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Italy's Parliamentary Budget Office: Issues and Challenges

“Fiscal Arrangements in Europe”, Berlin, June 24, 2013

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MINISTERO DELL'ECONOMIA E DELLE FINANZE

Can we clearly define what a Fiscal Council is?

- An old Indian story tells about a group of blind men touching an elephant to learn what it is like. Each one feels a different part and then **they compare the experience and learn that they are in complete disagreement.**
- The same may apply to the **Fiscal Council ...**



AGENDA

A long and winding road ...

- The evolving **EU fiscal framework** and related issues.
- The **institutional setting** in Italy.
- Sources of Italy's **deficit bias**.
- **Setting up** Italy's PBO: key topics to be addressed.
- **Some issues** at EU level.
- Defining a **Code of Practice**.



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Six Pack: broad guidelines only

- “Rules should be 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.”
- “Compliance of national correction mechanism [...] with the common principles laid down by the EC **monitored at national level by independent institutions**”.
- How can the monitoring function be performed?
- What is an “independent body” or a “body endowed with functional autonomy vis-à-vis the fiscal authorities”?



Two Pack: more specific

- “Member States shall have in place an **independent fiscal council for monitoring the implementation** of national fiscal rules...”
- “Forecasts from independent bodies can provide **unbiased and realistic macroeconomic forecasts.**”
- What does “monitoring of implementation” really mean?
- What is “unbiased and realistic”?



Italy's strengthened framework

- April 2012: a **constitutional amendment** introduced a **balanced budget rule**: it will enter into force in January 2014.
- July 2012: Parliament **ratified the Treaty** on Stability Coordination and Governance (Fiscal Compact).
- December 2012: Parliament approved Law 243/2012 which implements April's Constitutional amendment by detailing **balanced budget** provisions and establishing a **Parliamentary Budget Office** (a **fiscal council**, in line with the requirements of the renewed Stability and Growth Pact, Directive 85/2011 and Fiscal Compact provisions).



Italy's Parliamentary Budget Office - Mandate

- Italy's PBO is responsible for **monitoring public finances** and **compliance with numerical fiscal rules**.
- It is mandated to assess the **underlying assumptions** of fiscal and macroeconomic projections, as well as macroeconomic effects of **major legislative packages** and **public finance sustainability**.
- Moreover, it verifies activation of **corrective mechanisms** and assesses **exceptional events**.
- No role in policy recommendations or distributional conflicts.



PBO - Composition

- The **PBO governing body** is a 3-member board appointed by the speakers of the two Houses of Parliament.
- Absence from political interference is key. Members of the board shall be selected among **qualified persons** of recognised independence.
- Board members shall have a **6-year non-renewable mandate**.
- **Staff recruitment** shall be based on open competition and selection procedures (up to 30 staff units in the first 3 years, 40 later). Autonomy in selecting/dismissing staff.



PBO – Main features

- Full access to economic and public finance **databases** managed by public administrations.
- All public administrations must provide **information** on public finance developments as required.
- Adequate multi-year public **PBO funding** (6 million euros that can only be revised through the budget law, equipment and premises provided by Parliament).
- **PBO annual programme**, reports and analysis are to be public and published on the web site.



PBO – Comply or explain

- In case PBO assessments are significantly different from those of government, upon request of at least one third of Members of the Parliamentary Budget Commissions the government shall **explain to Parliament** the reasons why it intends to confirm its own assessments.
- Otherwise, the government shall **align with the assessments of the PBO**.

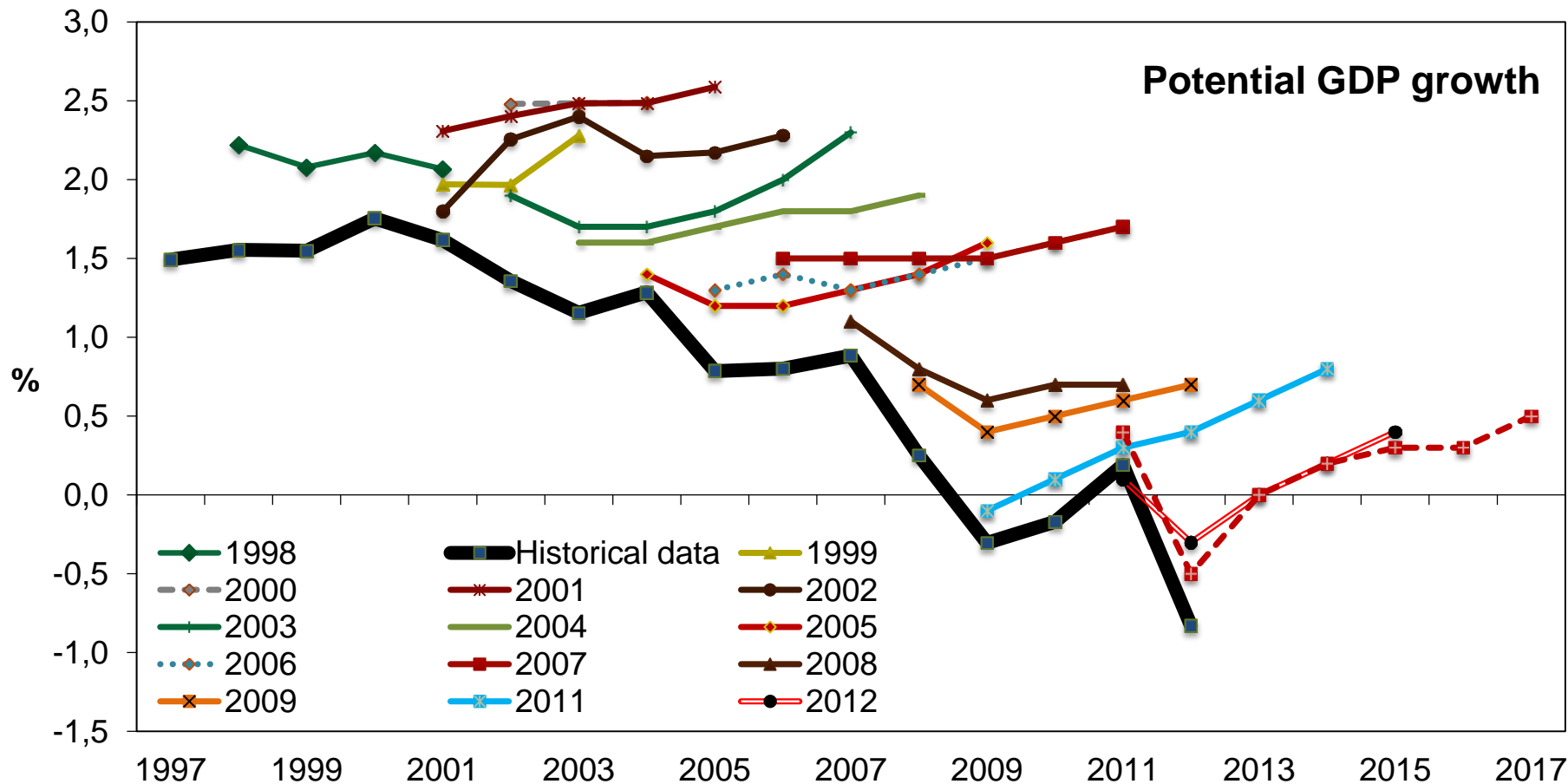


What are Italy's country-specific sources of the deficit bias?

- What are the **sources of the macro forecast errors**: real GDP? Deflator? How to calculate the bias?
- Where is the deficit bias coming from? The **spending side** or the **revenue side**?
- **Current legislation vs. current policies.**
- Bad forecasts or bad **ability to control** the expenditure side?
- **Decentralisation vs. centralisation**: issues of coordination.
- No **debt break**: is the newly-established EU debt rule enough? Or is there a risk of debt overruns?



