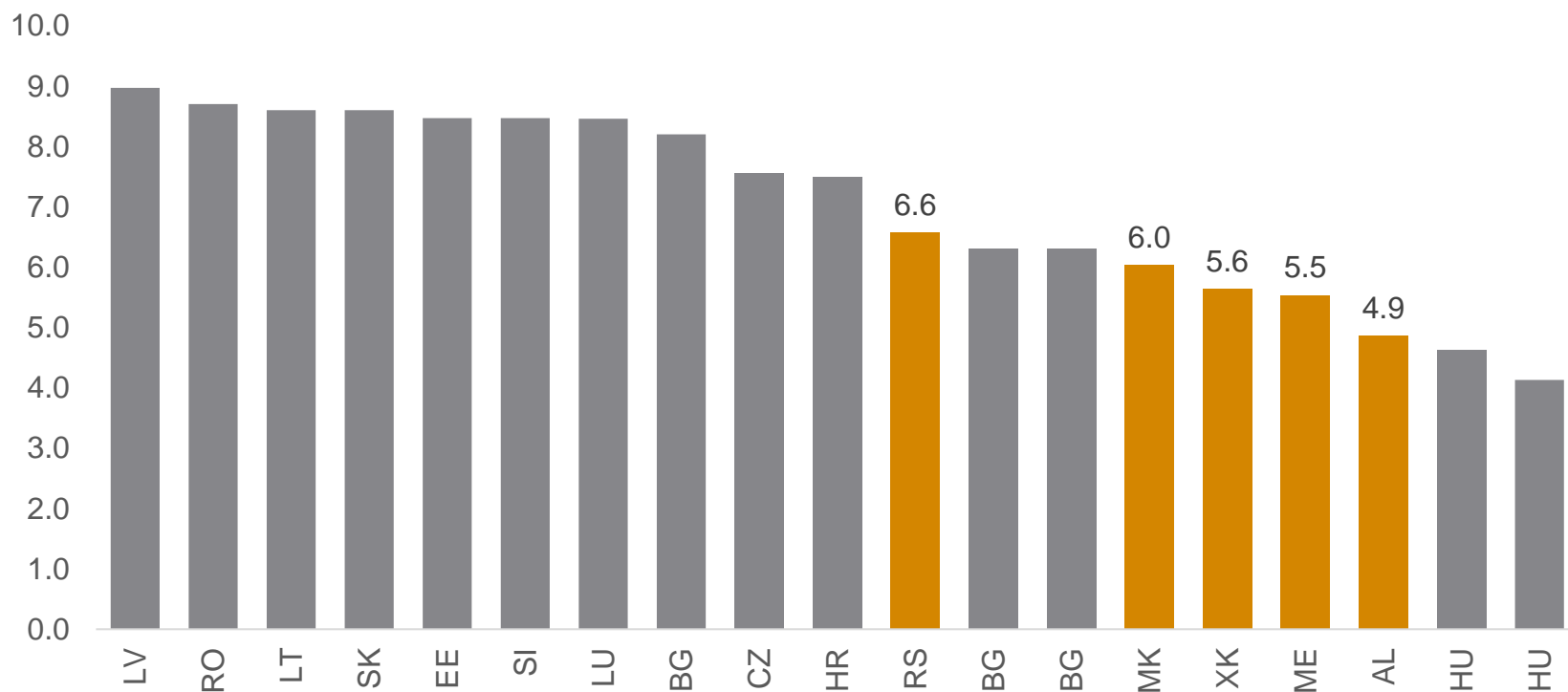
## **Areas where the WB6 debt rules don't score highly**

- They are not defined in the constitutions of the countries but in ordinary or organic laws
- There is no real time monitoring of the compliance
- There is no correction mechanism that is triggered automatically if the rules are broken
- The rules are not defined in cyclically-adjusted ways, which allows pro-cyclicality



# Fiscal Rule Strength Index for the budget balance rule

WB6 countries and the EU member states from Central, East and Southeast Europe



Note: Rules for MK and RS should become effective in 2025. HU has two budget balance rules.

