Fiscal Affairs Department

Asian Regional Conference on Public Financial Management

PFM Reforms: The lessons learnt -promises and tears

Session 4- Diagnostic Tools-FTEs and their use in PFM Reform

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26th November

財務省 Ministry of Finance Japan

FISCAL TRANSPARENCY EVALUATIONS AND THEIR USE IN PFM REFORM

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Phnom Penh, 26 November 2014

Outline

- Background and Context
- Why a New Fiscal Transparency Code (Pillars I, II, & III)
- A New Fiscal Transparency Evaluation
- Natural Resource Management (Pillar IV)
- Next Steps In the Roll-Out
- Use in PFM Reform

I. Background and Context:
a. Origins of the Global Fiscal Transparency Effort

- **A concerted effort to improve fiscal transparency since the late 1990s**
  - Asian crisis highlighted weakness in public and private financial reporting
  - Also underscored the risks associated with undisclosed linkages between the two

- **New fiscal reporting standards were developed**
  - **General:** IMF's Code & Manual on Fiscal Transparency
  - **Budgeting:** OECD Best Practices for Budget Transparency
  - **Statistics:** EU's ESA 95, IMF's GFSM 2001, & UN's SNA 08
  - **Accounting:** IFAC's International Public Sector Accounting Standards (IPSAS)

- **New tools for monitoring compliance with standards were introduced**
  - **Multilateral:** Fiscal and Data ROSCs, GDDS/SDDS, & PEFA
  - **Regional:** Eurostat, WAEMU & CEMAC harmonization of fiscal reporting
  - **Civil Society:** Open Budget Survey and Index, GIFT Principles

I. Background and Context:
b. Weakness of Old Fiscal Transparency Code & ROSC

- **Old Methodology: focus on clarity of reporting procedures not quality of reports**
  - Code's 4 "Pillars" reinforce focus on formal laws, institutions, and processes
    - i. Clarity of Roles and Responsibility
    - ii. Open Budget Processes
    - iii. Public Availability of Information
    - iv. Assurances of integrity
  - ROSCs did not pay enough attention to the content of fiscal reports themselves

- **Old Methodology adopted "single standard" approach to evaluating countries**
  - Did not take into account different levels of institutional capacity
  - Did not provide milestones to full compliance with international standards
  - Made it difficult to benchmark against comparator countries

- **Old assessments tended to be exhaustive rather than risk-based**
  - Place equal weight on all elements of the Code
  - Difficult to judge relative seriousness of different fiscal reporting gaps
  - Include a large number of unprioritized recommendations

II. New Fiscal Transparency Code

a. Architecture of the New Code

Four Pillars of the New Code

I. FISCAL REPORTING	II. FISCAL FORECASTING & BUDGETING	III. FISCAL RISK ANALYSIS & MANAGEMENT	IV. RESOURCE REVENUE MANAGEMENT
1.1. Coverage	2.1.Compre-hensiveness	3.1. Risk Analysis & Disclosure	4.1. Legal & Fiscal Regime
1.2. Frequency & Timeliness	2.2. Orderliness	3.2. Risk Management	4.2 Fiscal Reporting
1.3. Quality	2.3. Policy Orientation	3.3. Fiscal Coordination	4.3. Fiscal Forecasting & Budgeting
1.4. Integrity	2.4. Credibility		4.4. Fiscal Risk Analysis & Management

II. New Fiscal Transparency Code:
b. Differences between 2007 and 2014 Codes

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Objective	2007 Code	2014 Code
Focus on outputs rather than processes	30 of 45 principles were procedural in nature	31 of 36 principles focus on quality or content of fiscal information
Take account of different levels of country capacity	"Code of Good Practices"	Basic, Good, and Advanced Practice
Greater emphasis on fiscal risk disclosure and management	1 principle on fiscal risk 5 others risk-related	12 principles focused on fiscal risk
Align with recent advances in standards & practices	**Institutions:** General Government **Stocks:** Financial Balance Sheet **Frequency:** Quarterly **Classification:** GFSM 2001 **Accounting:** GAAP **Budgeting:** N/A	**Institutions:** Public Sector **Stocks:** Full Balance Sheet **Frequency:** Monthly **Classification:** GFSM 2014 **Accounting:** IPSAS **Budgeting:** PEFA & OECD

