The Role of Fiscal Councils in Modern Fiscal Policy Making and Other Policy Areas: IMF, Detroit, PROMESA

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Executive Summary

Coverage Topic 1

General approaches and key characteristics of fiscal boards

- Motivation
- Definition and Approach
- Similarities and Differences Between Fiscal Boards
- Purpose
- Do they work?
- Fiscal Board Approach Relative to the IMF

Coverage Topic 2

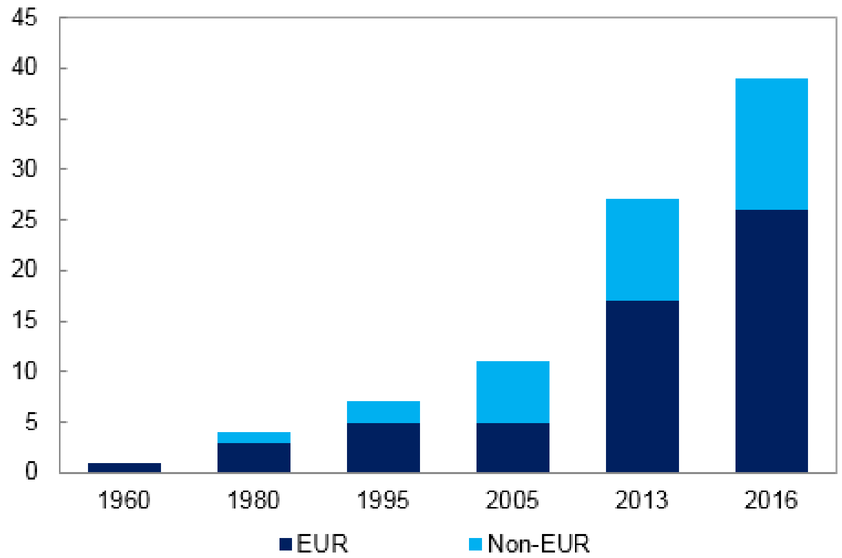
Historical case studies

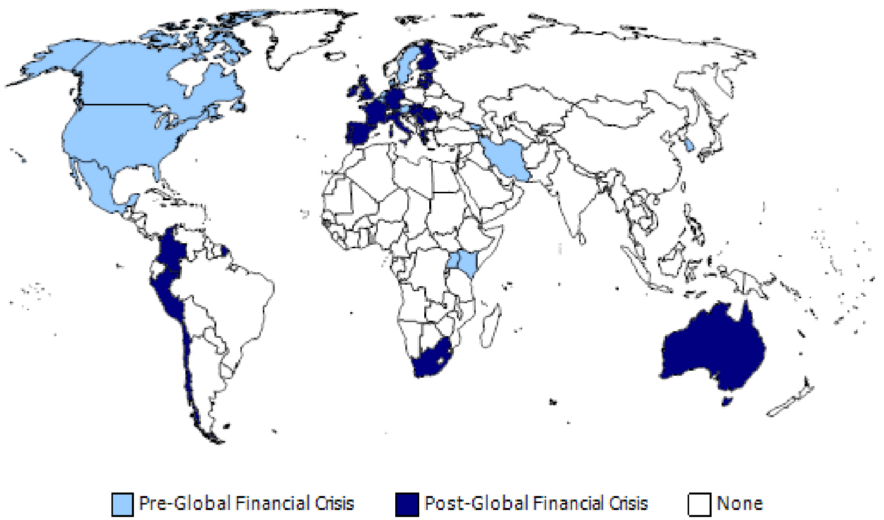
- New York City in 1975
- Washington, DC in 1995
- Detroit in 2014
- Puerto Rico in 2016
- Connecticut in 2017

Motivation

§ Traditional restructuring involves static, deterministic analytical techniques

§ Global rise in the number of *independent fiscal institutions* ("fiscal councils" and "parliamentary budget offices") à good practice.





Source: IMF fiscal council dataset.

What do Fiscal Councils Do?