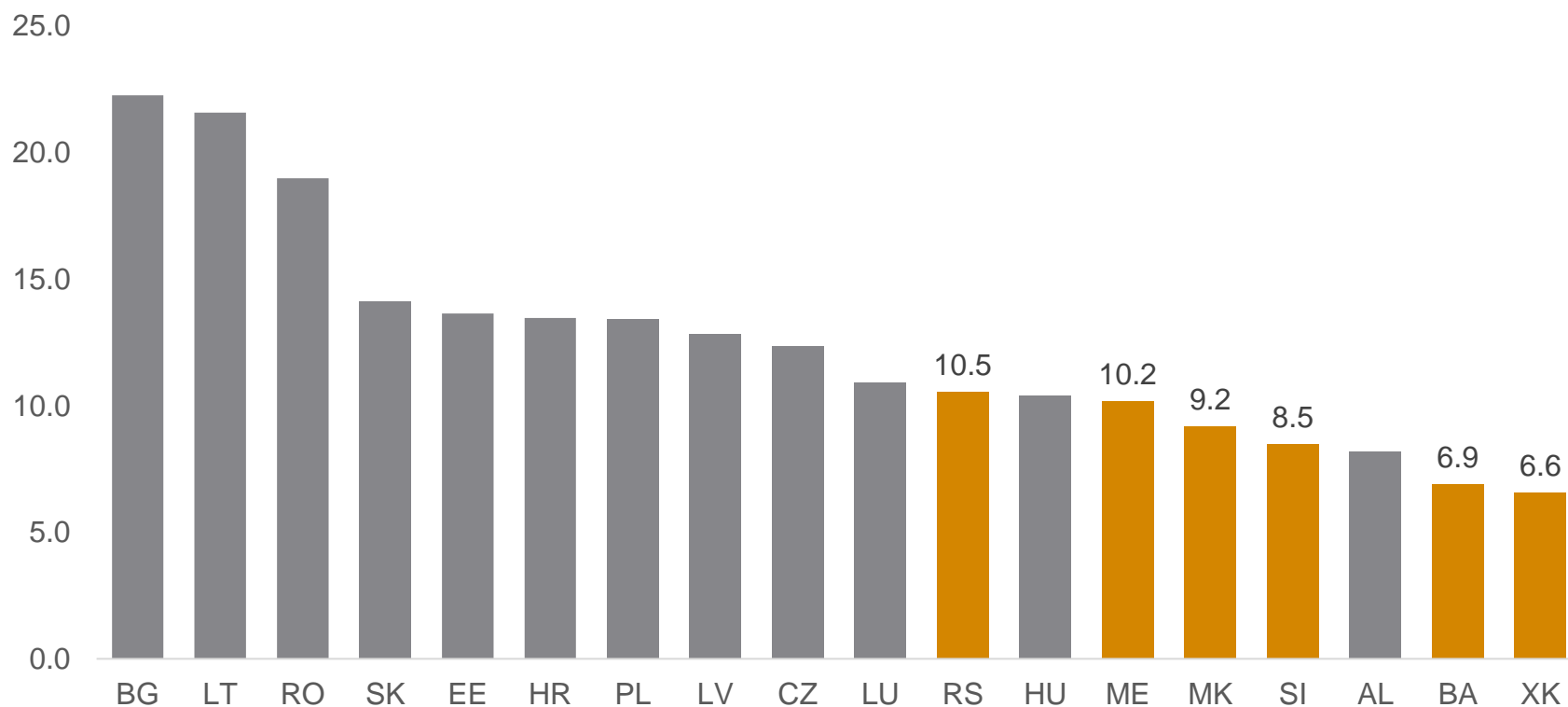
Source: DC-ECFIN for EU member states, authors' calculations for WB6

## **Areas where the WB6 deficit rules don't score highly**

- Same issues as with debt rules
- In addition, deficit rules in WB6 do not allow for exclusions from the rule of items that fall outside authorities' control at least in the short term

# The Country Fiscal Rule Strength Index

WB6 countries and the EU member states from Central, East and Southeast Europe



Note: Rules for MK and RS will become effective in 2025. The score for BA encompasses all the rules in the country, including the entity-level rules.

