

Fiscal Councils: the Chilean experience

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Hermann González B.

Chilean Fiscal Council and Clapes UC

hegonzal@uc.cl

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Agenda

1. Chile's fiscal institutional framework: a timeline
2. The Chilean fiscal rule
3. The Advisory Fiscal Council (2013-2018)
4. The Autonomous Fiscal Council (2019 to date)
5. 7 lessons from the Chilean experience with Fiscal Councils

Chile's fiscal institutional framework: a timeline

- 2001: Chile adopted a “cyclically adjusted balance” rule (GDP and copper price committees)
- 2006: the **Fiscal Responsibility Law (FRL)** was enacted (sovereign wealth funds)
- 2011: a committee of experts recommended the creation of a Fiscal Council by law.
- 2013: the government created the first **Advisory Fiscal Council** by decree.
- 2019: the **Autonomous Fiscal Council (AFC)** replaced the Advisory Council with more powers and autonomy.
- 2022: the government added a **second fiscal target** (prudent debt level) and submitted to Congress a series of changes to the Fiscal Responsibility Law, adopting recommendations from the AFC.

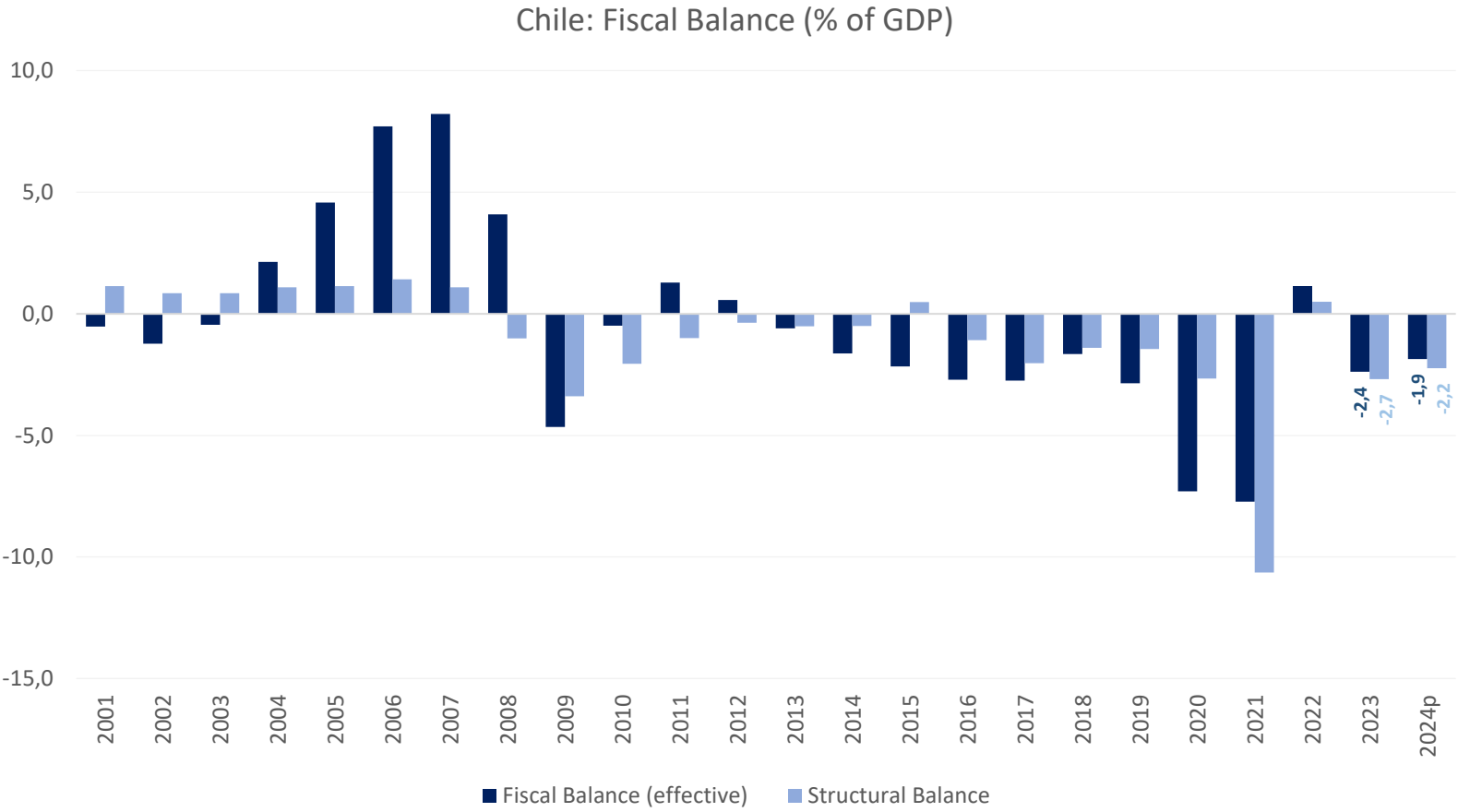
The Chilean fiscal rule

- **Tax revenues are procyclical.** They depend on the cyclical situation of the economy and the price of copper in the case of Chile.
- The **cyclical revenue adjustment methodology** seeks to separate the cyclical component from the long-term trend of non mining GDP and copper prices.
- Trend GDP and long-term copper prices are estimated annually by **experts who are independent of the Ministry of Finance.**