§ *Permanent agency with a statutory or executive mandate to:*

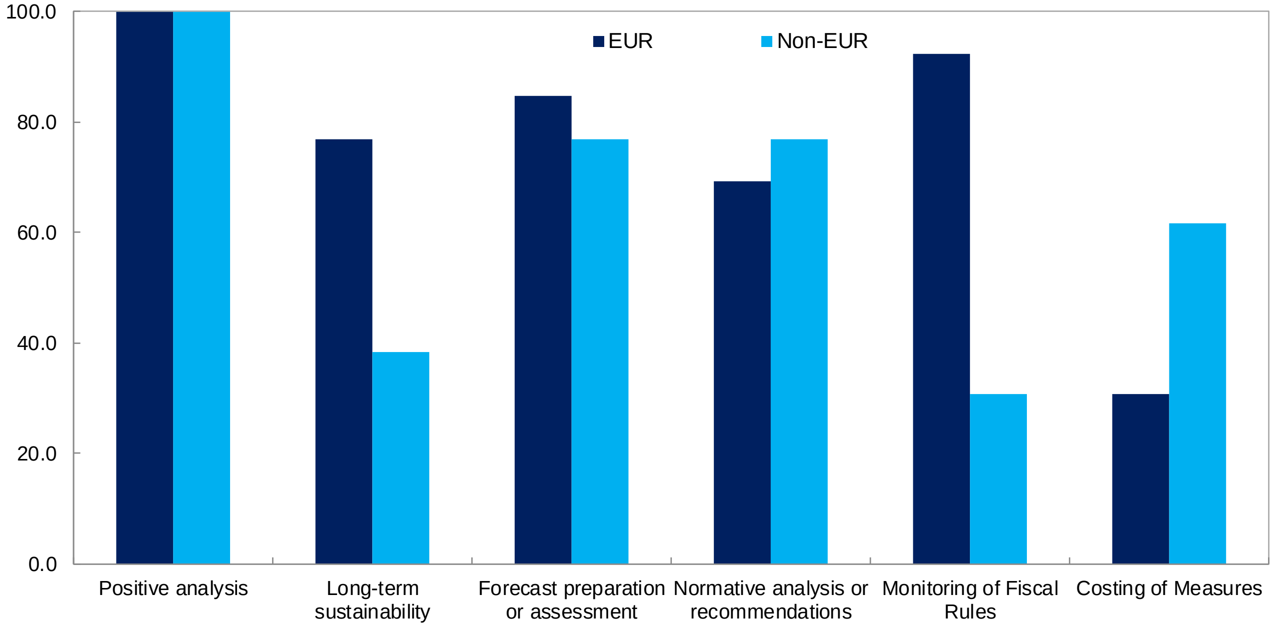
– *assess publicly and independently from partisan influence government's fiscal policies, plans and performance against macroeconomic objectives related to the long-term sustainability of public finances, short-medium-term macroeconomic stability, and other official objectives.*

– In addition:

- (i) contribute to the use of unbiased macroeconomic and budgetary **forecasts** in budget preparation (through forecasting or proposing prudent levels for key parameters),
- (ii) identify sensible fiscal policy options, and possibly, formulating **recommendations**, and
- (iii) facilitate the implementation of **fiscal policy rules.**
- (iv) cost new or planned policy initiatives. (watchdog picture); insist no delegation.

What do Fiscal Councils Do?

§ Work through political/public debate on fiscal policy.



Source: IMF fiscal council dataset.

State Approaches To Fiscal Boards Vary Greatly

LESS AUTHORITY

Typically run by existing government officials

Type of new boards created with non-government officials

MORE AUTHORITY

Approach	Some states blend these four approaches depending on a city's distress
State-Level Monitoring	• Some states proactively monitor the finances of their municipalities. • **North Carolina** requires its municipalities to file periodic financial statements with the state. Cities must secure approval from a local oversight commission before issuing new debt.
State-Led Assistance	• When a municipality is under distress, step in and offer technical assistance. • **Ohio's State Auditor office** classifies some cities as: *fiscal caution, fiscal watch*, or *fiscal emergency*. May lead to responses ranging from technical assistance to a planning and supervision commission.
Third-Party Oversight Board	• Oversight boards serve as advisors to monitor reforms and are often triggered when the local government fails to meet various financial conditions. • **Florida's Financial Emergency Oversight Boards** have broad authority over municipal fiscal affairs including budgetary and debt approval as well as the power to review operations, management and collective bargaining.
Third-Party Control Board	• Typically removes power from the local authorities. • **Massachusetts** has a receivership structure for cities under severe fiscal distress. The board appoints, removes, supervises and controls all city employees. It also reviews and approves or rejects all proposed contracts for goods and services and can raise or reduce fees for city services.