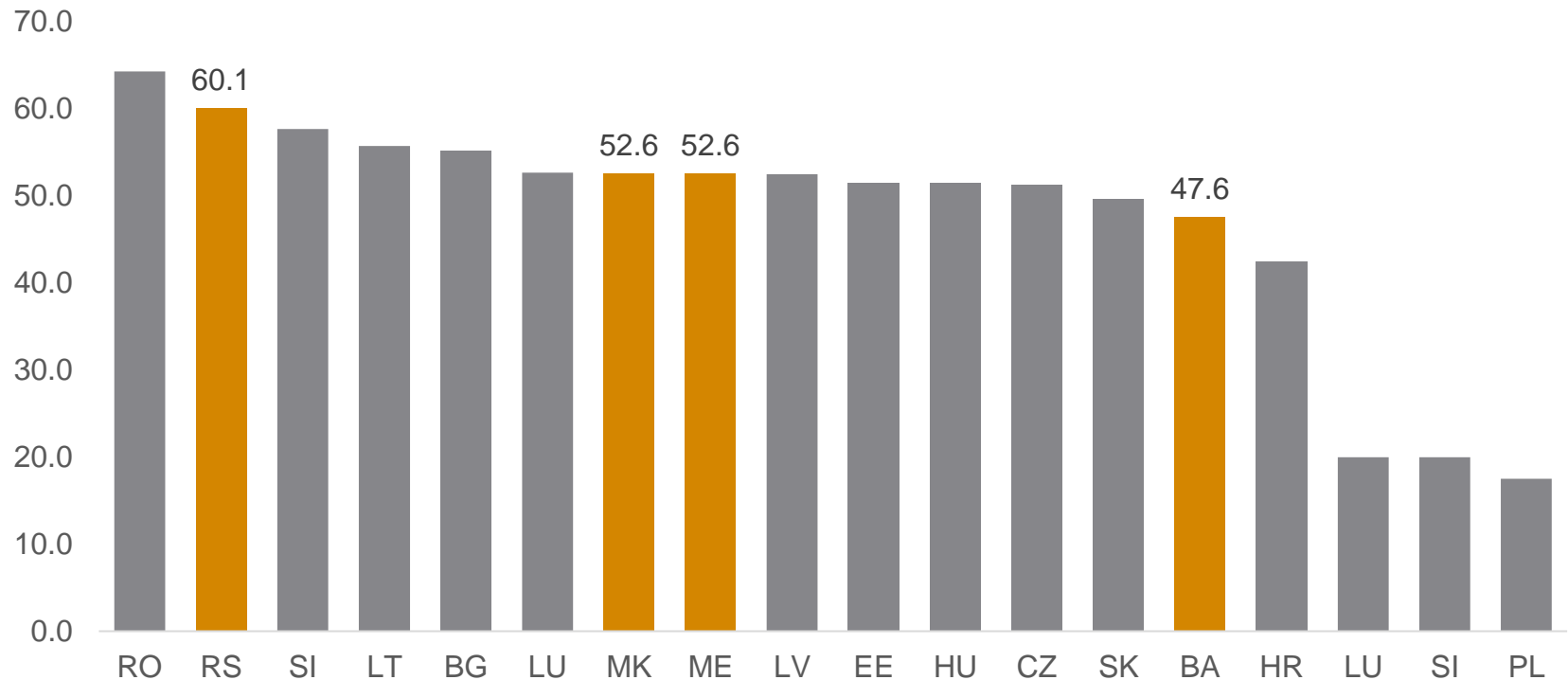
Source: DC-ECFIN for EU member states, authors' calculations for WB6

## Areas where the WB6 overall rules don't score highly

- In addition to the reasons mentioned above, the overall country rules in WB6 lose points because of the poorer coverage of the budgets in the Western Balkans.
  - All the general government budgets in the region exclude the SOEs, which reduces the coverage of the budget to between 84% and 90% of the public finances.
  - The exclusion of the SOEs may understate the levels of deficit and debt, as these enterprises often have high expenditures and debts, but low revenues.