- The Budget Office estimates “**structural revenues**” that seek to represent the revenues that the government would have in a situation in which the economy is at its trend level and the price of copper is the long-term price.

The Chilean fiscal rule

- **Each government must define its structural balance targets** at the beginning of its term (FRL). These objectives are defined by a decree.
- Every year's **public spending** is the result of the estimate of cyclically adjusted revenues and the structural balance target defined by the government.
- In positive cycles, fiscal revenues in excess of structural revenues are saved in a sovereign wealth fund (FRL).
- **Some challenges of the fiscal rule:**
 - In several years, the structural balance target has not been met. Sometimes in “normal” years (no crisis)
 - The fiscal rule has no defined escape clauses or correction mechanisms for deviations.
 - As a result, public debt has risen (4% of GDP in 2007, 40% of GDP in 2023)

The Chilean fiscal rule



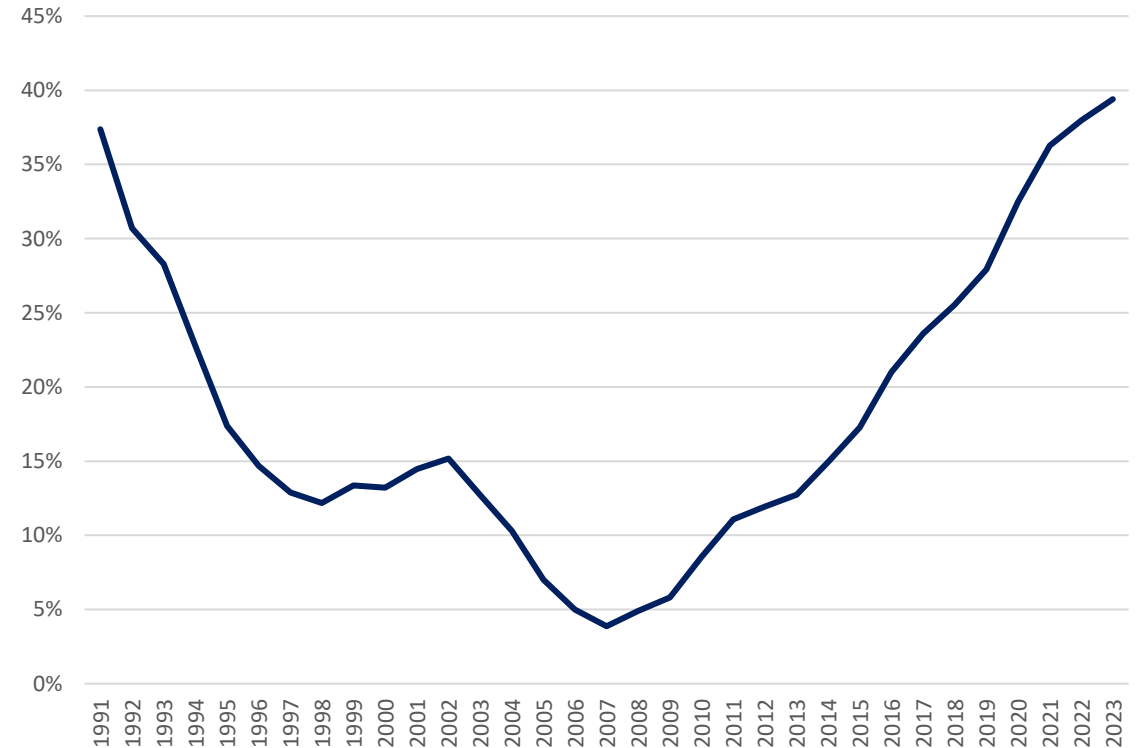
The Chilean fiscal rule

FEES* (million dollars)



*Economic and social stabilization fund.

Public Debt (% of GDP)



The **Advisory** Fiscal Council (2013-2018)

- Following the recommendations of a committee of experts, the government created the first fiscal advisory council in 2013.
- The main functions of Chile's first Fiscal Council were as follows:
 - Express its opinion on the calculation of the cyclical adjustment of the structural balance.
 - Participate as observers in the Committees that estimate trend GDP and long-term copper price.
 - To express its opinion to the Ministry of Finance on the possible methodological changes to the calculation of the structural balance.
 - Advise the Ministry of Finance on fiscal matters.