Potential growth: consistently overstated, steady decline



Source: AMECO database for historical data; Italy's Stability Programme

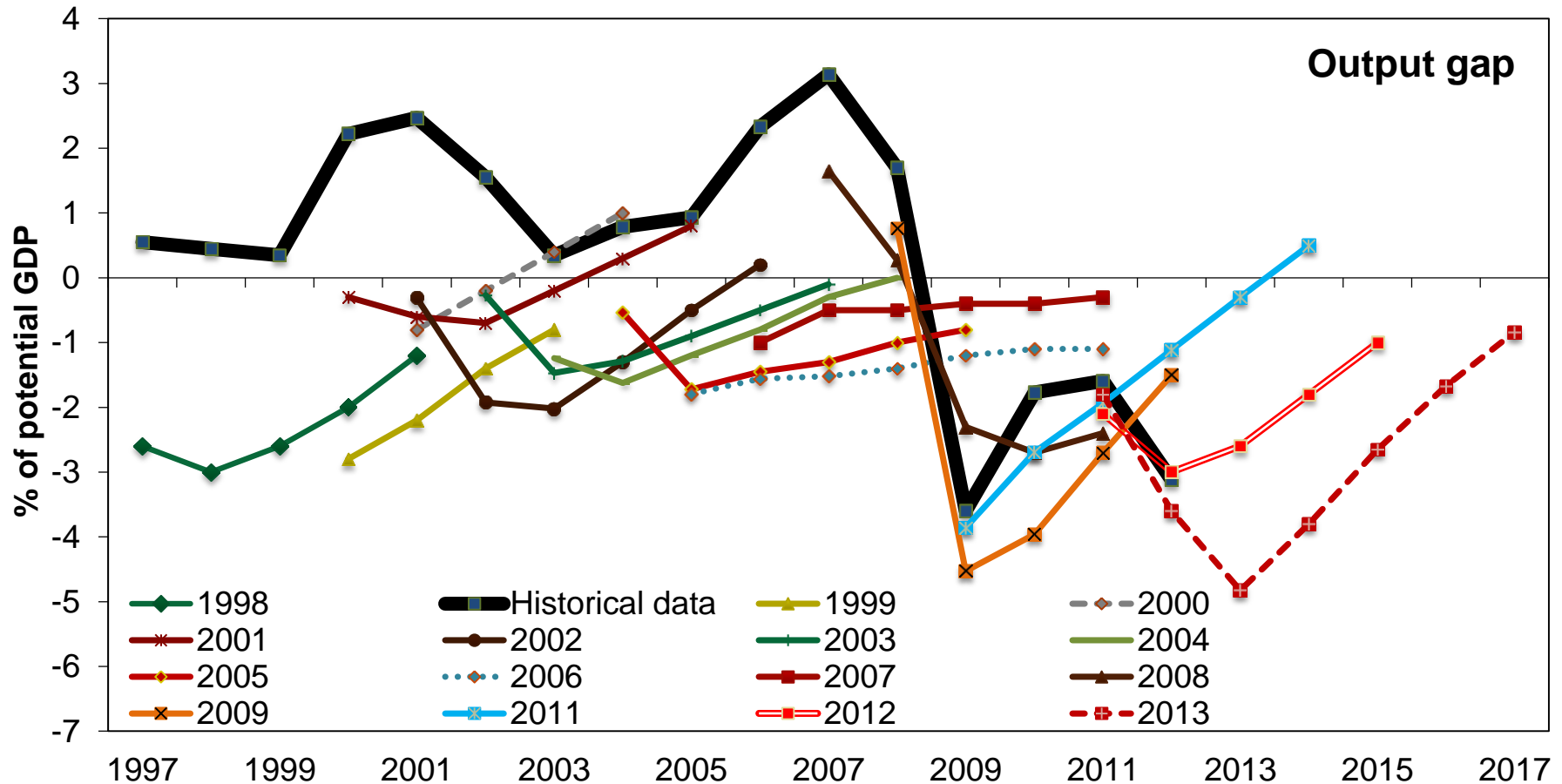
Note: In the 1998-2007 period, the Stability Programme was released in December; in 2008 and 2009, the document was published in February and January respectively; in the period 2011-2013, the document was released in April.



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Output gap: understated, at least until 2009



Source: AMECO database for historical data; Italy's Stability Programme

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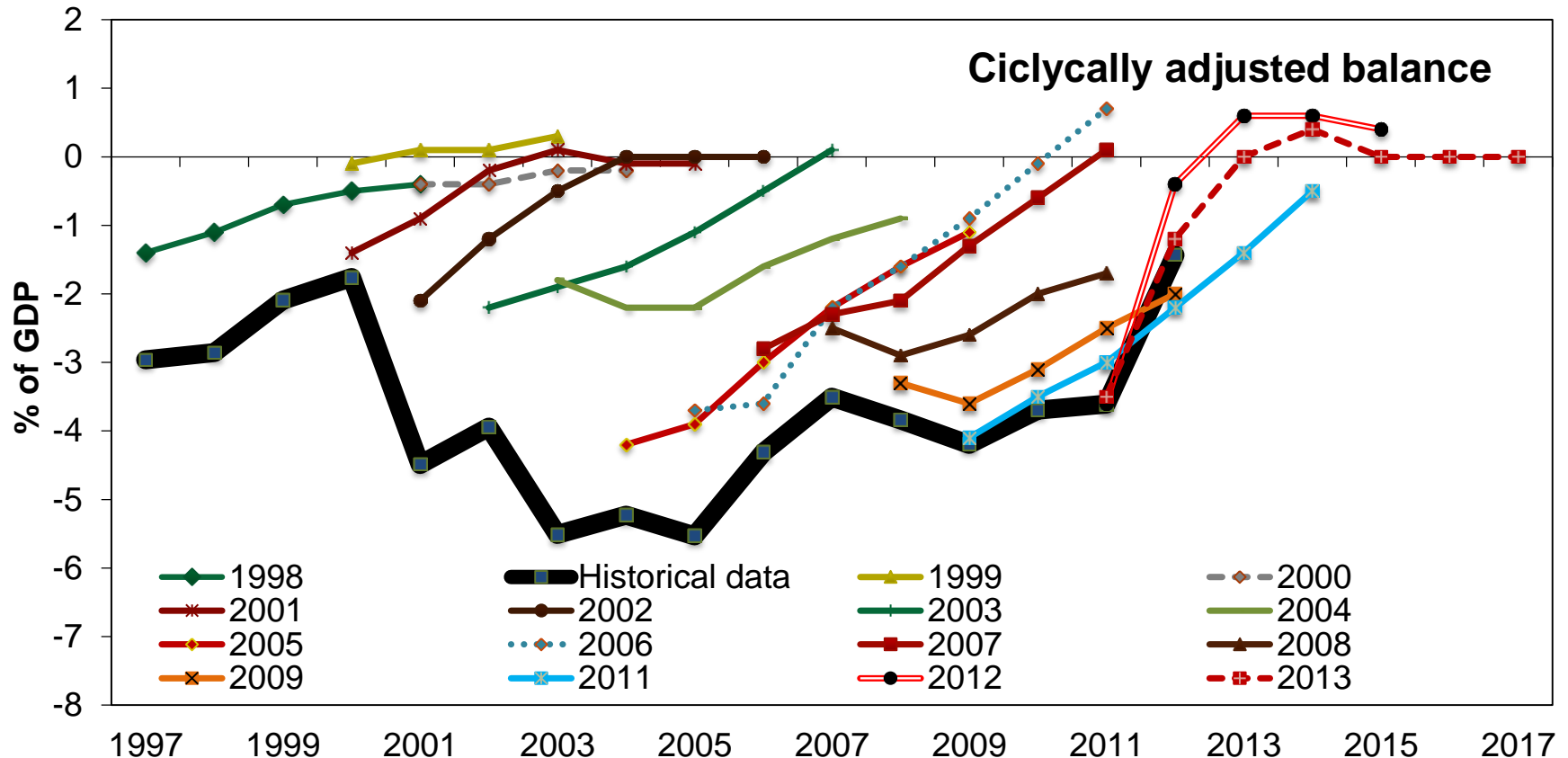


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Cyclically adjusted balance: as a result, CAB overstated