# Scope Index for Independent Fiscal Institutions

WB6 countries and the EU member states from Central, East and Southeast Europe



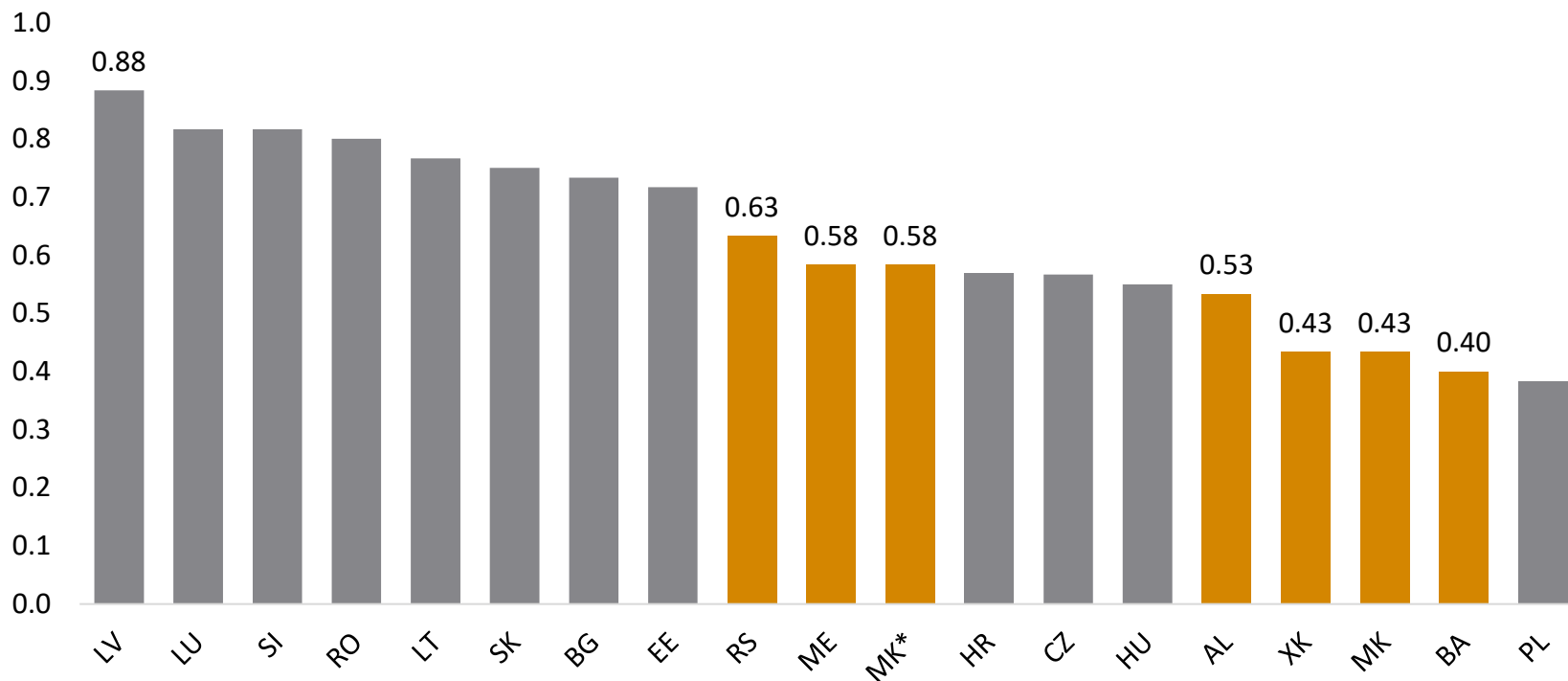
Note: The fiscal councils in ME and MK are not operational yet. The council in BA covers only the entity-level of Republika Srpska. Source: DC-ECFIN for EU member states, authors' calculations for WB6

## Areas where the WB6 fiscal councils lose points

- They do not produce macroeconomic forecasts, but in the best case just assess the forecasts of the ministries of finance
- They do not assess the forecasting accuracy of the official macro and fiscal forecasts
- They do not conduct long-run sustainability analysis
- Some do not actively promote transparency
- Some do not give normative recommendations on how the fiscal policy should be conducted

# Medium-term budgetary framework index

WB6 countries and the EU member states from Central, East and Southeast Europe



Note: MK\* refers to the new fiscal framework, that should become effective in 2025, MK to the current one. BA refers to the Global fiscal framework in the country, which is valid for the Government of the country, and the two entity governments.