Similarities Between Fiscal Boards

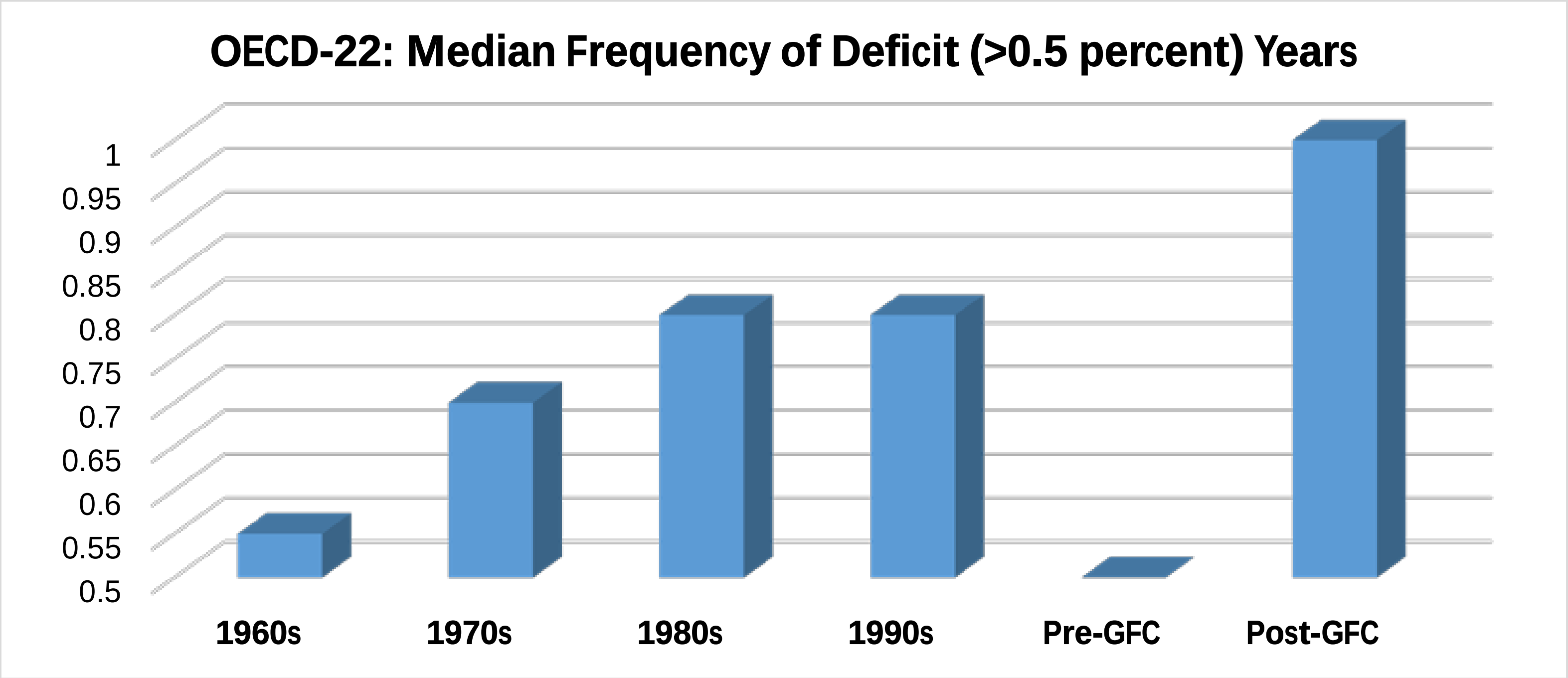
Always an odd number of representatives	• **5** for **Chicago** and **Philadelphia** PICA boards • **7** for **Puerto Rico**, **Cleveland**, **Yonkers**, **Waterbury**, CT and **NY** Boards • **9** for **NY** Municipal Assistance Corp., **North Carolina**, and **Indiana** Financial Boards as well as **Connecticut's** Municipal Accountability Review Board • **11** for **Bridgeport**, CT, **Illinois** Board, and **Detroit** Financial Review Commission
Members serve without compensation	• Members must have **significant credibility** and be committed to the endeavor • They are **often leaders in business, finance or management** with direct ties to the local community
Appointees are typically not publicly elected officials	• When there are ex-officio members, **most likely person is the mayor**, although at least one ex-officio member typically has budgetary expertise (State Comptroller, Treasurer, or Secretary of the Budget) • Typically **not an employee of a Federal, State, or Local Government** • In some cases, like Ohio and Puerto Rico, **appointed members cannot have held public office** for several years before their appointment
Reason often motivating a Board's creation	• City's poor credit rating could spill over to the state itself or to other sub-jurisdictions and agencies • Responsibility for health and welfare of citizens in the distressed jurisdiction and others in the state