Source: AMECO database for historical data; Italy's Stability Programme

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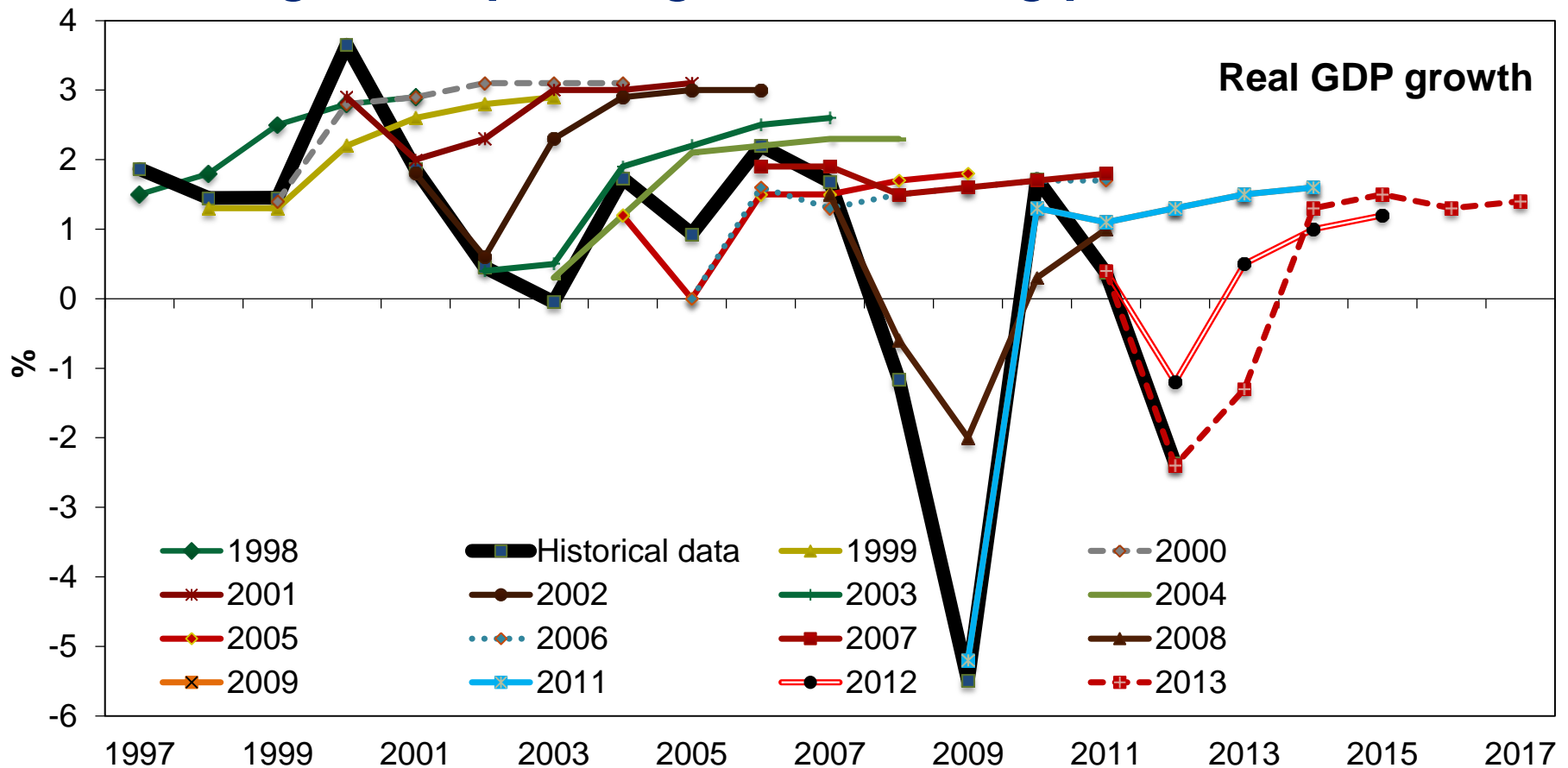
Note 2: In the 1998-2002, the ciclycally adjusted balance doesn't includes the one-off measures; in the 2003-2012, the one-off measures are included in the ciclycally adjusted balance.



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Real GDP growth: pointing to a declining potential



Source: AMECO database for historical data; Italy's Stability Programme

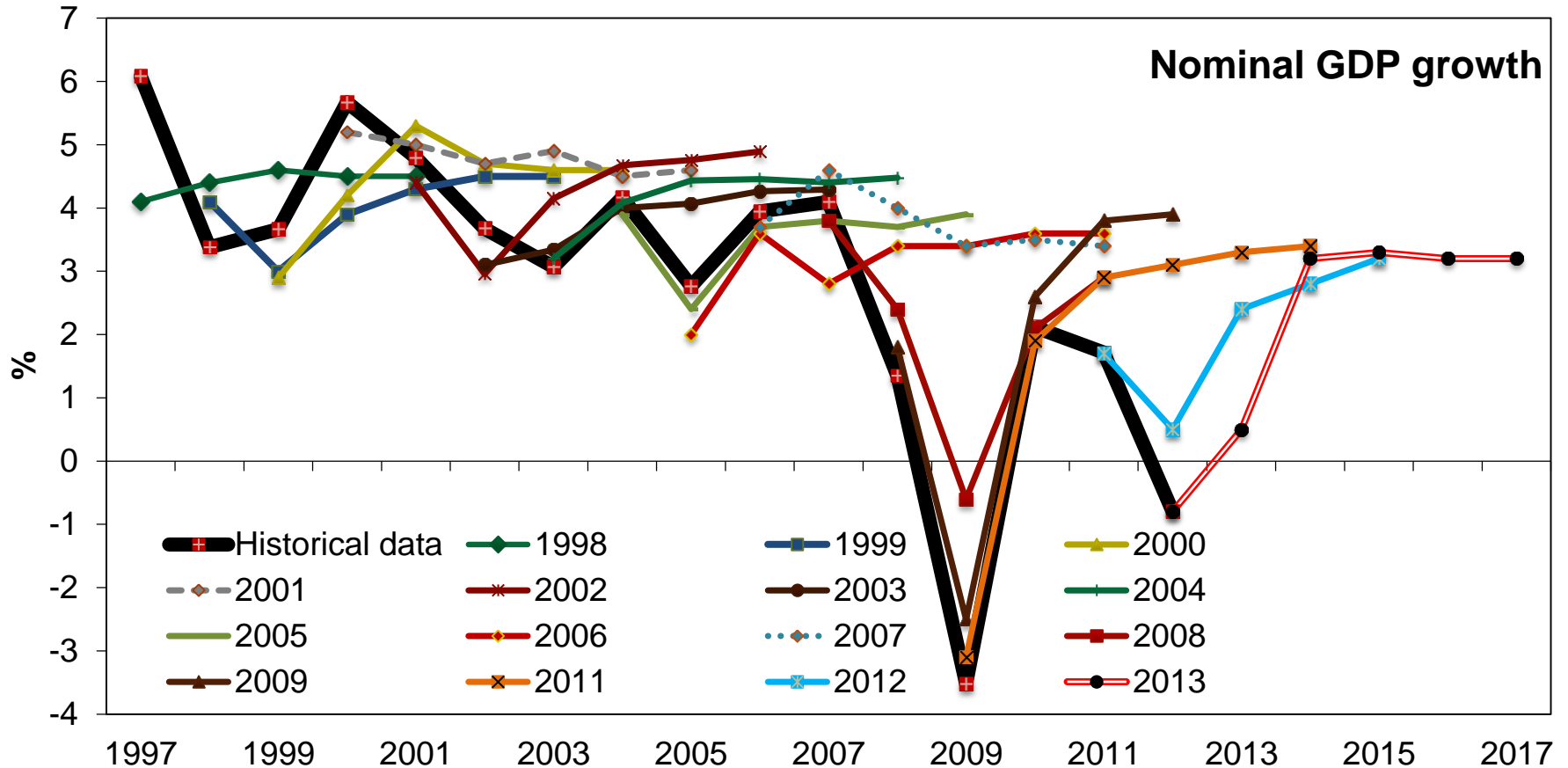
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Nominal GDP growth: similar picture



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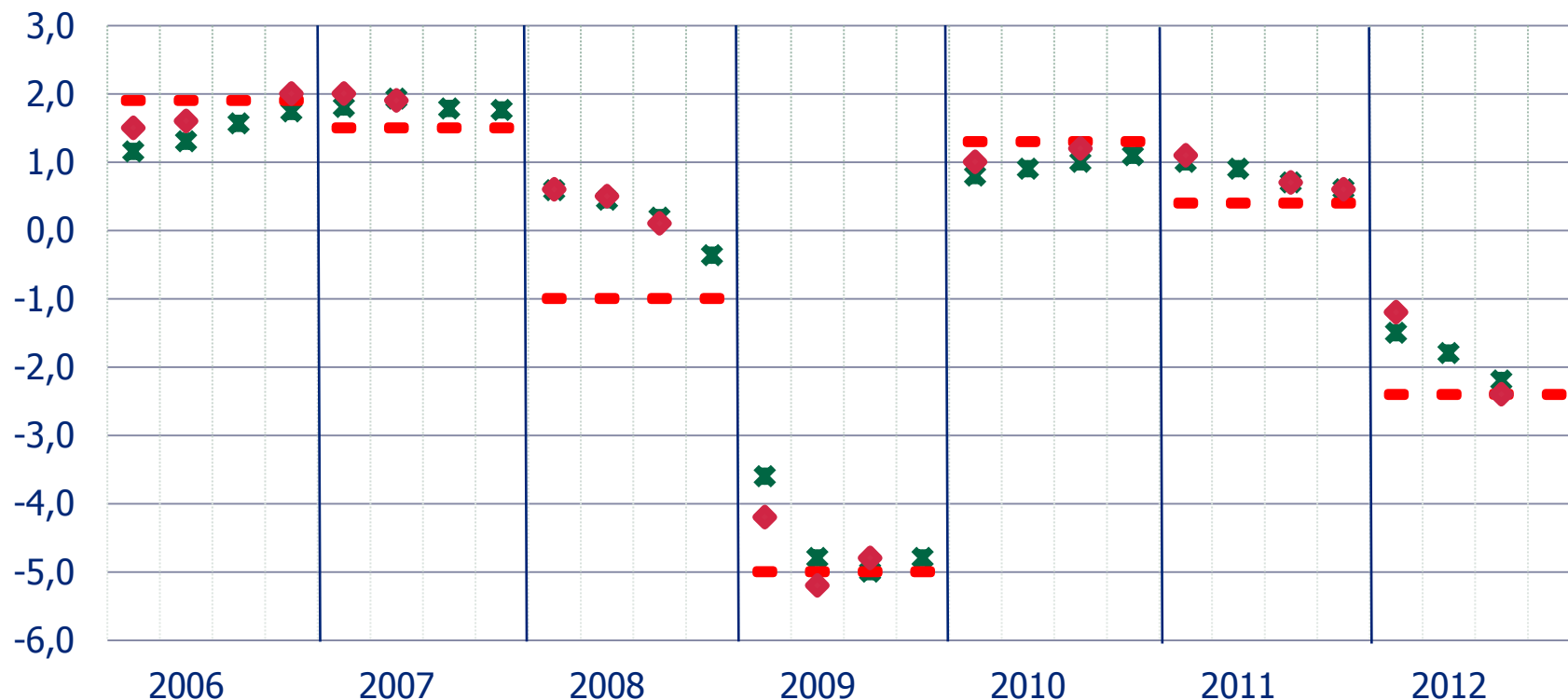


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Are forecasts biased?