The **Advisory** Fiscal Council (2013-2018)

- The first fiscal council had some weaknesses:
 - It was created by decree (not by law) and without budgetary or management autonomy.
 - It did not have a working team (staff).
 - It met only a few times a year and had to be appointed by the Minister of Finance.
 - The Board members were elected by the Minister of Finance and did not receive a compensation for their work.

The **Advisory** Fiscal Council (2013-2018)

- Despite its weaknesses, the AFC made several contributions:
 - With the creation of the Fiscal Council, for the first time the Ministry of Finance shared the structural balance calculations with an external party.
 - The Fiscal Council made recommendations to increase transparency.
 - It also contributed to improve the quality of the public debate on fiscal policy issues.
 - The AFC functioned for almost 7 years in two different governments and was a relevant step before the creation of the Autonomous Fiscal Council that exists today in Chile.

The **Autonomous** Fiscal Council (2019 to date)

- In 2018, the government sent to Congress a bill to create the Autonomous Fiscal Council.
- The discussion of this project was fast for several reasons:
 - **Experts' recommendations.** To date, there was a set of recommendations from experts and international organizations that indicated that the country should move in that direction.
 - **Counterweight.** The opposition to the government appreciated the creation of a counterweight at the beginning of President Piñera's administration (2018-2022).
 - **Political consensus.** The idea of creating by law an autonomous fiscal council was part of the previous government program (the opposition of the moment).
- The bill with some modifications was approved in January 2019.

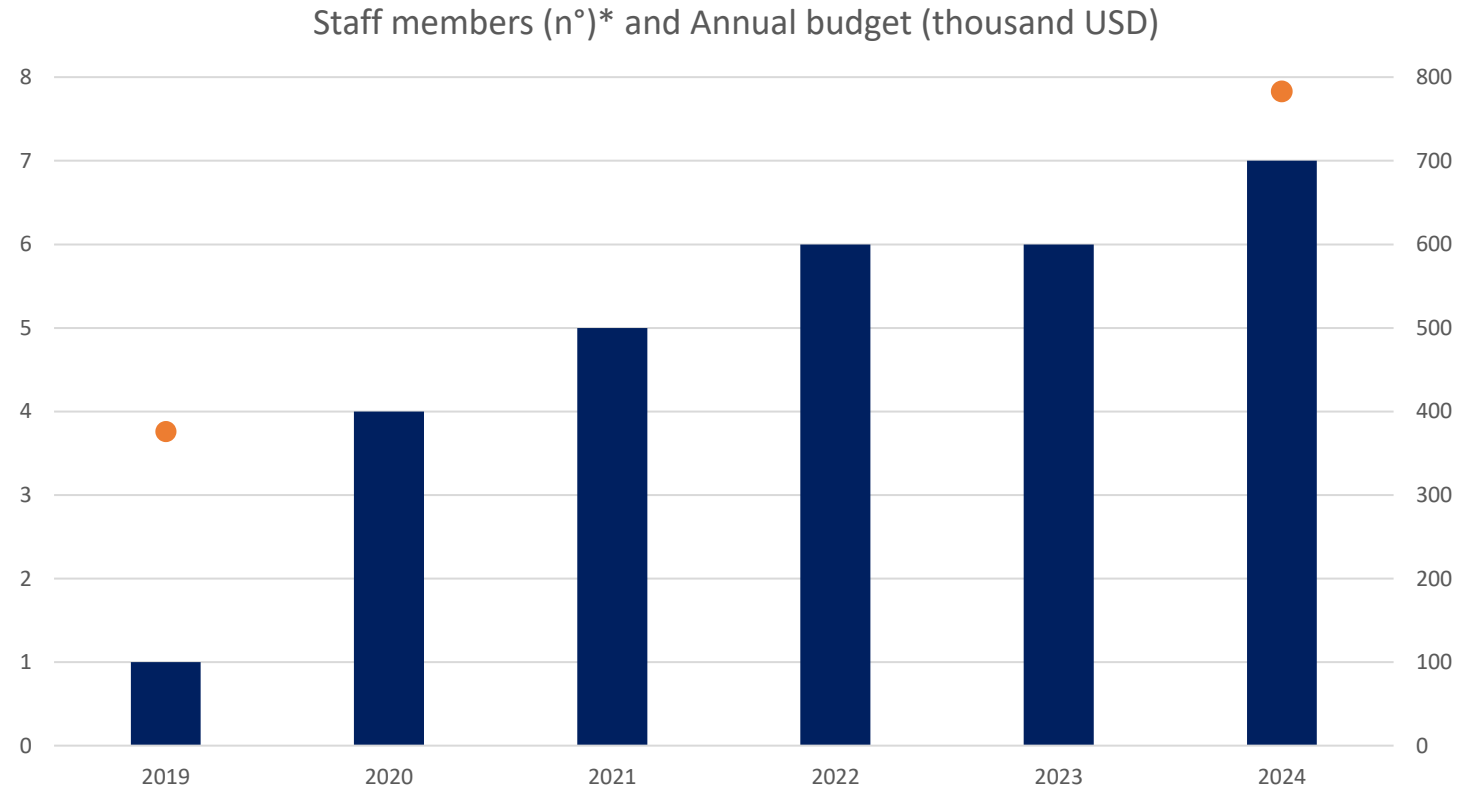
The **Autonomous** Fiscal Council (2019 to date)