Differences Between Various Fiscal Boards

Membership	• Membership and representation by city officials differs
Board or Governor selects chairman	• NY's Governor selected the chairman of the Municipal Assistance Corp • Cleveland elected its chairman and vice-chairman from its own members • Puerto Rico's Oversight Board selected its own chairman
Non-voting members & who appoints them	• There were no non-voting members in Chicago, Cleveland, and NY Municipal Assistance Corp • In Yonkers and the NY FCB, there are large numbers of non-voting members. Puerto Rico's Oversight Board has one non-voting member
Whether city employees are represented	• Consideration given to whether the political parties in the minority at the state and city level are represented • In Yonkers, the mayor was ex-officio and was the only voting member representing the city
Oversight versus control board	• Function as a forum versus impose decisions • Detroit's Financial Review Commission approves budgets and contracts
Professional Staffing	• In-house staff of oversight boards are often small but the actual size varies

Purpose

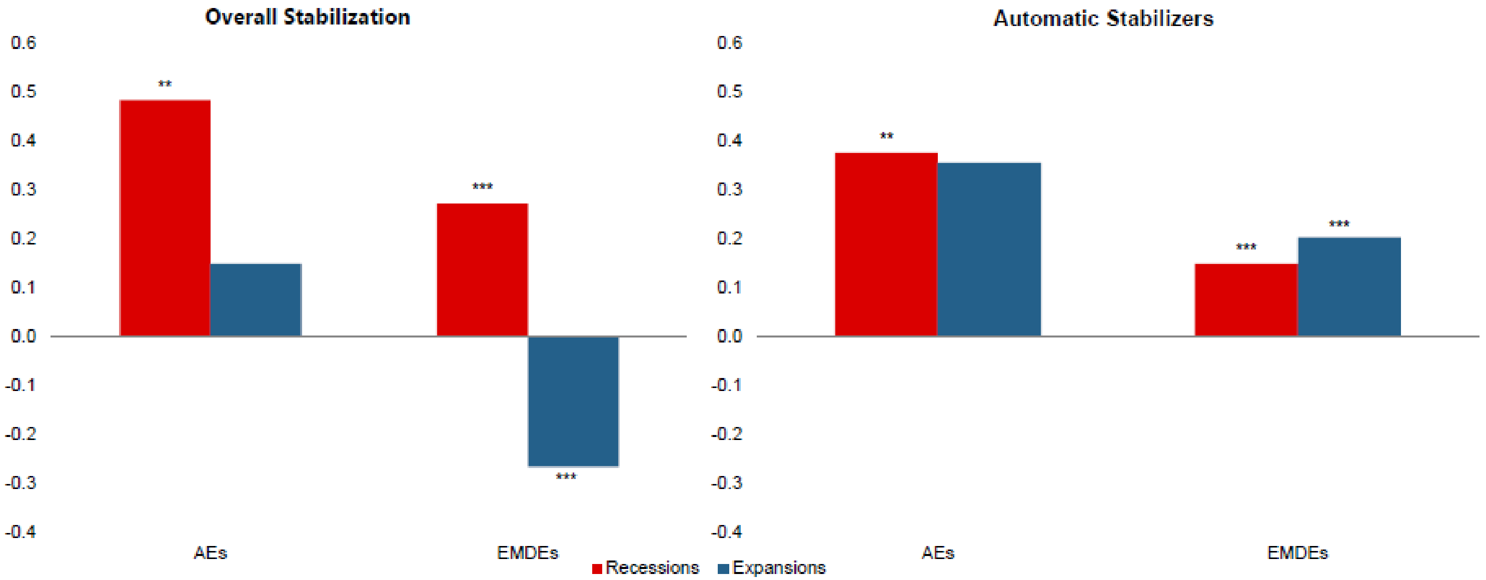
§ Need to constrain fiscal “discretion” à deficit bias