Source: DC-ECFIN for EU member states, authors' calculations for WB6

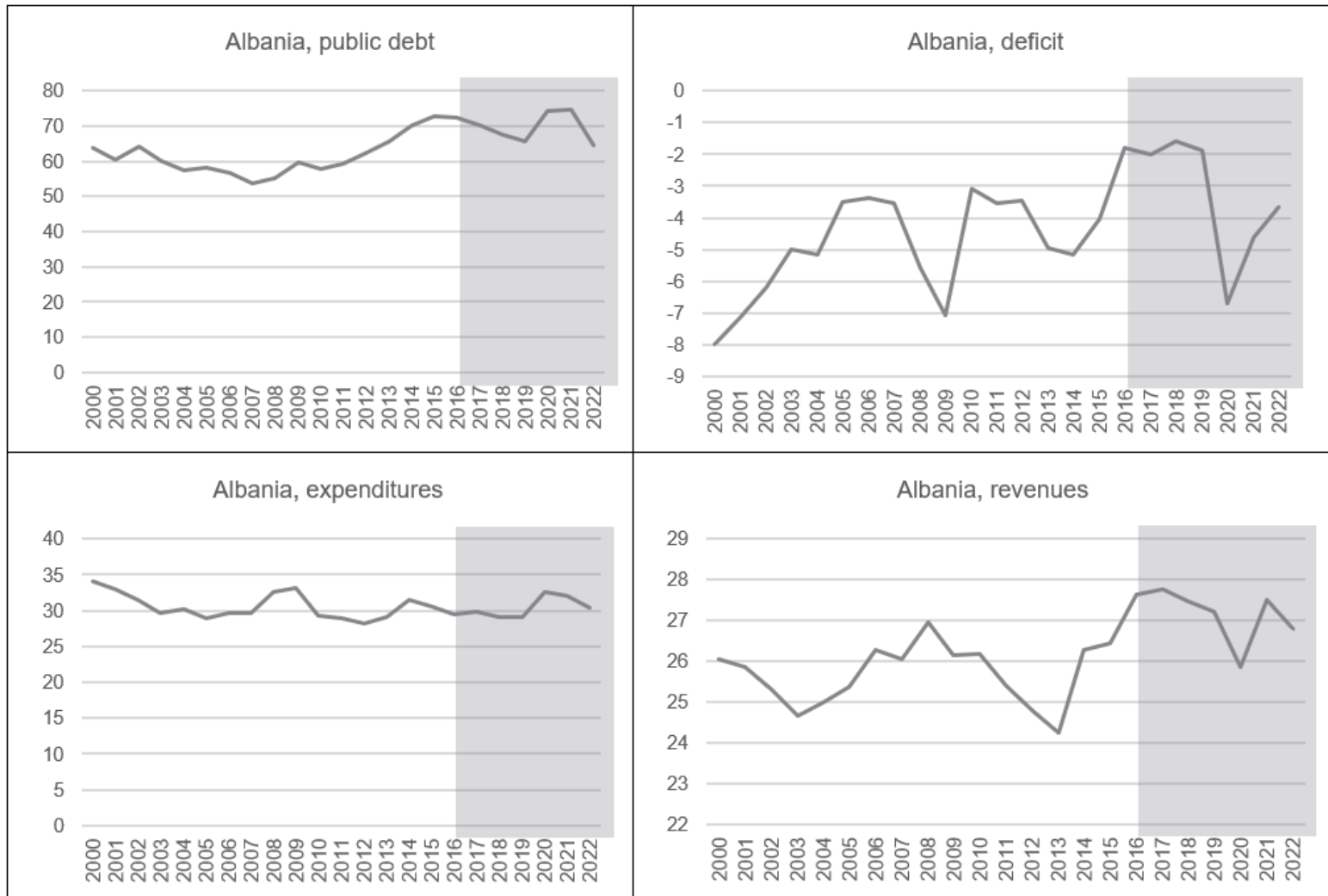
## **Areas where the WB6 medium-term frameworks lose points**

- There is no firm connection between the medium-term fiscal plans and the annual budgets
- There are no correction mechanisms in place if there are differences between the two
- The macro and fiscal forecasts used in the medium-term plans are not prepared or endorsed by the fiscal councils, but in the best case, only assessed