GDP forecasts for the current year (t)



Year of the forecasts' release

✕ consensus

— GDP released by the national statistical institute (in real time)

◆ Official estimates

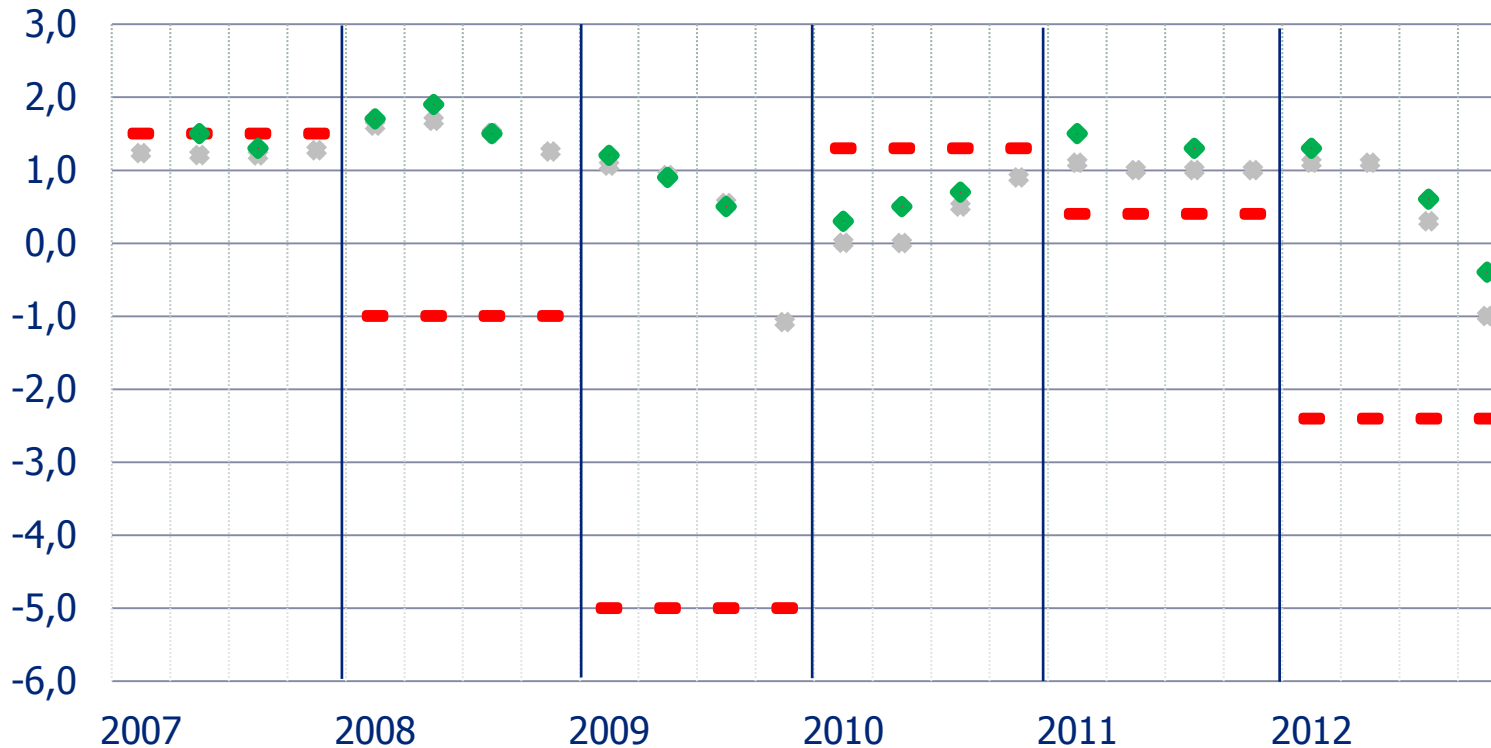


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Are forecasts biased?

GDP forecasts for the next year (t+1)



Year of the forecasts' release

● consensus

— GDP released by the national statistical institute (year t+1)

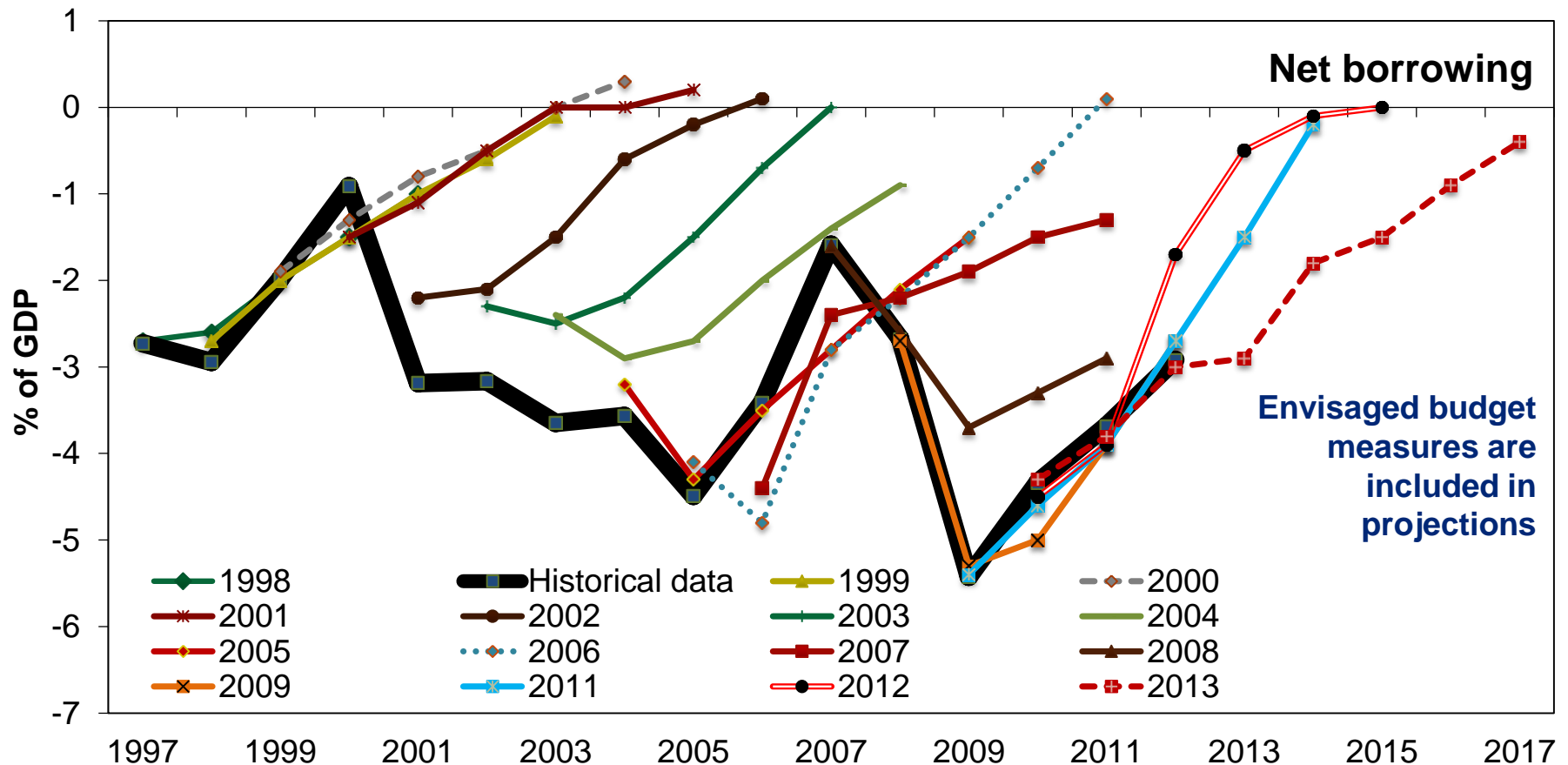
◆ Official estimates



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Net borrowing: not as bad as it looks in recent years