Purpose

§ Need to constrain fiscal “discretion” à procyclicality

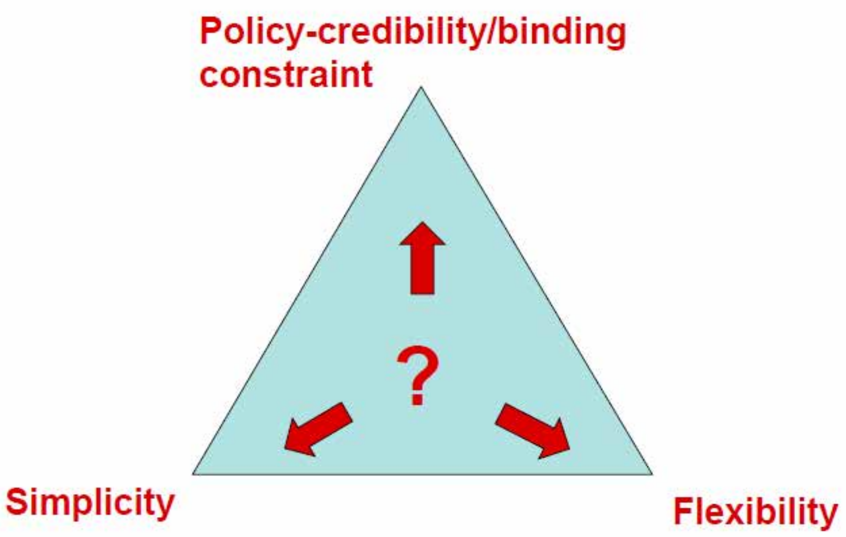
Fiscal Stabilization over the Cycle

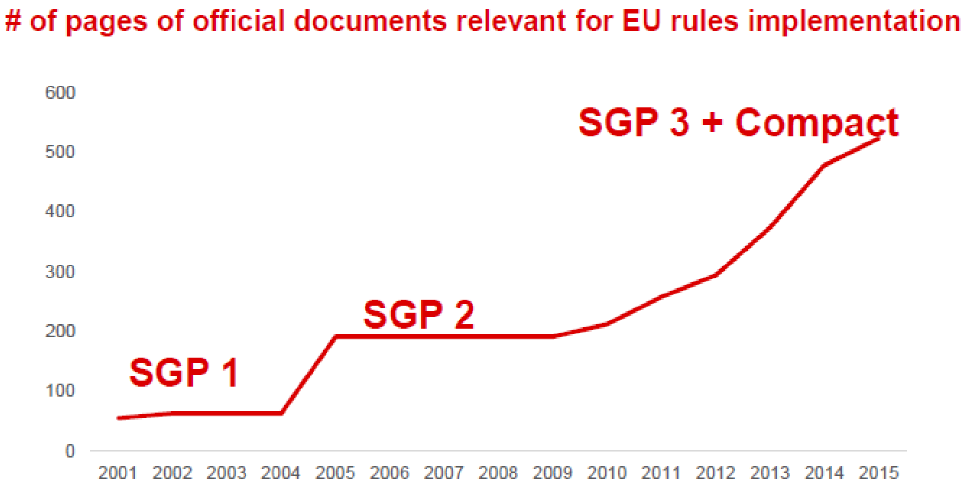


Sources: European Commission; Organisation for Economic Co-operation and Development; and IMF staff estimates.
Note: Recessions and expansions are defined using an approach equivalent to the smooth transition autoregressive model developed by Granger and Terasvirta (1993). The figure displays ordinary least squares regressions with country and time fixed effects and robust standard errors. To reduce heterogeneity in the panel, commodity exporters have been excluded. AEs = advanced economies; EMDEs = emerging market and developing economies. ** $p < 0.05$; *** $p < 0.01$.

