Fiscal Transparency and Managing Fiscal Risks

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What is fiscal transparency and what is fiscal risk?

FAD

- **Fiscal transparency:**
  - ***Clear***, ***reliable***, ***relevant*** and ***timely* reporting** and ***openness* to the public** of the government's fiscal policy-making process.

- **Public fiscal reporting:** the publication and dissemination of summary information about the state of the public finances to citizens in the form of:
  - government finance **statistics**; and
  - government **financial statements** or accounts
  - fiscal **forecasts**, including related assumptions;
  - analysis of **risks** to fiscal prospects/forecasts

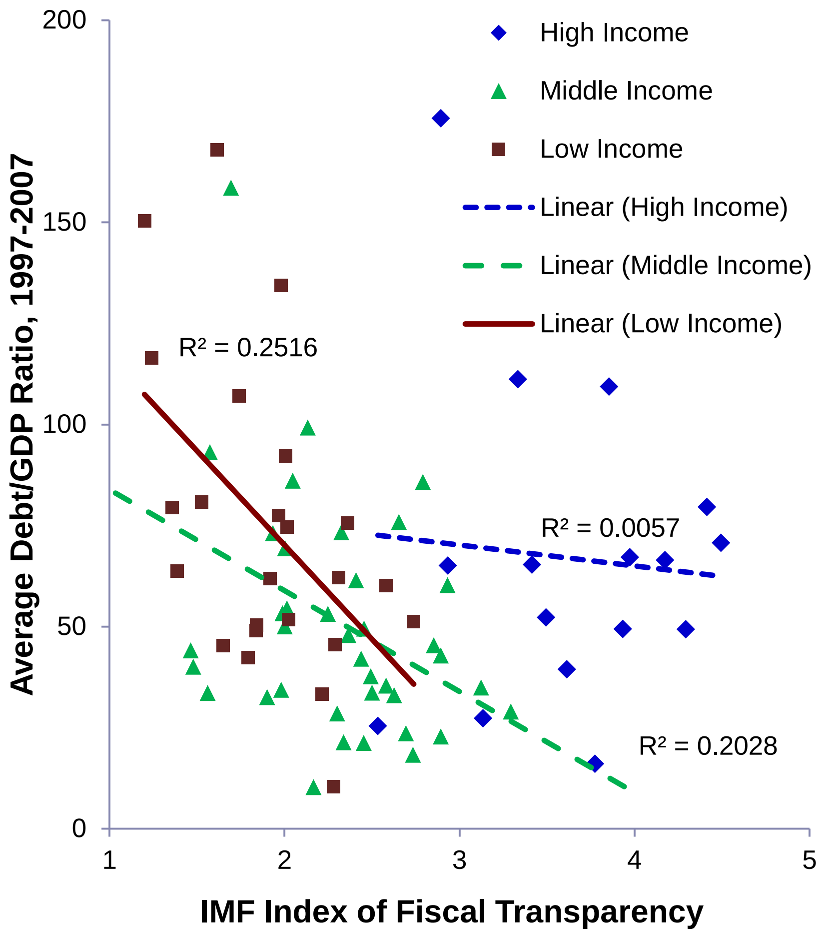
Retrospective Reporting

Prospective Reporting/forecast

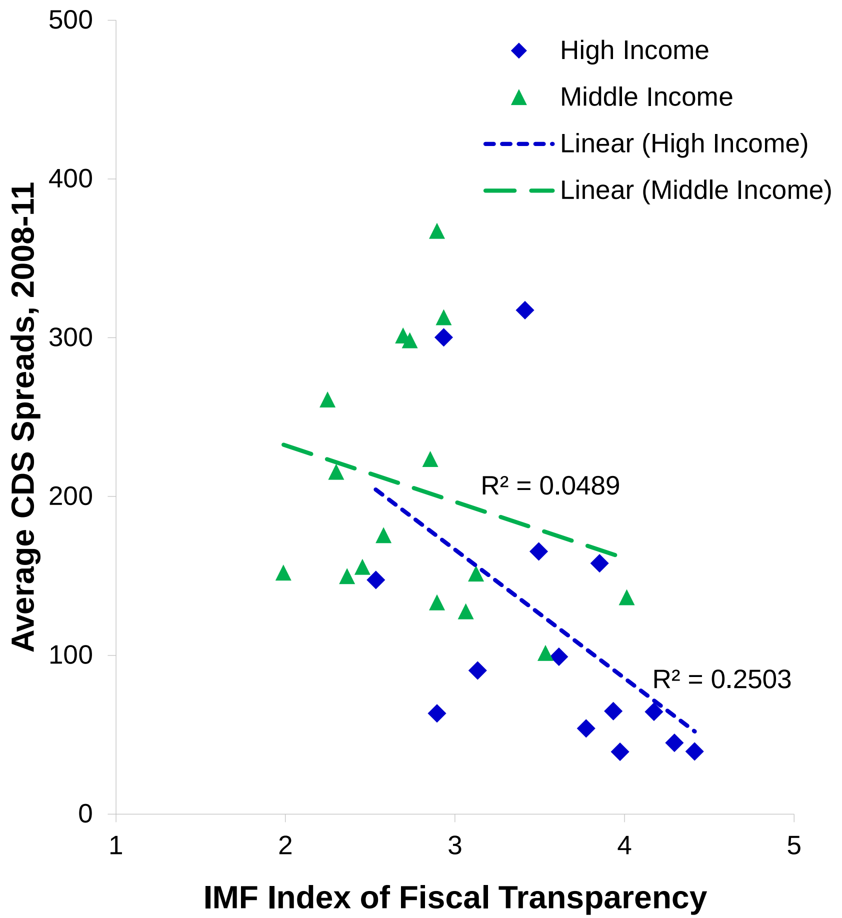
Uncertainties/risks around forecast

Why fiscal transparency matters ?

Fiscal Transparency & Fiscal Performance



Fiscal Transparency & Fiscal Credibility



On average, more transparent countries have better fiscal outcomes, such as lower debt and lower interest rates