Source: AMECO database for historical data; Italy's Stability Programme

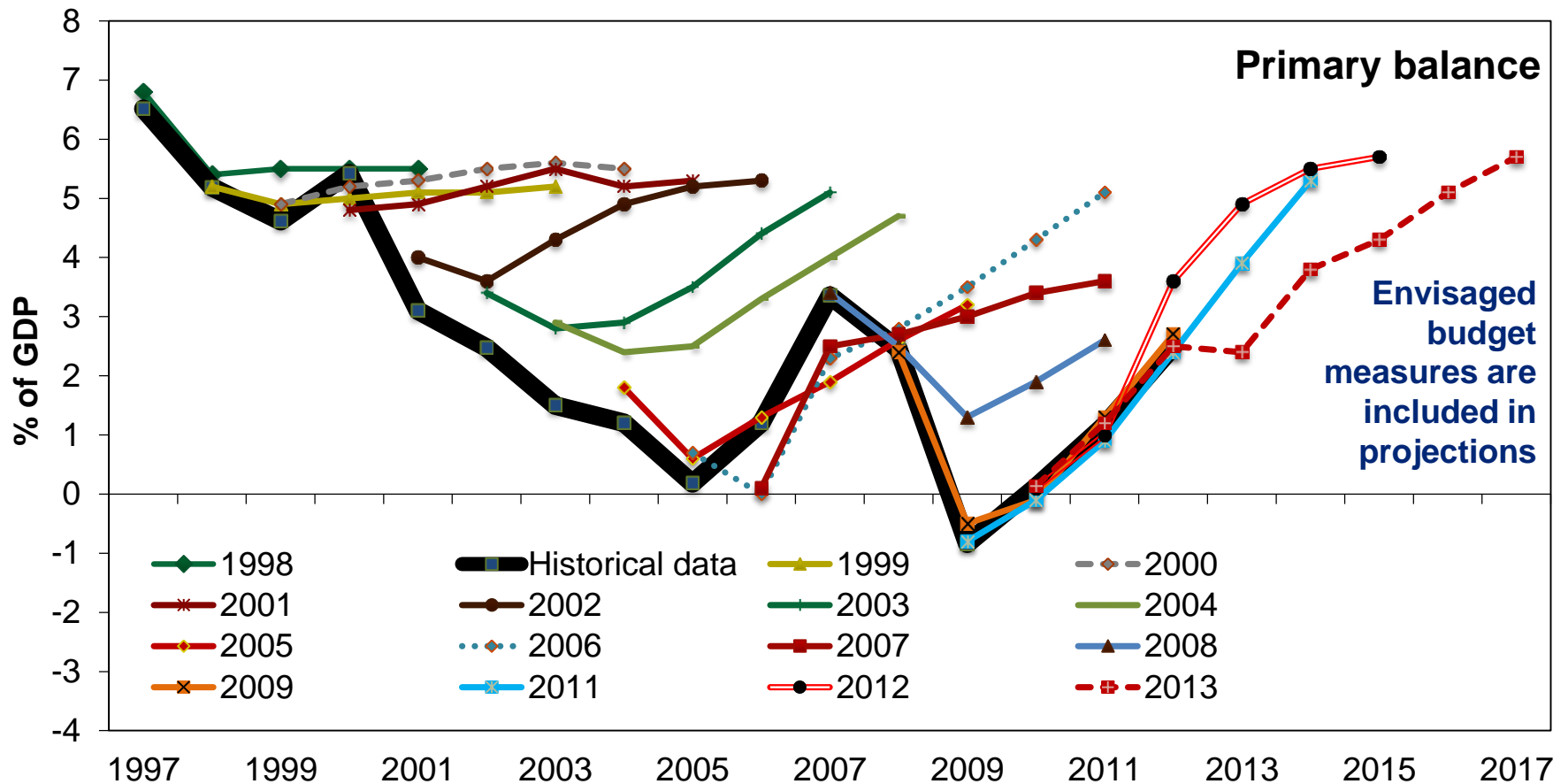
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Primary balance: again, not as bad as it looks



Source: AMECO database for historical data; Italy's Stability Programme

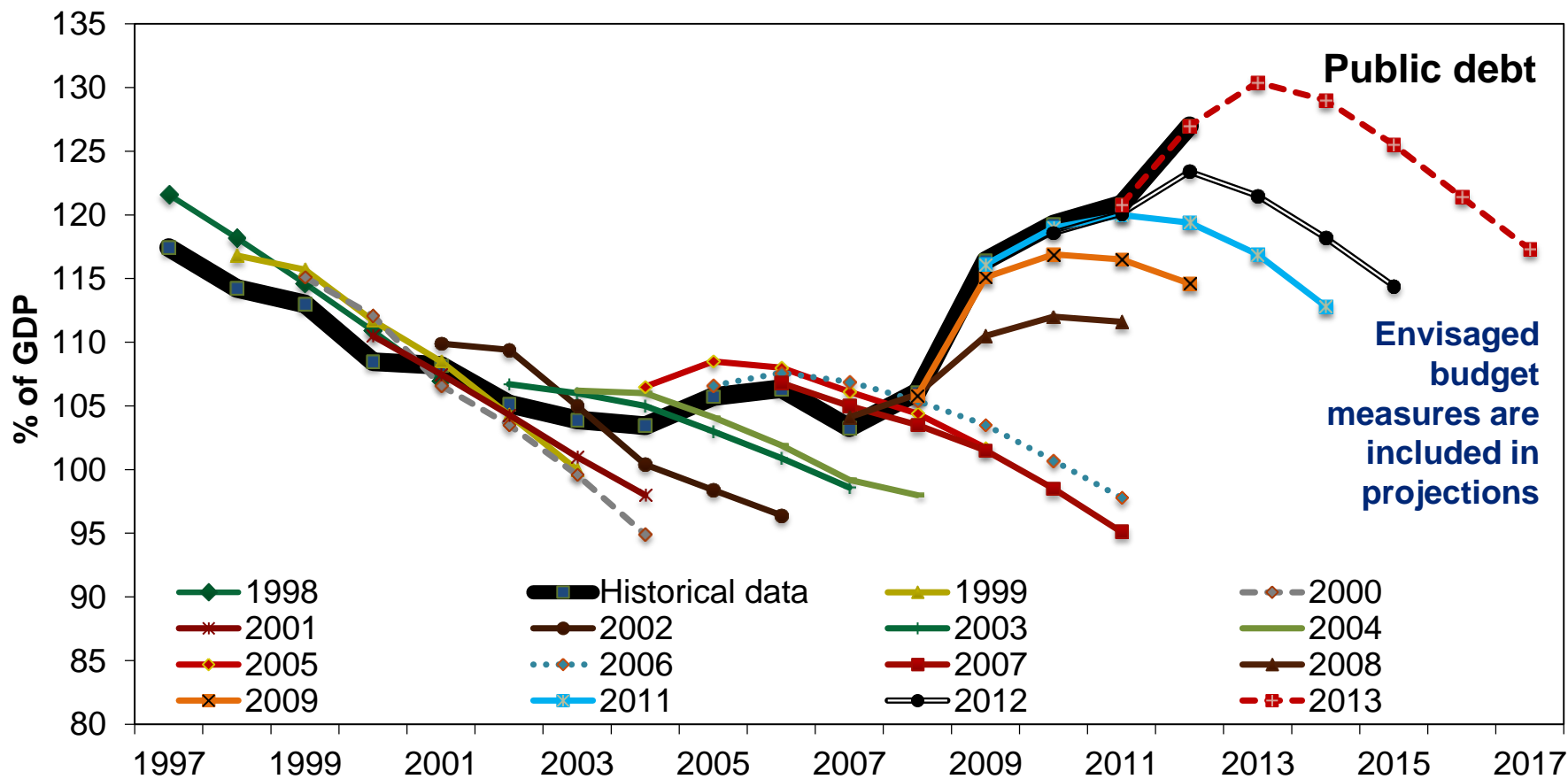
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Public debt: driven by a collapse in nominal GDP