II. New Fiscal Transparency Code:
c. Graduated Set of Practices

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#	DIMENSION	PRINCIPLE	PRACTICES		
			BASIC	GOOD	ADVANCED
I	**FISCAL REPORTING**	**Fiscal reports should provide a comprehensive, relevant, timely, and reliable overview of the government's financial position and performance**			
1.1	***Coverage***	***Fiscal reports should provide a comprehensive overview of the fiscal activities of the public sector and its sub-sectors according to international standards***			
1.1.1	Coverage of Institutions	Fiscal reports cover all entities engaged in public activity according to international standards.	Fiscal reports consolidate all central government entities.	Fiscal reports consolidate all general government entities and report on each subsector.	Fiscal reports consolidate all public sector entities and report on each subsector.
1.1.3	Coverage of Stocks	Fiscal reports include a balance sheet of public assets, liabilities, and net worth.	Fiscal reports cover all cash, deposits, and debt	Fiscal reports cover all financial assets and liabilities.	Fiscal reports cover all financial and non-financial assets and liabilities, and net worth.
1.1.2	Coverage of Flows	Fiscal reports cover all public revenues, expenditures, and financing.	Fiscal reports cover cash revenues, expenditures and financing.	Fiscal reports cover cash flows and accrued revenues expenditures, and financing.	Fiscal reports cover cash flows ,accrued revenues, expenditures, and financing, and other economic flows.

III. New Fiscal Transparency Evaluation:
a. Objectives

1. Identify deficiencies in a countries' fiscal transparency practices, distinguishing between more and less serious ones

2. Draw a clear picture of a country's fiscal reporting practices relative to comparator countries and international standards

3. Provide a targeted and sequenced action plan for countries to address the main weaknesses

4. Allow for modular application including assessments of just one of the three pillars or assessments of their internal risk management practices

III. New Fiscal Transparency Evaluation:
b. Differences with Old Fiscal ROSC

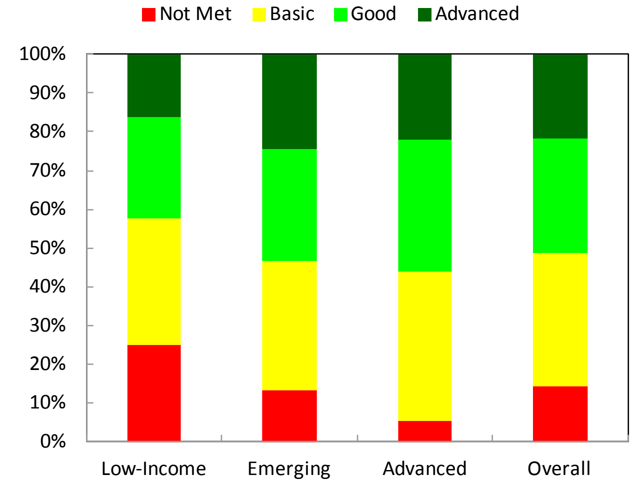
Reform Objective	Fiscal ROSC	Fiscal Transparency Evaluation
More analysis of coverage and reliability of fiscal data	Focus on assessing reporting procedures	Quantitative fiscal transparency indicators
More accessible summary of strengths and weaknesses	Long narrative accounts of strengths and weaknesses	Summary Heatmaps highlight reform priorities
Identify concrete steps to address weaknesses	Unprioritized list of recommendations	Sequenced 5-Year Action Plan
More scalable product	Comprehensive, one-size-fits-all assessment	Modular evaluations of individual Code Pillars

III. New Fiscal Transparency Evaluation
c. Piloting the New Evaluation

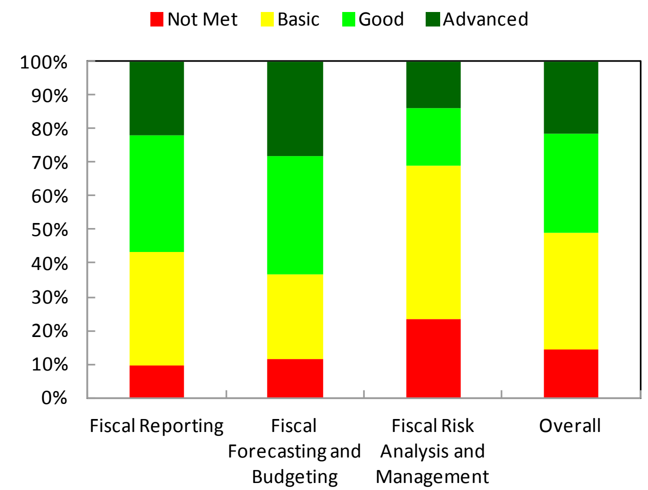
BACKGROUND

- **10 countries volunteered**
- **Wide range of income levels**
  - 3 advanced economies
  - 5 emerging markets
  - 3 low income countries
- **Variety of regions**
  - 5 from Europe
  - 2 from Africa
  - 2 from Latin America
  - 1 from Asia-Pacific
- **3 iterations of the Code tested**
- **5 FTE reports published so far**
  - Bolivia, Costa Rica, Ireland, Russia, and Portugal

FTE Results by Income Level
(Percent of total scores)