- What are the **main features** of the AFC created by law?
 - Broad mandate: The AFC's objective is to contribute to the responsible management of the Central Government's fiscal policy.
 - The Fiscal Council is composed of 5 members who are experts in fiscal and budgetary matters, appointed by the President of the Republic and ratified by two thirds of the Senate.
 - The term of office of the directors is 5 years, and they may be reelected for one more term. The renewal of directors is overlapping, at the rate of one director per year.
 - The directors cannot be removed by the government, unless some conditions established by law are met.
 - The AFC has a budget to have a small working team, to hire studies and to remunerate the directors.
 - The AFC must report twice a year to Congress on the exercise of its functions and powers.

The **Autonomous** Fiscal Council (2019 to date)

- What are the **main functions** assigned to the Fiscal Council by law?
 - Review the calculation of the cyclical adjustment of fiscal revenues.
 - Participate as an observer in the consultation process with experts on GDP and long-term copper prices.
 - Propose to the Minister of Finance the names of the members of the long-term copper price and trend GDP committees to fill the vacant seats.
 - Formulate observations and propose methodological changes for the calculation of the Structural Balance.
 - Express its opinion on possible deviations from the Structural Balance targets and propose mitigation measures.
 - Evaluate the medium and long-term sustainability of public finances.
 - Advise the Ministry of Finance on fiscal policy topics.

The **Autonomous** Fiscal Council (2019 to date)



*This number does not include the Board Members. In 2024: a lawyer, a journalist and 5 economists.

Board members receive compensation per meeting attended, with a cap of 6 meetings per month. This remuneration is US\$470 gross per session, with a cap of US\$2,800 per month for the 6 sessions. These figures are 50% higher for the president of the Council.

The **Autonomous** Fiscal Council (2019 to date)

- **Some challenges** of the AFC after five years of operation:

Requests for the Fiscal Council's opinion from different stakeholders have increased and the dedication of the directors (6 sessions per month) is not enough to respond to all the emerging issues

- It is necessary to increase the time that board members dedicate to their functions and to remunerate them accordingly (it requires legal change).

The Fiscal Council has technical and political autonomy, but not management autonomy (it depend on the Ministry of Finance)

- Giving the Fiscal Council management autonomy (human resources, computing, administration) requires increasing the staff and the entity's budget.

Some fiscal councils have the function of making macro-fiscal projections and assessing the cost of public policies that involve significant uses of resources or tax reforms

- To perform these functions, the Chilean Fiscal Council would need a larger staff and better access to the required information.

7 lessons from the Chilean experience with Fiscal Councils

1. The Chilean Fiscal Council has been built as an institution gradually over time and the process is not yet finished. For countries that do not have a Fiscal Council, Chile's path is a possibility, but **an alternative is to look at the lessons learned in other countries and create institutions with the long term in mind from the beginning** (difficulty of approving changes in Congress).

2. **The creation of Fiscal Councils should be by permanent laws** and the Directors should last longer than the periods of government, so that their role transcends political cycles. One of the main contributions of the Fiscal Councils is to have a longer-term view of fiscal policy, which governments often lack.

3. **Timely access to the information** required for their studies and analysis is a key condition for the Fiscal Councils to properly perform their role.

4. **Autonomy requires accountability.** It is essential for the success of Fiscal Councils to have broad autonomy (political, technical, budgetary, management). At the same time, they must be accountable for their actions and decisions to Congress and the public.

7 lessons from the Chilean experience with Fiscal Councils

5. **The technical quality of the work of the Fiscal Councils must be safeguarded**, since these institutions do not execute fiscal policy, but must be a high-level intermediary between the Ministries of Finance, Congress, the market, etc.

6. The functions of the Fiscal Councils are diverse, but they should at least consider **making methodological recommendations, assessing emerging fiscal risks -including fiscal sustainability analysis- and analyzing macro-fiscal assumptions and projections.**

7. **A key factor for the success of Fiscal Councils is communication.** It is the Council's way to influence the public debate and, therefore, it is an aspect that should be considered in the design of this type of institutions.

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