Lessons from the recent financial crisis

- Governments' understanding of their fiscal position was inadequate, as manifested in unreported deficits and debts.
- Countries had substantially underestimated the risks to their fiscal prospects, especially those emanating from the financial sector and State Owned Enterprises.
- IMF analyzed the role of fiscal transparency in 10 countries that saw the largest unanticipated increases in General Government debt between 2007 and 2010
- This increase was due to 3 explanatory factors:
  - Shortcomings in understanding of current fiscal position
  - Underestimation of potential risks to the public finances
  - Policy changes introduced in the response to the crisis

Fiscal transparency has a strong linkage to governance and corruption

Main institutional weaknesses with potential impact on governance and corruption

A. **Incomplete coverage of fiscal reports** (do not reflect some activities of government entities)

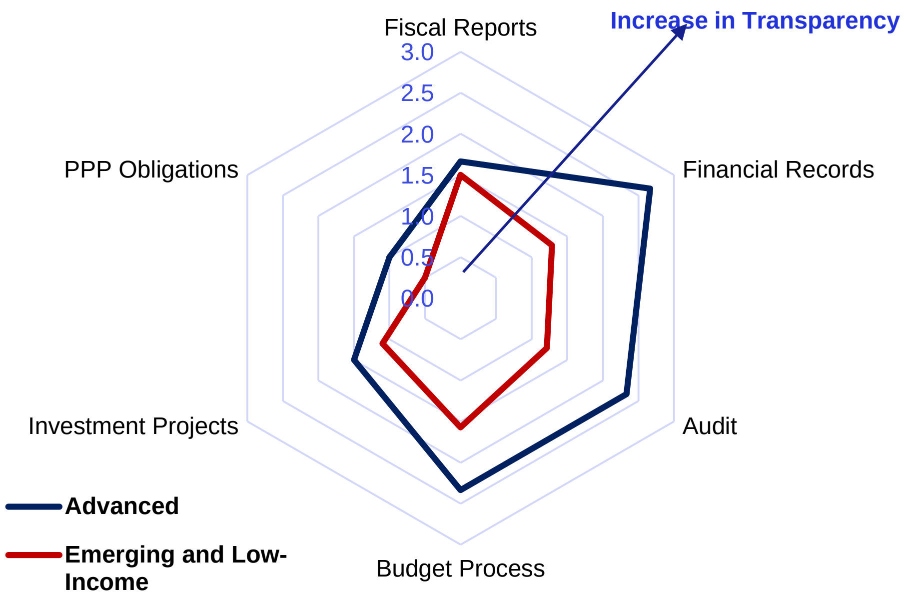
B. **Financial records not reliable** (e.g., no bank reconciliation of treasury accounts)