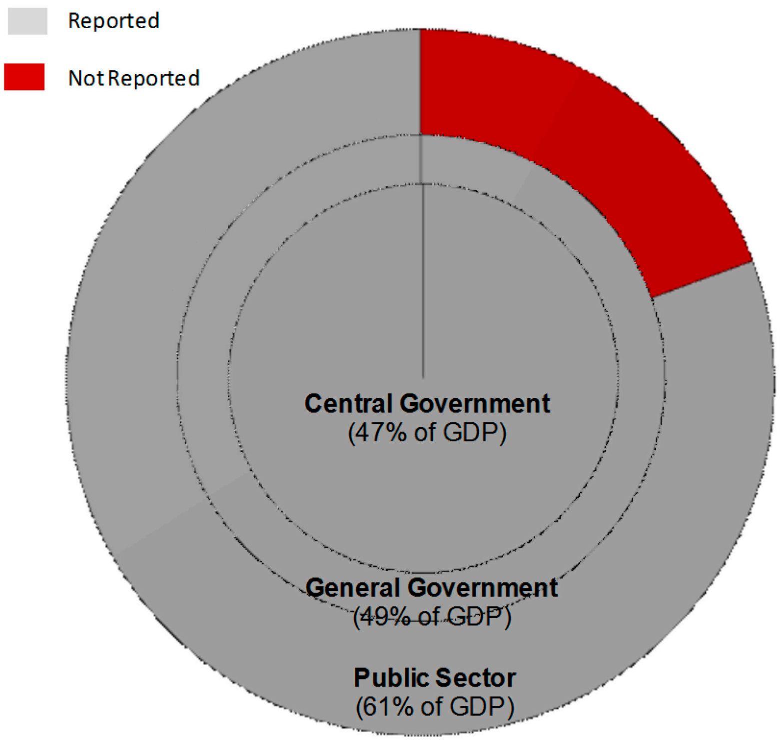
FTE Results by Pillar
(Percent of total scores)



III. New Fiscal Transparency Evaluation:
d. Initial Findings: Fiscal Reporting

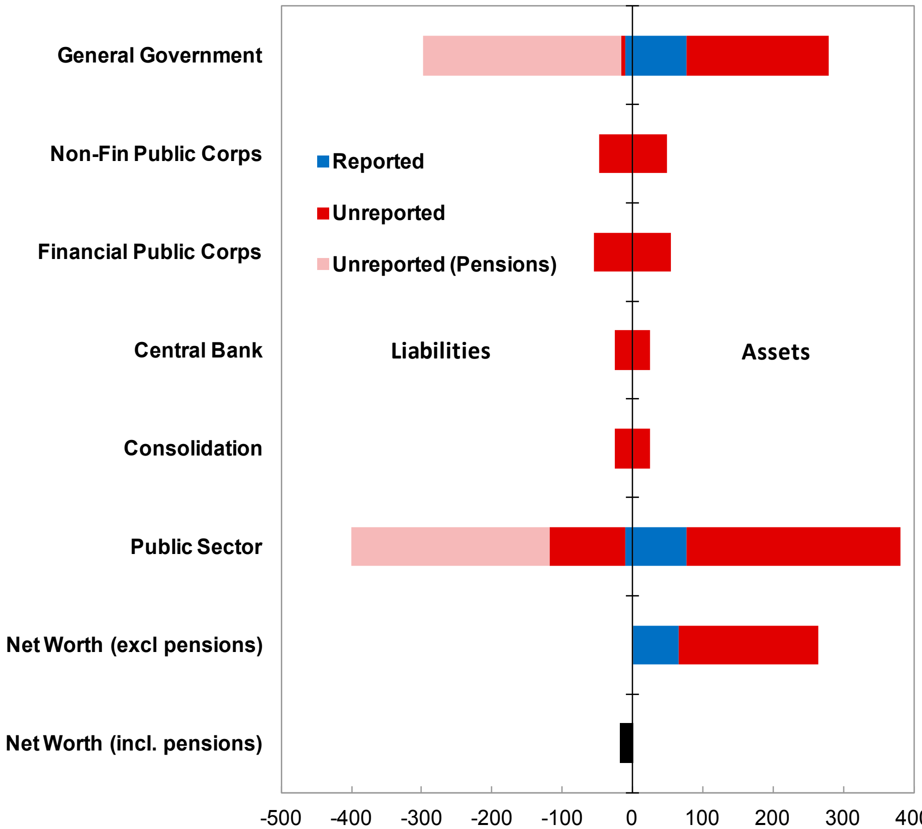
The "State" is bigger than we think…

Ireland: Coverage of Fiscal Reporting
(Percent of expenditure, 2012)