Source: AMECO database for historical data; Italy's Stability Programme

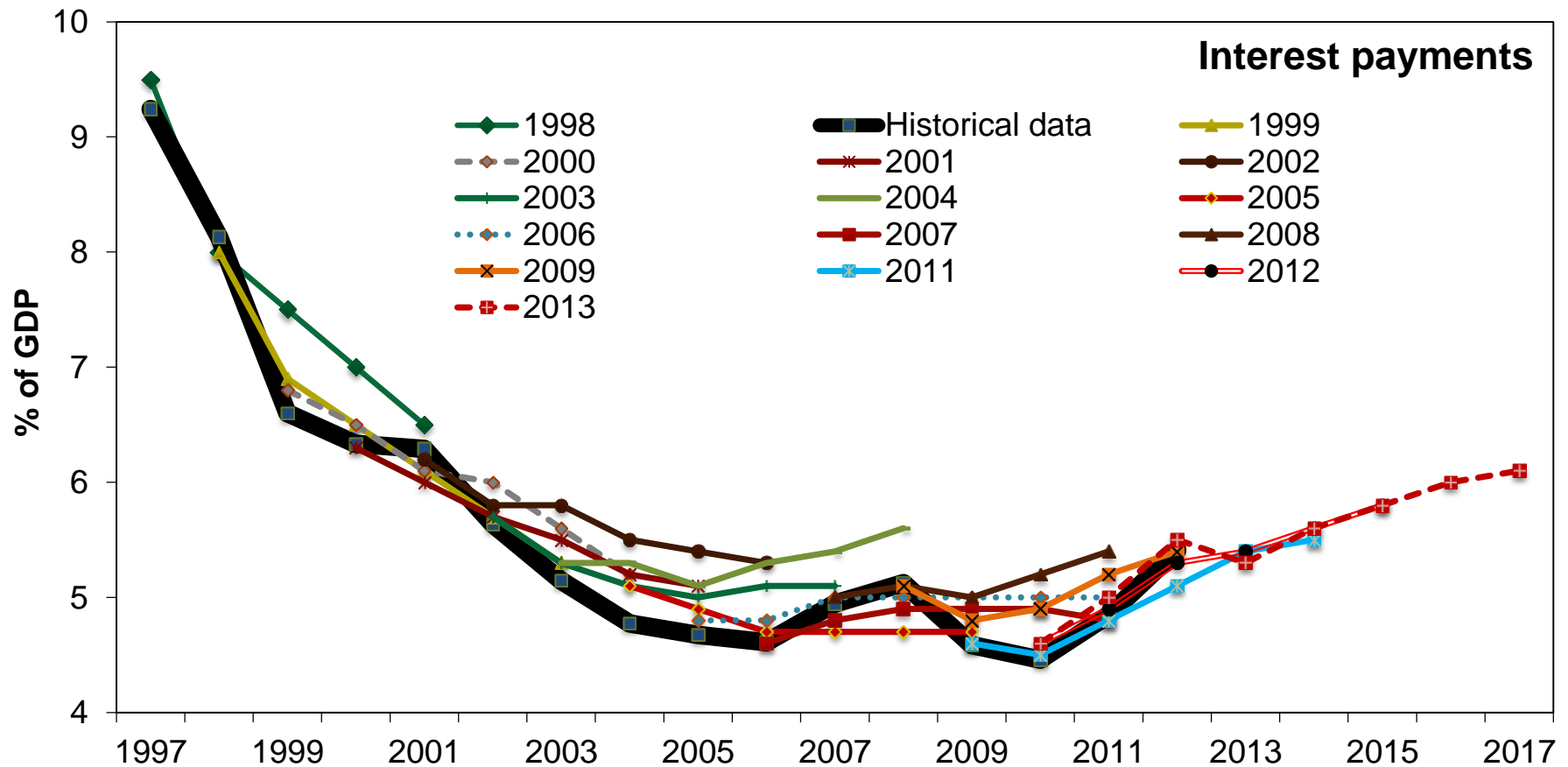
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Interest payments: some overstatement

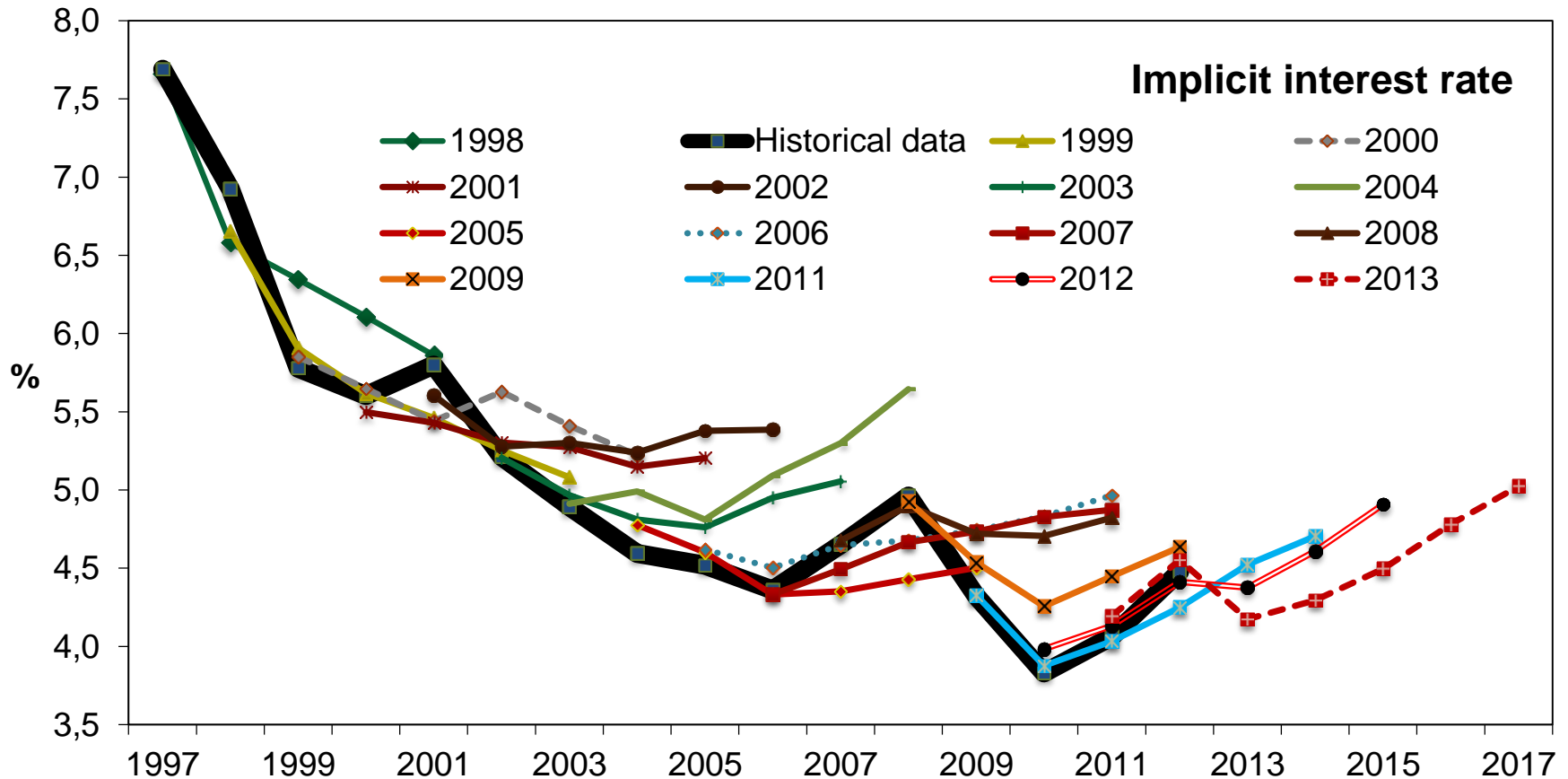


Source: AMECO database for historical data; Italy's Stability Programme

Note: In the 1998-2007 period, the Stability Programme was released in December; in 2008 and 2009, the document was published in February and January respectively; in the period 2011-2013, the document was released in April.