Purpose: Frustration with fiscal rules

§ Trilemma (simplicity, flexibility, enforcement) à Complexity

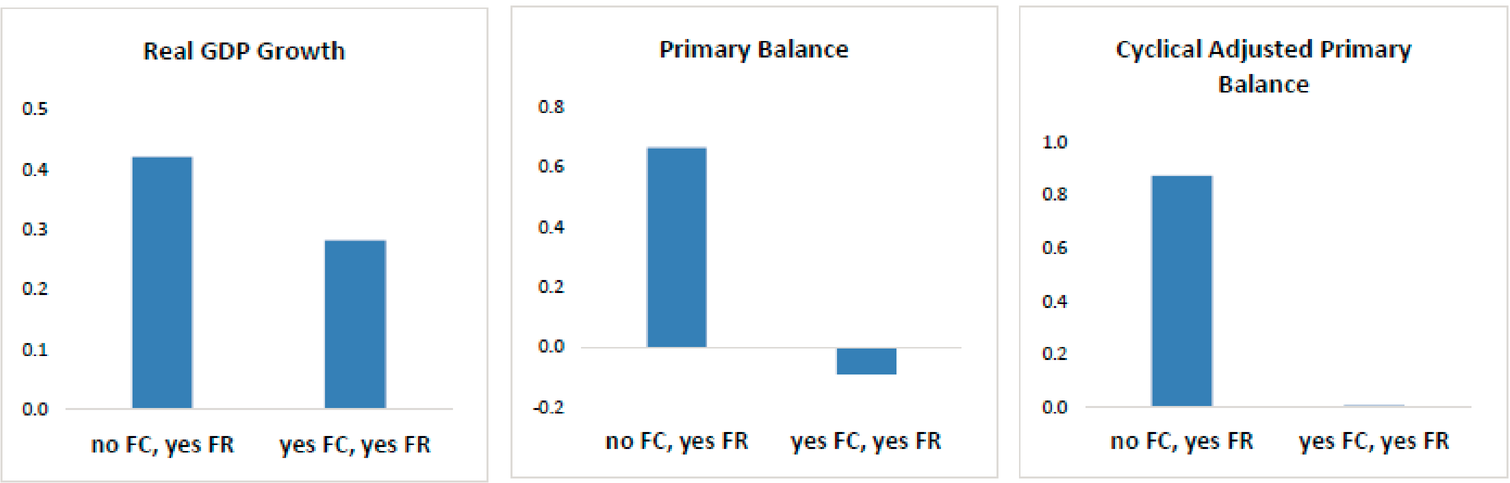




Data courtesy of Wim Suyker, Netherlands CPB.

Do they work?

§ Broad correlation: less biased forecasts (average forecast error)



Notes: the figure reports variables averaged over all observations within a given bin. The bins are (no FR, no FC), (FR, no FC), (no FR, FC) and (FR, FC). FR = fiscal rule, FC = fiscal council.

Do they work?

- Case studies point to certain issues:
  - Understaffing
  - Independence
  - Noise vs. signal
  - Political buy in—sensitive to political environment—uneven support

Elements that Often Improve Fiscal Board Effectiveness

Provide politicians with the ability to pursue unpalatable, but necessary, austerity measures and override resistance to raising local taxes.

Sanctions must be sufficient to motivate the government to restore financial order so oversight is no longer necessary.

Be able to enforce veto power. Prevent jurisdiction from spending funds if it is not operating under a balanced budget.

Power of the purse. Enforce authority to review budgets and revenue estimates and enforce modifications.

Able to enable or prevent the city from borrowing and set the amount of debt issued.

While fiscal boards are often used to get access to new financing, new money needs are not always an element. Sometimes oversight is deployed without the need for financing.

Fiscal Board Approach Relative to the IMF Approach

Historically, the bulk of non-concessional IMF assistance has been provided through Stand-By Arrangements ("SBAs")

Purpose	• SBA's are designed, in part, to help countries address short-term balance of payments problems in an economic or fiscal crisis.
Targets	• Program targets are designed to address balance of payment challenges and disbursements are made conditional on achieving reform targets. • SBA's typically last for 12-24 months with repayment due within 3.25 to 5 years of disbursement.
Borrowing Covenants	• Borrowing terms vary with the severity of liquidity needs but typically involve tranched lending on a preferred basis (i.e. IMF is repaid before unsecured creditors even if not legally senior), conditional on a set of policy reforms.
Assessment	• These reforms are assessed according to several quantitative targets (government deficits, international reserves), which are collected by IMF staff through regular visits to the debtor nation. Some of these reforms may be required prior to any disbursement.
Rates	• The rate at which IMF SBA loans are made is tied to the IMF's Special Drawing Rate (SDR) – derived from a weighted average of interest rates on short-term debt instruments in money markets of the four key international currencies – plus a fixed margin set annually by the IMF Executive Board.

