



Fiscal Council with Real Teeth: the Magic Solution?

Irena Jankulov

If Bosnia and Herzegovina wants to manage its future, it must manage its fiscal policy! There must be clear decision making process on how much of the public money will be spent, for what, will loans be taken, and, if borrowed, how the loans will be repaid. Without it, BiH fiscal policy would be condemned to limited ad hoc maneuvering and increasingly endangered of falling behind other transition economies.

At the moment, fiscal policy of Bosnia and Herzegovina is run on ad hoc basis. The country does not have a coherent countrywide fiscal policy rules or an institution responsible for setting and monitoring overall fiscal target. And yet what does this mean?

It means that the wallet of Bosnia and Herzegovina is not controlled, the money is spent by different levels of government autonomously without knowing or thinking how much money is still there and how will the wallet be filled again. So million dollar question is how to know what is going on?

And YES recently an institution was formed to address this problem – Fiscal Council of Bosnia and Herzegovina where Chairman of the BiH Council of Ministers, Entity Prime Ministers, and their colleagues, Ministers of Finance were talking about global fiscal issues.

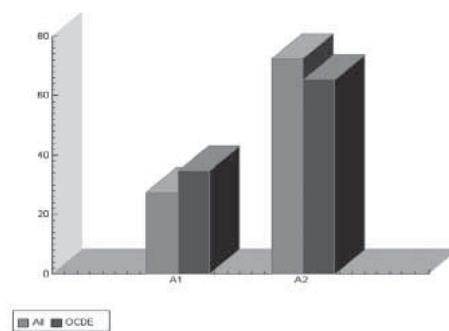
However, this is more less all that was achieved. There is no Fiscal Council Law, decisions are not binding, and since Office of the High Representative and International Monetary Fund stopped insisting on talking with the Fiscal Council, there has not been even a meeting of the Council.

Yet, is this institution so important and WHY?

Understanding the problem

International experience could help in better understanding the problem. It essentially entails choosing institution versus rules, or the mixture of the two, and explores where the ultimate fiscal and macroeconomic responsibility should be.

Many countries have adopted institutional mechanisms to facilitate fiscal coordination among different levels of government. The evidence shows that almost two thirds of total of 60 countries included in joint OECD and World Bank questionnaire on budgeting practices¹ have some fiscal rules limiting the executive fiscal policy discretion (Figure 1 where A1 means “fiscal rules do not exist”, and A2 “fiscal rules exist”).



Source: Joint OECD and World Bank

Figure 1 - Adherence to Fiscal Rules

The main driving factor in choosing the mechanism is country’s constitutional setting. Constrained by this internal environment, a country opts between achieving various fiscal objectives and applying different fiscal rules.

Interview results conducted and presented in the Study on “Fiscal Council-Magic Solution?” also support these findings. All main stakeholders in BiH agree over two things: (1) BiH lacks rules that would enhance fiscal coordination and, (2) if BiH wants to run prudent fiscal policy it should create a coordinating institution tasked to set, implement and monitor the guiding rules.

This policy brief is based on the Policy Study “Fiscal Council – the Magic Solution?” prepared by Irena Jankulov, MSc within the framework of Policy Development Fellowship Program of the Open Society Fund of BiH. Full report is available upon request on irena.jankulov@epn.ba

¹ For more information see <http://ocde.dyndns.org/>

Nevertheless, such institution was not created nor automatic mechanisms were embedded in the Dayton Constitution. Bosnia and Herzegovina has been organized as a multilayer country with 14 autonomous and highly interdependent Ministries of Finance belonging to different levels of government (State, FBiH, RS, Brcko District and 10 cantons) without someone in fiscal driving seat.

With the introduction of laws that allow local borrowings, consolidated fiscal position becomes even more vital. If a way to agree, implement and maintain these targets is not found, BiH jeopardises potential for its future economic prosperity.

International community pushed for addressing this problem and BiH pledged to set up a Fiscal Council. The Council was seen as a forum where top ranking politicians would make decisions on which level of government could spend how much. However, considering that there was no Law, the Council's decisions were not binding.

What can be done to improve the situation?

Respecting the theoretical concepts, on fiscal policy objectives², fiscal rules³, and bounded by political, economic, legal and cultural factors, four different policy alternatives could be isolated:

1. Constitutional rule - would be a simple way to promote fiscal rules, but virtually impossible to implement at this stage. Furthermore, even if a set of numerical rules was embodied in the BiH Constitution, in any case there would have to be an institution monitoring compliance with the rules.

2. State level institution (such as the Ministry of Finance and Treasury) - assigning overall fiscal responsibility at the state level might be seen as policy prudent behavior. However, it might be politically quite impossible to accomplish without serious rethinking of the Bosnia and Herzegovina institutional setting.

3. Intergovernmental coordinating body

- considering that fiscal policy would be in the hands of an intergovernmental body, thus agreed at a common panel is a major motivation of advocating this approach. However the question is whether there is potential to turn this approach into a success?

4. Status Quo

- Potentially, doing nothing is an option. However in this specific case, the decision on introducing an institution or a set of rules is simply a matter of time, and more the time passes, harder it will be felt in the country.

The Way Ahead...