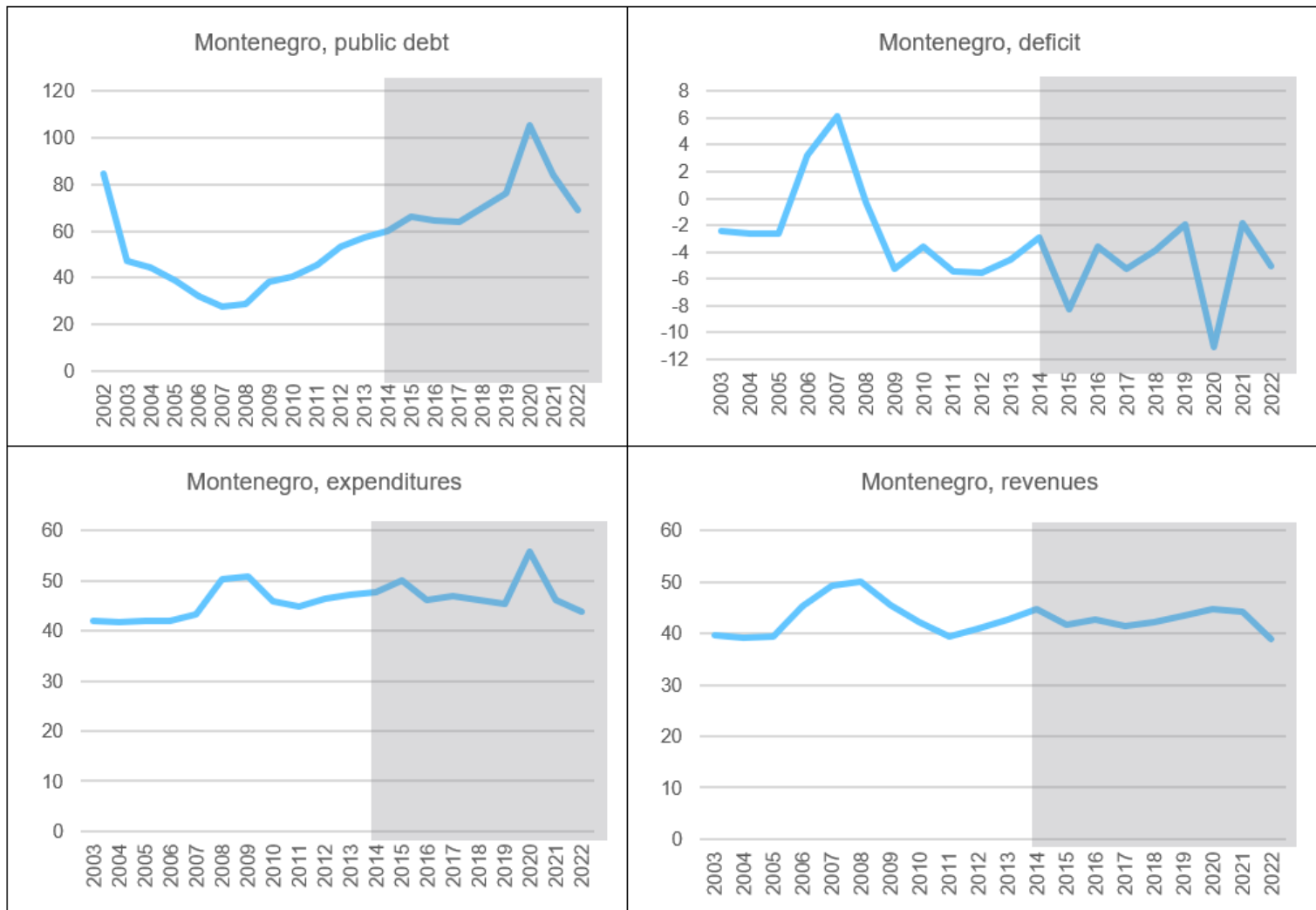
# **Descriptive analysis of effects**

# Fiscal outcomes in AL before and after the introduction of the fiscal rules in 2016



Source: The Vienna Institute for International Economic Studies

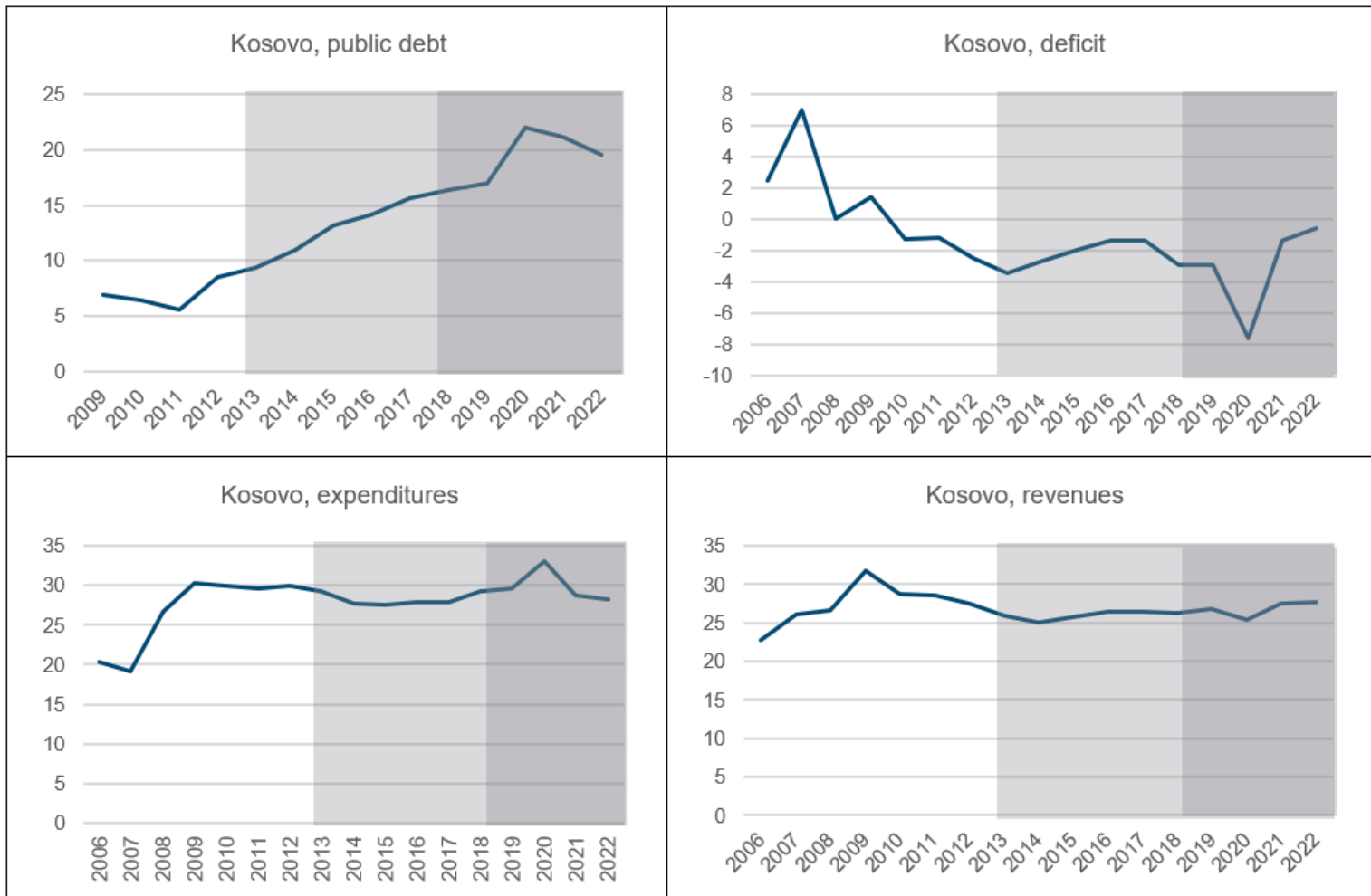
# Fiscal outcomes in ME before and after the introduction of the fiscal rules in 2014



# Fiscal outcomes in RS before and after the introduction of the debt and deficit rules and the council in 2011, and the expenditure rule in 2015