CASE STUDIES

- New York City in 1975
- Washington, DC in 1995
- Detroit in 2014
- Puerto Rico in 2016
- Connecticut in 2017

New York City's Emergency Financial Control Board

Municipal Assistance Corporation (MAC)

- Created in June 1975, MAC was an independent corporation with a 9 member board of private citizens authorized to issue bonds on behalf of the City of New York
- To repay these bonds, the state passed legislation converting the city's sales and stock transfer taxes into state taxes. Revenues from these taxes passed directly to MAC, not through the city's books
- MAC was authorized to issue up to $3 billion of securities but could only sell $2 billion at high interest rates. Notes issued by the MAC yielded 11% at a time when an index of high-grade municipal bonds yielded 6.89%
- In 2008, having sold almost $10 billion in bonds to keep the city solvent, MAC settled its final accounts and voted itself out of existence

The New York State Financial Control Board (FCB)

- NY State Municipal Assistance Corporation Act created a financial control board in September 1975 to supplement MAC and restructure the city's fiscal management
- Consisted of a 7 member board including the governor, the mayor, the city and state comptrollers and three business executives appointed by the governor
- Enforced austerity measures and revenue control. The Board ordered hundreds of millions in budget cuts and demanded thousands of workforce reductions. It also rejected contracts negotiated by the City's teacher and transit worker unions
- In 1986, after affirming the city had balanced its budget for three consecutive years, paid off its federally guaranteed debt and restored its credit-worthiness, the board switched to ''sunset'' status and power over city budgets and contracts was dropped. Today, just issues quarterly reports on the city's finances

Washington, DC's Emergency Financial Control Board

Washington, DC's emergency financial control board was in place from 1995 through 2001. It was suspended after the District achieved four consecutive balanced budgets.

- Pursuant to the District of Columbia Financial Responsibility and Management Assistance Act of 1995, Congress created a 5 member board of experts in finance and management to oversee the city's finances

- Board members were appointed by President Clinton, in consultation with Congress. They were required to have a "primary residence" or a “primary place of business" in the District

- The board oversaw and approved virtually all fiscal operations of the city government. It also had the power to help city officials develop strategies to improve services, streamline the government and restore a balanced budget
    - The board recommend long-term solutions to keeping the city financially stable, like creating enterprise zones to attract new business, eliminating Federal taxes for city residents as a way to reverse middle-class flight and returning the operation of the municipal prison system to the Federal Government

- The board was the only authority allowed to borrow money from the Federal Treasury on the District's behalf. No federal guarantees were offered in the new debt issued

- The bill also provided for a new chief financial officer position and, to insure integrity, an inspector general

Recent Case Studies - Detroit

- **Financial Advisory Board** (pre-bankruptcy) that monitored financial performance, recommend restructuring initiatives, and changed expired CBAs

- Detroit declared bankruptcy in July 2013 on $18 billion in debt

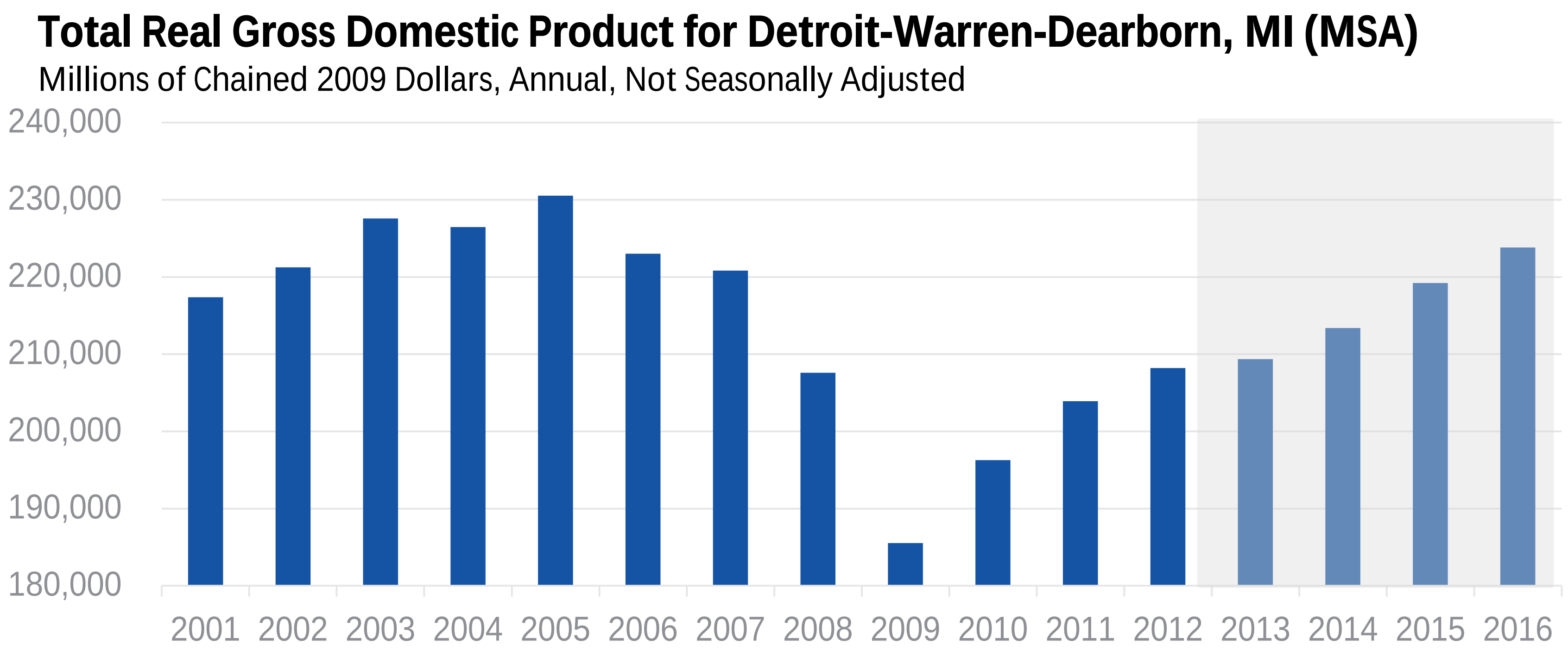
- **Financial Review Commission** established in 2014 to review budgets and contracts and prudent fiscal management. **5 appointed and 6 ex-officio members.**
  - **Emergency Manager** that assumed Mayor and City Council authority, rejected CBAs, and restructured debt and operations