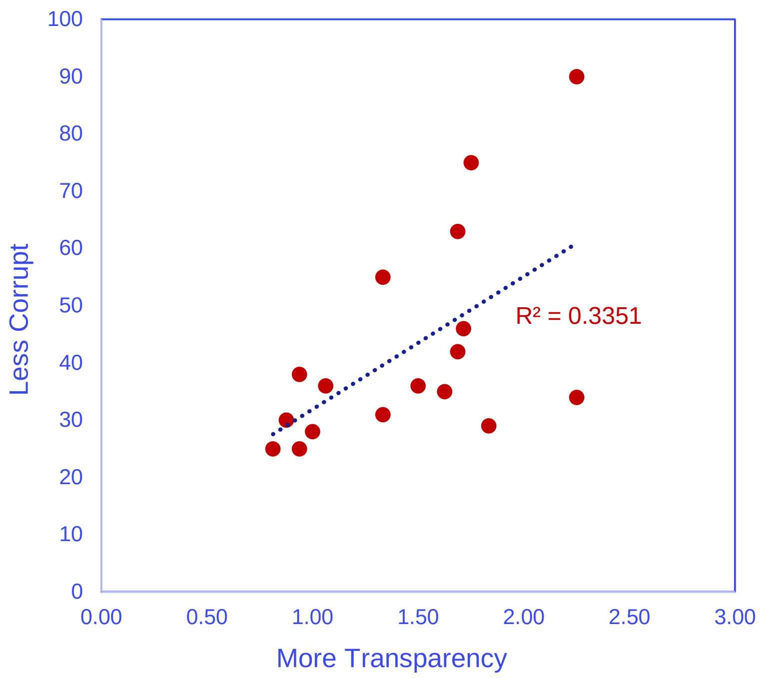
C. **Absence of independent and timely audit** of government financial statements

D. **Off-budget fiscal decisions** (revenue/expenditure decisions taken outside the budget process)

E. **Investment projects not subject to open and competitive tender**

F. **PPP obligations not identified and disclosed**





Several ways of being nontransparent in fiscal disclosure

- **Publishing only partial information**
  - Net but not gross spending
  - No information on off-budget government entities/activities
  - Revenues and spending (flows), but not assets and liabilities (stocks)
- **Publishing information that is difficult to understand**
  - Without summary tables or explanatory text
  - Not easily accessible by stakeholders and public
- **Exploiting weaknesses in accounting rules**
  - Selling assets and treating the proceeds as revenue
  - Off-balance sheet borrowing

IMF Fiscal Transparency Code (Internationally recognized standard)

Integrated Four Pillars of the IMF Code

I. FISCAL REPORTING	II. FISCAL FORECASTING & BUDGETING	III. FISCAL RISK ANALYSIS & MANAGEMENT	IV. RESOURCE REVENUE MANAGEMENT
1.1. Coverage	2.1. Comprehen-siveness	3.1. Risk Analysis & Disclosure	4.1. Resource Ownership and Rights
1.2. Frequency and Timeliness	2.2. Orderliness	3.2. Risk Management	4.2 Resource Revenue Mobilization
1.3. Quality	2.3. Policy Orientation	3.3. Fiscal Coordination	4.3. Resource Revenue Utilization
1.4. Integrity	2.4. Credibility		4.4. Resource Activity Disclosure

Fiscal Transparency Evaluation (FTE)

Fiscal Transparency Evaluations (FTEs) are the IMF's fiscal transparency diagnostic:

- **Assesses country fiscal transparency practices** against the standards set by the Code and identifies deficiencies
- Provides a rigorous analysis of the scale (**quantification of gaps**) and sources of fiscal vulnerability
- Provides a visual account of their fiscal transparency strengths and reform priorities through **summary heat maps**;
- Provides a **targeted and sequenced action** plan to help countries address areas of weakness
- Allows for **modular application** focused on just one of the pillar of the Code