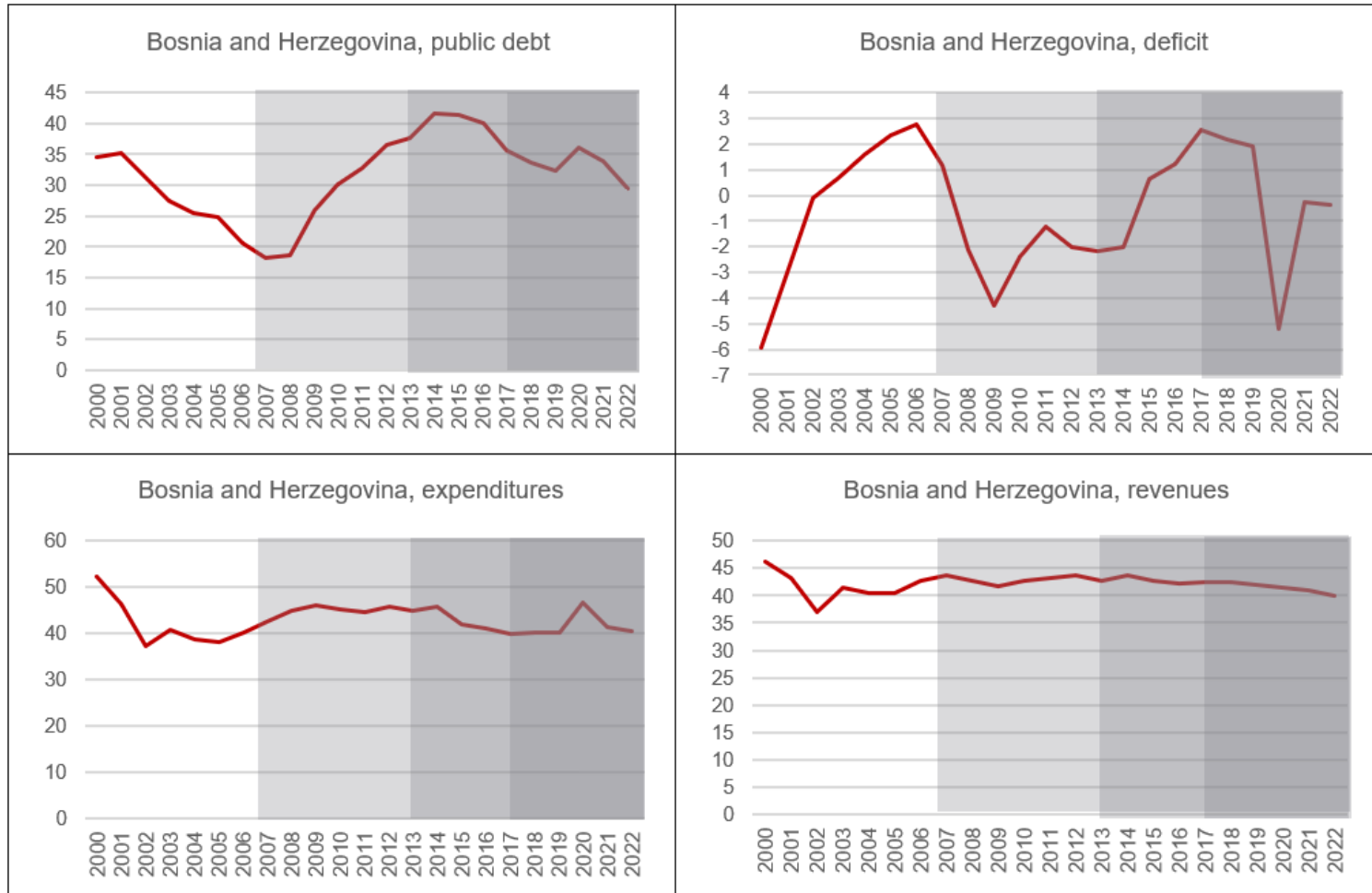


# Fiscal outcomes in XK before and after the introduction of the debt and deficit rules in 2013, and the expenditure rule in 2018



Source: The Vienna Institute for International Economic Studies

# Fiscal outcomes in BA before and after the adoption of the debt rule in FBiH in 2007, the adoption of the deficit rule in FBiH in 2013, and the establishment of the fiscal council in RSr in 2017



Source: The Vienna Institute for International Economic Studies

## Conclusions...

- Fiscal rules and fiscal councils are not a new thing in WB6 – some countries have had them for more than 10 years
- In general, rules and councils in WB6 are weaker than in other Eastern European countries
- Limited evidence that they have had effects on fiscal outcomes. This might be due to their general weakness, but also non-compliance
- There is a need to strengthen fiscal rules, councils and medium-term budgetary frameworks in WB6 to ensure greater fiscal discipline and a more predictable fiscal policy. But they are not a guarantee of debt sustainability.

## Conclusions...

- Western Balkans should ideally have fiscal rules that neither restrict investment nor growth to better accommodate economic convergence.
- The investment in human capital is important determinant of long-term economic growth in Western Balkans.
- Countries with less monetary policy headroom should be especially careful in restricting their fiscal policy.
- Benefits from big investments project cannot be taken as granted in the Western Balkans, without improvement of the institutional setting.





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