- Plan lowered debt by ~$7 billion
  - Privatized key assets (Museum) through new funding
  - Included nearly $2 billion to restore services, hiring 200 new police officers and 100 new firefighters
  - Included long-term measures e.g. COLA adjustments of 1% instead of 2.5%
  - Measures were aimed at reversing population loss, from over 1 million in the early 1990s to 672,795 in 2016

Recent Case Studies - Detroit

Measures implemented in Detroit lend themselves to **dynamic modeling, risk metrics**

Payments conditioned on upside risk can
- Help mitigate short-term cuts to get a deal
- Help creditors and participants benefit from future upside to get a deal



Recent Case Studies - Detroit

- **2016-17 Financial Plan**
  - Marks third straight year of balanced budgets, $30 million surplus, allowing exit of state oversight in 2017

- A $490-million hole in pension funding the city must be addressed.
  - The budget projects an increase of less than 1% in annual revenues.
  - The city's income tax, property taxes, utility users tax, casino revenues and state revenue sharing account for 78% of Detroit's annual budget.
  - Duggan said consultants hired by the pension funds found that experts in the bankruptcy case used outdated life-expectancy tables, vastly undercounting the city's long-term pension obligations.

- *"There's nothing in this budget that reflects that economic development activity, so I think that there's real upside, but as the mayor said, we're going to need that upside to help us support pension obligations."*

Recent Case Studies – Puerto Rico

- **Oversight Board** established by the Puerto Rico Oversight and Management Act in June 2016 as an entity within the territorial government
- **7 member Board** established to provide a method for Island to achieve fiscal responsibility and regain access to capital markets
  - Certify long-term fiscal plans and annual budgets
  - Krueger report suggested dynamic approach
  - Dynamic approach captures
  - Trend economic growth
  - Impact of fiscal policy on business cycle
  - Impact of structural reforms
  - First round effects of growth on fiscal policy
  - Second round effects on financing costs
  - Dynamic debt projections
  - Dynamic debt sustainability analysis
- Allows more **policy options**
  - Dynamic scoring
  - Upside payments to creditors and beneficiaries

Recent Case Studies - Connecticut

- Recently established the **Municipal Accountability Review Board**
- Tiered system of accountability under which municipalities would be subject to increasing levels of state review and intervention based on the state of a municipality
- The weaker a local government's finances are, the greater the accountability and state involvement
- **9 member Board**, including representatives appointed by the Governor and local officials

Uncertain Future

- Part of “best practice:” lack of political buy-in à ornament without much traction

- Open questions about channels of action:
  - Greater transparency (in a broad sense) à grease effect on accountability
  - Educate public about fiscal matters (amplify reputational/electoral cost)
  - Expose common pool problems and strengthen procedures

- Relevant channel matters for optimal design: how to get it right?