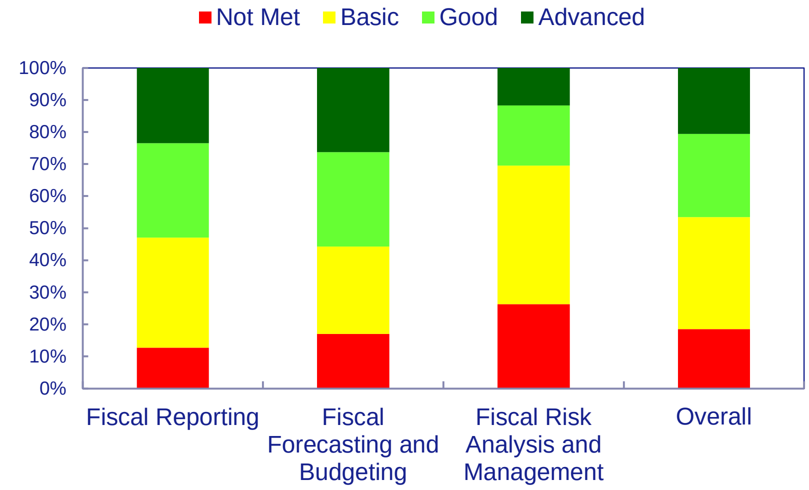
FTEs undertaken so far (overall findings)

BACKGROUND

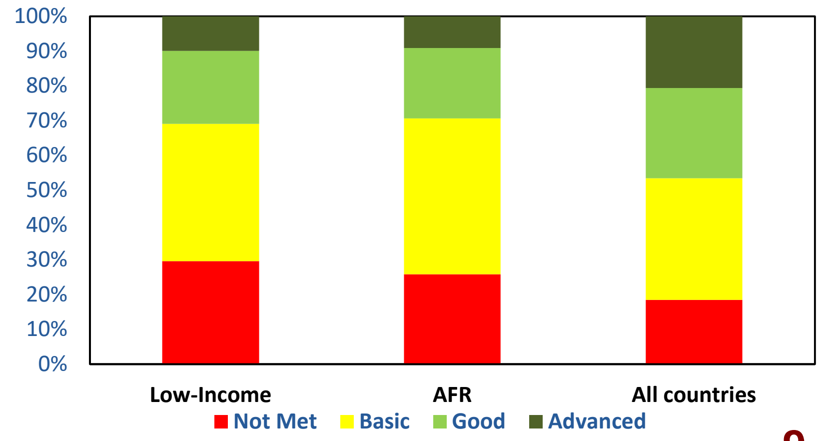
- **29 countries volunteered**
- **Wide range of income levels**
  - 6 advanced economies
  - 15 emerging markets
  - 8 low income countries
- **Variety of regions**
  - 13 from Europe
  - 5 from Africa
  - 8 from Latin America
  - 1 from Asia-Pacific
  - 2 from MENA
- **25 FTE reports published**

  Albania; Austria; Bolivia; Brazil; Colombia; Costa Rica; Guatemala; Finland; Georgia; Ireland; Kenya; Macedonia; Malta; Mexico; Mozambique; Peru; Portugal; Philippines; Romania; Russia; Senegal; Tunisia; Turkey; Uganda; United Kingdom

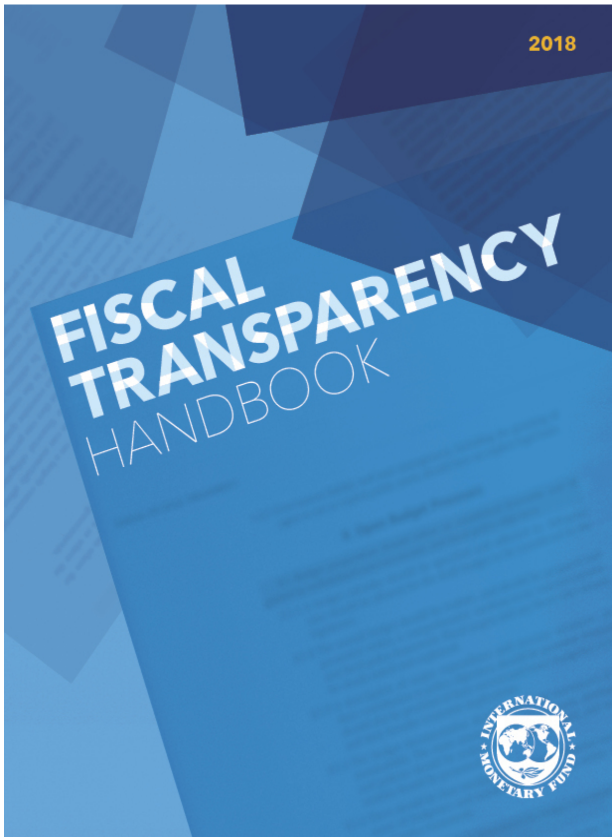
FTE Results by Pillar
(Percent of total scores)