Interest rate forecasts: term premia and great moderation



Source: AMECO database for historical data; Italy's Stability Programme

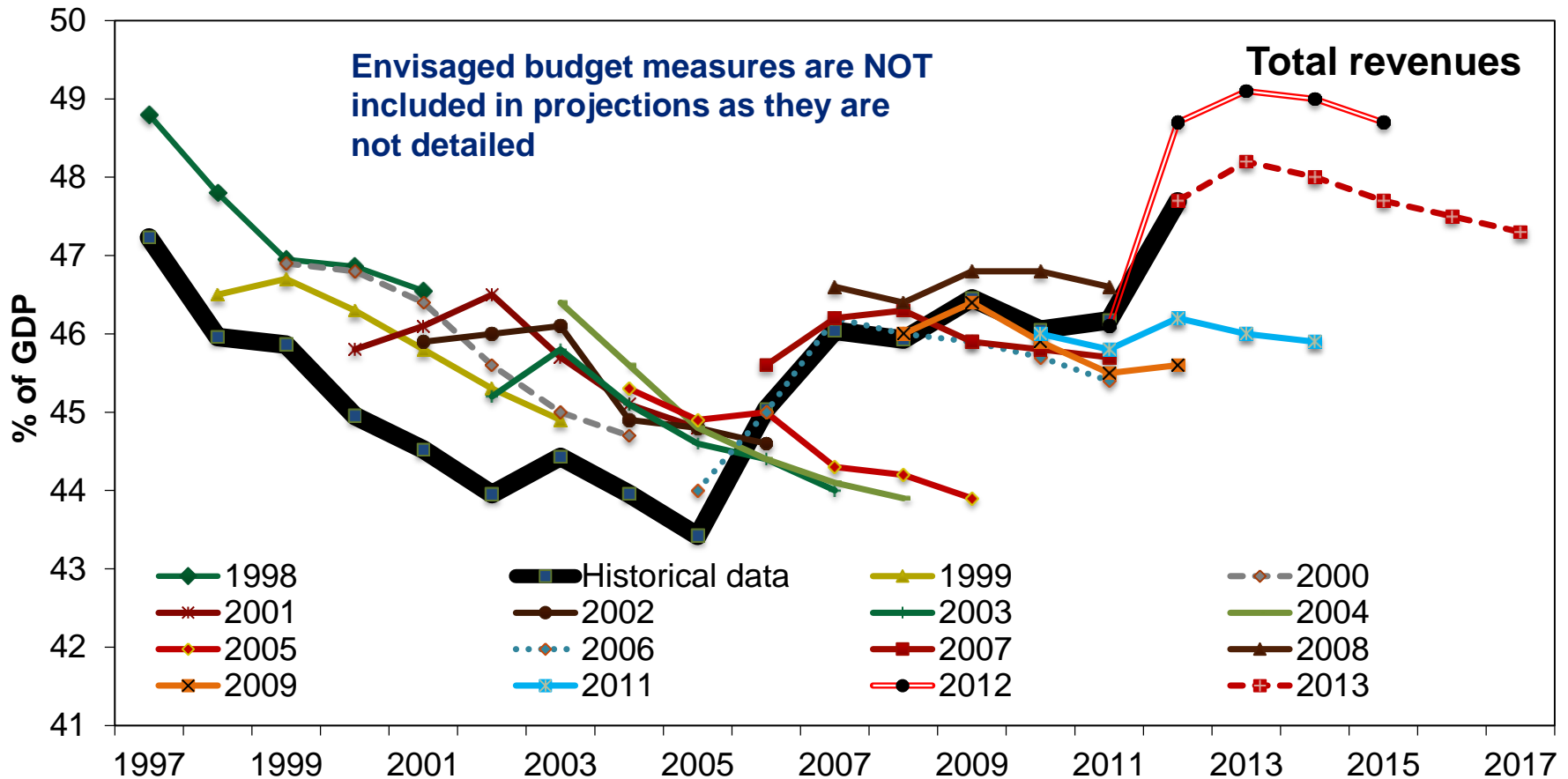
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Total revenues: missing targets but ... GDP, CL vs CP, BM



Source: AMECO database for historical data; Italy's Stability Programme

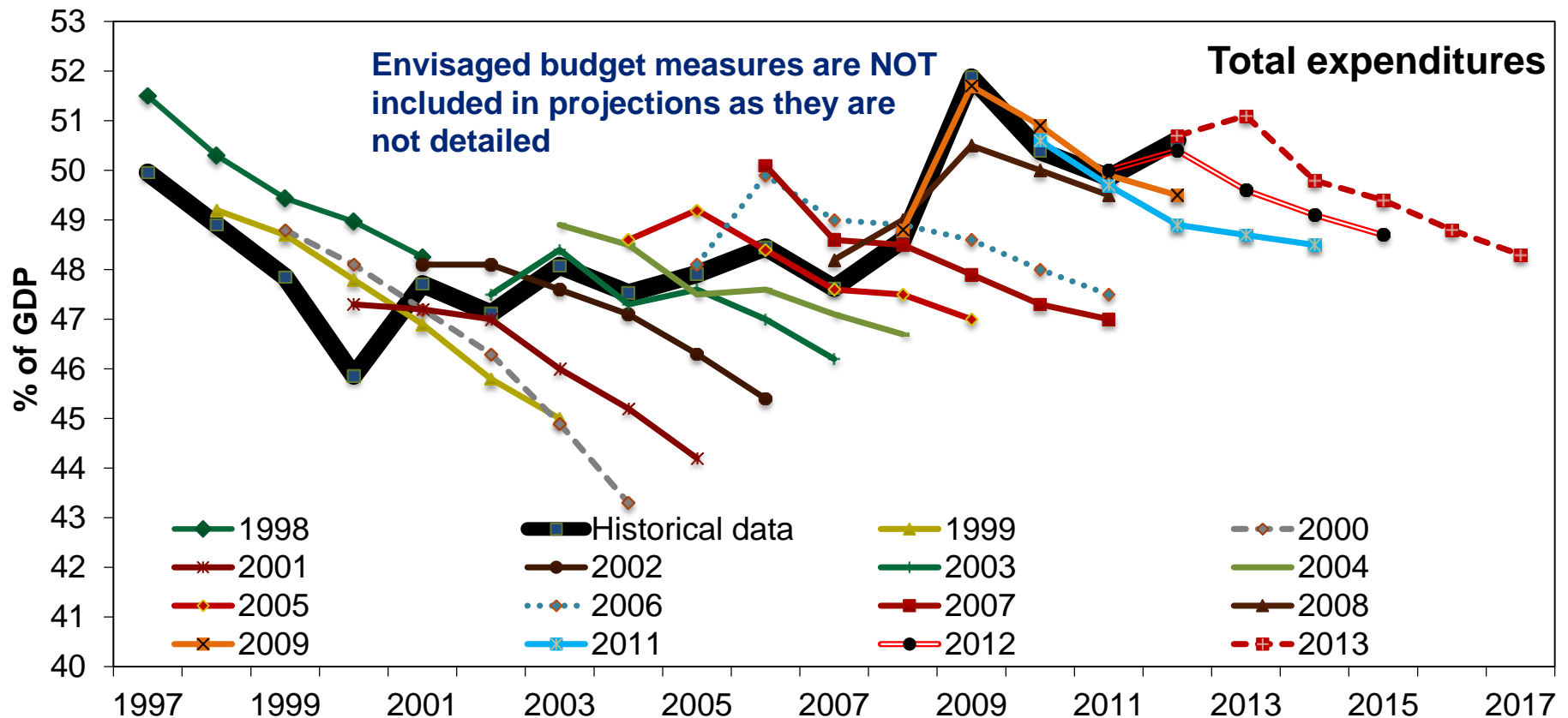
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Total expenditure: the major challenge for the PBO (CL vc CP)



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PBO: in line with best international practices, on paper ...

- How will the **election of the 3 Council members** be performed? (10-member shortlist selected by budget committees with 2/3 majority; speakers of the two houses then decide). How is the hiring of staff going to be implemented? Risk of selection based on party affiliation impinging on operational independence.
- How the PBO will fit into Italy's institutional fiscal framework which includes **several actors** (Treasury, State Accounting Office, Court of Auditors, the statistical office and the Bank of Italy) **different levels of government, technical and political bodies, different EU and internal rules.**



PBO: disclosure and transparency

- Will the PBO be able to **reduce information asymmetries** and enhance transparency? At the Treasury, we have already started to **publish on the website** all methodologies we use (CAB, impact analysis on GDP, sustainability analysis) and underlying hypotheses.
- Will the PBO raise the **reputational/ electoral reward (cost)** of (un)sound fiscal policy? Will it raise public awareness? How can the PBO make its **analysis public and effective in driving the policy debate**? A purely technical (neutral/unbiased) role but fully into the **political debate/must have political impact (Winnie-the-pooh effect)**.



Endorsing/making forecasts: the tradeoffs

- Is there a **forecast bias**: is it worthwhile to risk the **PBO credibility with forecasts**? (monitoring is a different business than making forecasts)
- **Establishing credibility** is not easy: what kind of superior knowledge does the PBO have in forecasting?
- **An pool of independent research institutes** may be a better solution, but they would not have full access to government information.



Broadening the scope of analysis ...

- **Areas of potential development:** implicit versus explicit liabilities, banking sector stability risks, macro-economic surveillance, risk analysis, spending review (especially health care, long-term care, with relevance for sustainability), long-term sustainability.
- **Advisory role:** how to achieve better budgetary outcomes? How to improve quality of public finance? Suggest how rules can be improved?
- **Accountability:** how can we measure PBO performance?



A few issues at EU level

- **Risks of duplication** at EU level: are the two main roles (making independent forecasts and checking compliance with rules) **overlapping with the role of the EU Commission?**
Issue of national ownership: EU offspring vs. potential conflicts.
- **Harmonisation or tailor-made solutions?** How important is to respect **country-specific features**? How important is to achieve a minimum level of **harmonisation** across the EU?



More fundamental issues at EU level

- Historically, the EU has put more emphasis on **rules**.
- As the implementation of rules got into troubles, the EU put more emphasis on **institutions**.
- What next? **Broad political consensus?** A **culture of stability?** Giving up **sovereignty?**
- **Endogeneity**: are FCs that make fiscal behaviour virtuous or are virtuous fiscal behaviour that call for FCs? We need to lower expectations on FCs.