At this stage of BiH development it is crucial to introduce an intergovernmental coordinating body - the Fiscal Council - preferably strengthened by a statutory commitment to at least two numerical rules, balanced budget and limits to debt.

In order to achieve this, **the Law on Fiscal Council should be adopted** where special attention would be given to.

1. The scope of work

- should be precisely defined and as policy oriented as possible. The Councils would be the place where decisions such as should country borrow more to finance investments or which region of the country should be given priority would be agreed. FC would also be responsible for statistical and accounting standards of the Government Finance, consolidated mid-term and long-term budget documents and adherence to harmonized budgetary calendar.

2. Membership and decision-making process

- In order to be efficient, the Council should not have too many members. Optimally, only State and Entity Ministers of Finance should be allowed to sit at the Council. However, political reality is suggesting that ethnic balance should be preserved. If this is the case, there must be some automatic, numerical criteria

Sustainability, macroeconomic stability, aggregate and allocative efficiency are all at stake in Bosnia and Herzegovina since there is neither institution nor binding fiscal rule guiding policy thinking.

² long-term sustainability, short-term stability, aggregate and allocative efficiency;

³ budget balance requirements, borrowing constraints, revenue-raising assignments, expenditure assignments and management, administrative aspects and expenditure management and process rules and enforcement mechanisms.



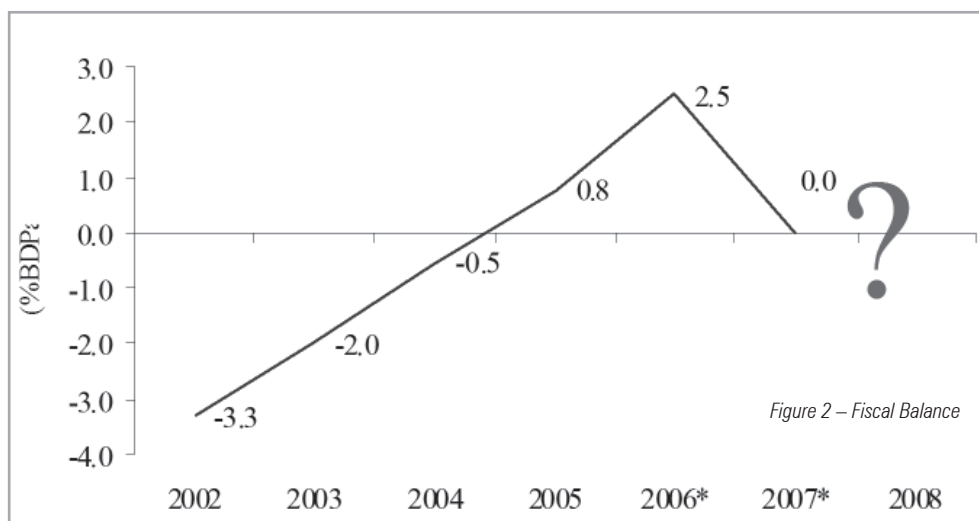
that would be activated in a case if the FC fails to reach a decision. Experience of using such criteria could be found in Stability and Growth Pact and the Maastricht Treaty, used by countries of the EU.

3. Implementation of Decisions - simply making a decision means nothing if it is not translated into actions. The coverage

of the governments' actions in this case depends on the coverage of its decisions. Hence, if a decision or a numerical rule is not honored, sanctions will be applied. Until a culture of respecting decisions is developed, it would be important to introduce as strict rules and penalties as possible in order to prevent irresponsible behavior.

To Conclude...

Ideal rule or an institution does not exist, and Bosnia and Herzegovina needs to find an appropriate mix that would allow it to take control over its fiscal policy, hence sustainability and growth. Political reality speaks that setting up the Fiscal Council is the only implementable option at this moment, although some strong legal commitments would be as important as well.



In the current system it is difficult to estimate what is the trend of fiscal balance, and almost impossible to manage its movements. However, if no action is taken soon, major fiscal earthquakes will shake the country and the actions taken now must be seen as preparations to counterbalance its magnitude.



Irena Jankulov was born on 31 December 1978 in Sarajevo. After receiving BSc in Economics degree from the University of Sarajevo, and a study visit to the USA, University of Montana, in 2003 she completed MSc studies at the University of Bologna, Economics Department in the field of development and international cooperation. She worked for World University Service BiH, Centre for international development of the Bologna University, Economic Policy Planning Unit (today's Directorate for economic planning) and the Chairman of the Indirect Taxation Authority Governing Board. Currently she works as a country economist for the IMF Sarajevo office on fiscal issues and key macroeconomic developments.

"The first lesson of economics is scarcity: There is never enough of anything to satisfy all those who want it. The first lesson of politics is to disregard the first lesson of economics."

Thomas Sowell



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A "Policy Development Fellowship Program" has been launched by the Open Society Fund BiH in early 2004 with the aim to improve BiH policy research and dialogue and to contribute to the development of a sound policy-making culture based on informative and empirically grounded policy options.

The program provides an opportunity for selected fellows to collaborate with the Open Society Fund in conducting policy research and writing a policy study with the support of mentors and trainers during the whole process. Twenty seven fellowships have been granted in three cycles since the starting of the Program.

All policy studies are available at www.soros.org.ba