FTE Results by Country Grouping
(Percent of total scores)



2018 Fiscal Transparency Handbook – provides guidance on FT Code and FTE



- **Defines** each pillar of the Code and the dimensions, **principles** under each pillar.
- **Describes recent trends** in implementation of each principle.
- **Lists relevant international standards** for principles.
- Sets out both the **benefits and challenges** of moving beyond basic practices.
- Cites **selected country examples** for each level of practice.
- **Specifies the indicators** to be used to measure adherence to the principles.

Fiscal risk management framework – key steps

Once countries better understand the scale and sources of their fiscal risks, the remaining challenge is to manage them more actively:

Step 1: Identify risks, their magnitude and likelihood
- Exposure
- Probability

Step 2: Reduce probability of risk occurring (for endogenous risks)
- Limit activities public entities
- Incentivize behavior
- Regulate private activities

Step 3: Reduce exposure to risk where it is cost-effective
- Policy instruments
- Market instruments

Step 4: Create fiscal space to absorb remaining risks
- Budget provisioning
- Buffer funds
- Fiscal headroom

Mitigating fiscal risks – policy instruments

- **Countries utilize a range of instruments for managing fiscal exposures:**
  - Caps on creation of contingent liabilities
  - Charges to reduce moral hazard and cover cost of realization
  - Insurance, options, and buffer funds
  - Regulation of risky activities
- **Choice of instrument depends on whether risk is:**
  - Endogenous or exogenous
  - Continuous or discrete
  - Probable, possible, or remote
- **Ultimate backstop remains low debt, but no framework for deciding “How low is low enough?”**

Fiscal risk management toolkit

Risk	1. Identify & Estimate		2. Reduce Probability			3. Reduce Exposure		4. Absorb Residual		
	Exposure (% of GDP)	Probability (% Annually)	Controls	Incentives	Regulation	Policy instruments	Market instruments	Budget provisioning	Buffer funds	Fiscal headroom
Financial Sector			Reduce state participation in banks	Reduce debt bias in tax system	Capital adequacy standards	Living wills	Deposit insurance	Expense expected payments (UK)	Deposit insurance funds (US, Canada)	Safe overall debt levels
Natural Disasters			Reducing public footprint in risky areas	Tax premia in high risk areas	Env. standards	Building codes Disaster preparedness	Insurance (NZ) Catastrophe bonds (Mexico)	Contingency reserves (Mexico, US)	Natural Disaster Fund (NZ, Turkey)	
Macro shock: e.g. Commodity Prices			Privatization of commodity producers	Tax base diversification	Commodity market regulation	Resource-based fiscal rules (Norway)	Hedging instruments (Mexico)	Prudent price assumptions (Chile)	Stabilization funds (Chile)	
Guarantees			Ceilings on issuance (Netherlands)	Risk related fees (Sweden)	Conditions on access to guarantee schemes	Obligation is contractual	Partial guarantees (Canada)	Expense expected cash flows (US) Provision for exp. calls (Columbia)	Guarantee funds (Sweden)	
State Owned Enterprises			Reduce size SOE sector	Management accountable for performance	Reporting requirements	Progressively reduce QFAs	Explicit no-bail-out clauses	Expense expected payments	-	
Subnational government			Limits on borrowing (Hungary)	Link degree of autonomy to performance (Iceland)	Reporting requirements	Adjustment plans for deviations from fiscal rules	Est. history of no-bail-outs (US)	Ceilings on annual budget allocations	-	

Thank You!

IMF Fiscal Transparency Web Page

http://www.imf.org/external/np/fad/trans/index.htm

Fiscal Transparency Handbook

www.elibrary.imf.org/fth