How to establish an efficient dialogue?

- A clear **timetable** is key, but any schedule will be very tight.
- **Many actors** are already involved: PBO to become another actor, probably the most important one.
- Tricky if there is **disagreement**: if any, it is important that it comes very early in the process.
- **Maximum transparency** (website) to avoid any subsequent trouble. But transparency may imply also some risks.
- **Need for more details**: one-off factors, explain changes of forecasts and ex-post differences with actual outcomes, assumptions (interest rates, monetary policy).



PBO: if producing forecasts ... (Two Pack)

- “The forecasting procedure of the independent body or the specific section of the Code of Practice could include a **template for an annual schedule**. The annual schedule would take into account the **constraints of the domestic budget cycle** and provide **milestones governing the preparation of the forecasts**.”
- “To be agreed between the Ministry of Finance and the independent body, the schedule would be **released publicly** at the beginning of every year by the Ministry of Finance. In particular, the delivery date(s) of the forecasts to the authorities would be specified.”

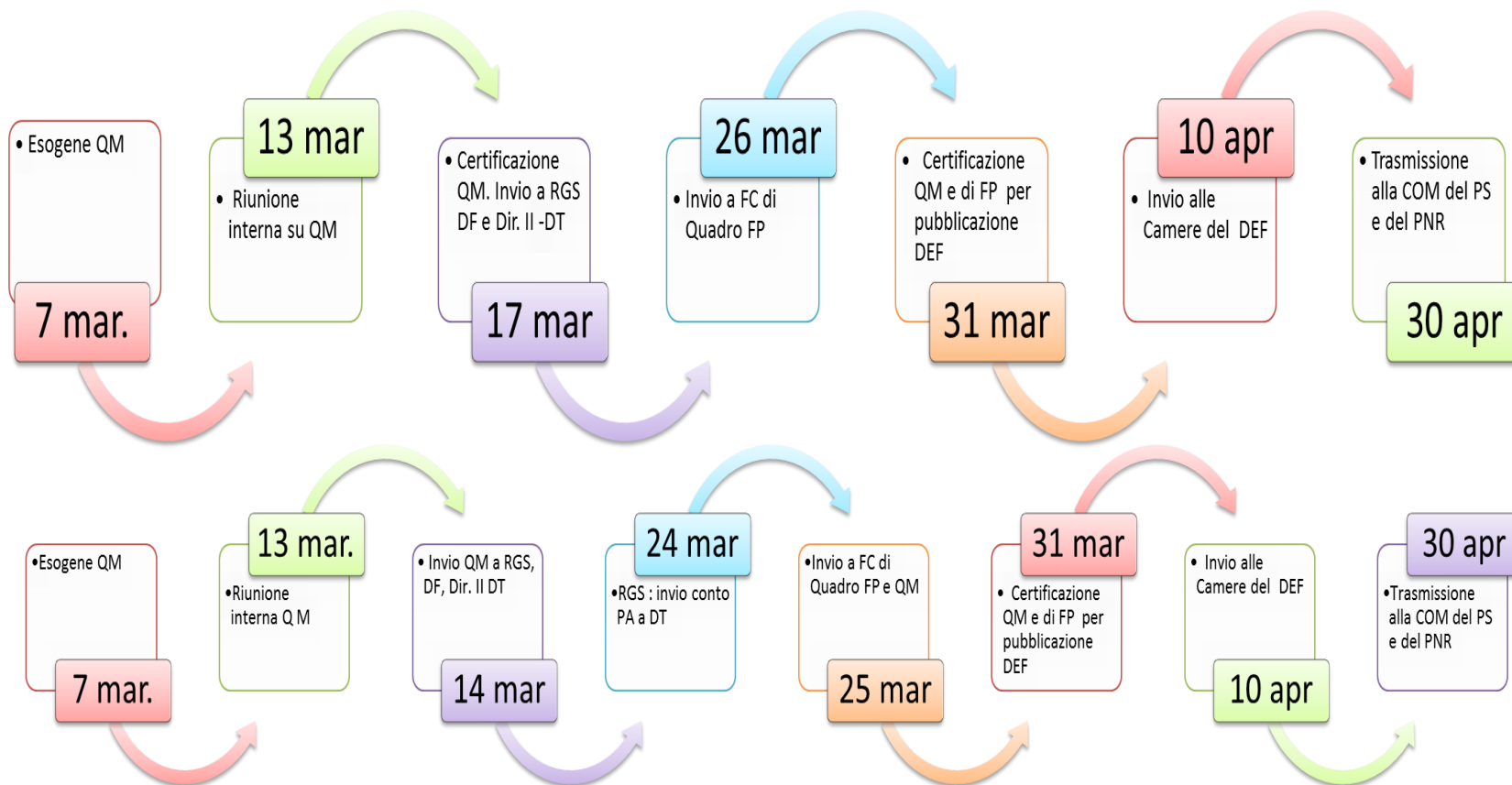


PBO: if endorsing forecasts ... (Two Pack)

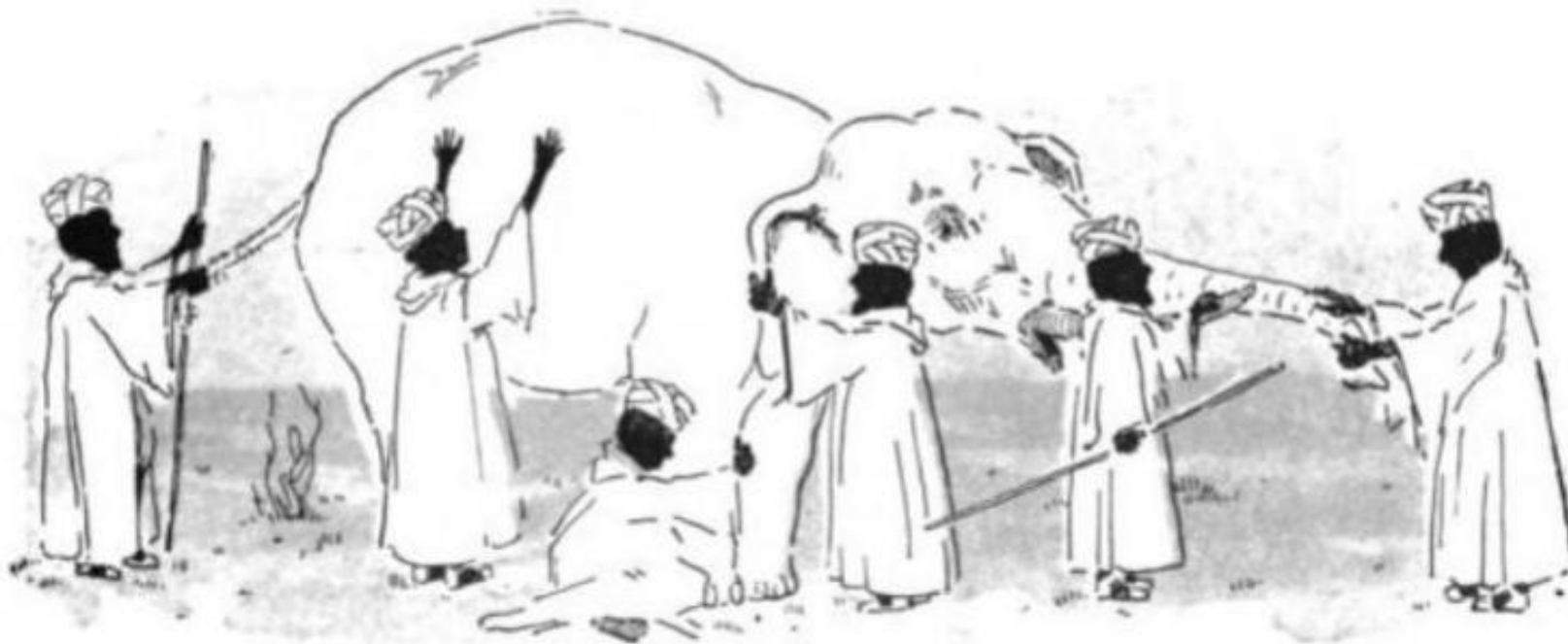
- “The national legislation and/or procedures could specify **deadlines** for the producer of the forecasts to submit them to the independent body. A **subsequent deadline** could be fixed for the independent body to **deliver its decision**, balancing the need for providing a reasonable amount of time for the independent body to shape its informed opinion and the **constraints implied by the annual budget cycle.**”
- “If, following an initial non-endorsement by the independent body and the subsequent preparation of a revised forecast, the independent body issues another **negative decision**, this should be **made public**, along with supporting explanations.”



Interaction Treasury/PBO: a tentative schedule.



And be careful when touching the elephant ...



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Does the South of Europe have a competitiveness problem?
Brussels, 29/4/2011



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