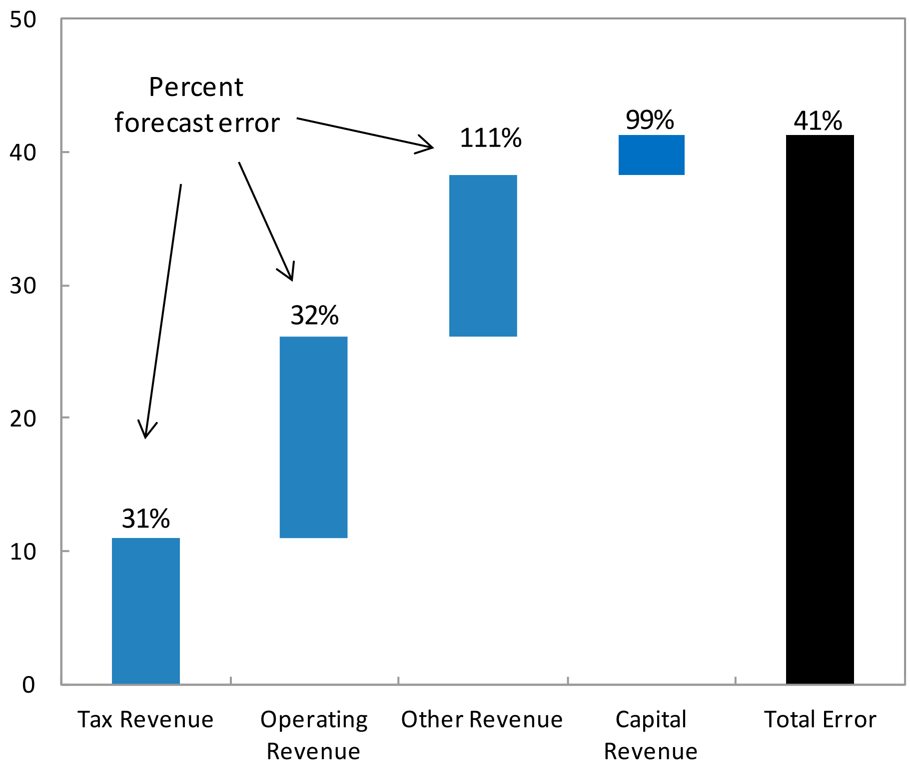
…with a more extensive balance sheet

Russia: Reporting of Assets and Liabilities
(Percent of GDP, 2012)

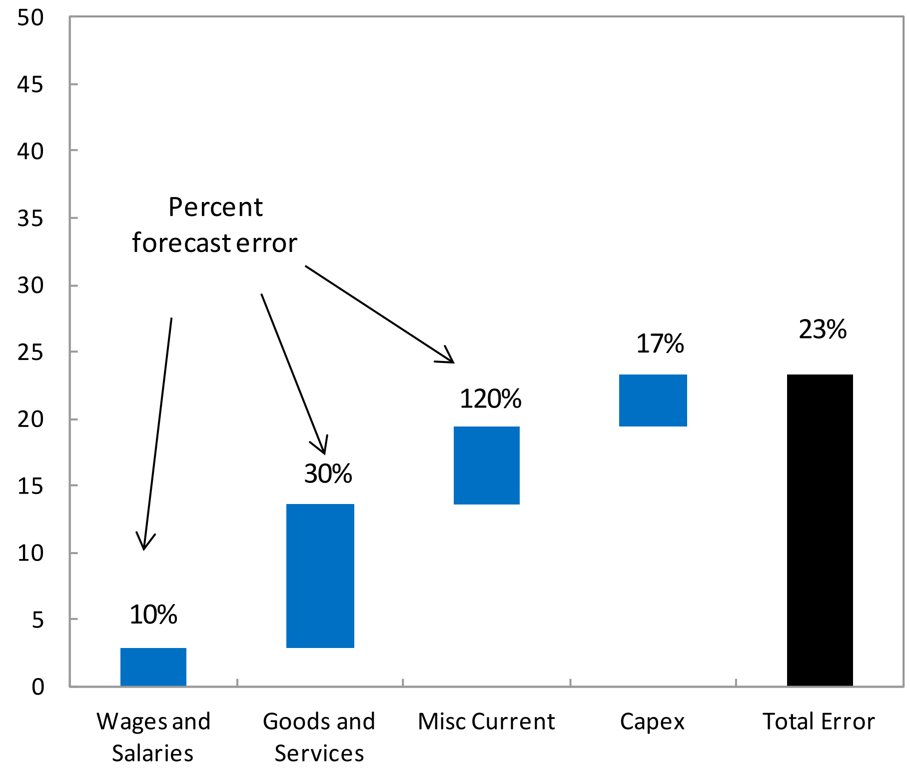


Budgets are not always a reliable guide to future revenues and spending

Bolivia: Year-ahead Revenue Forecast Errors
(Percent of total forecast revenue, 2010-11)

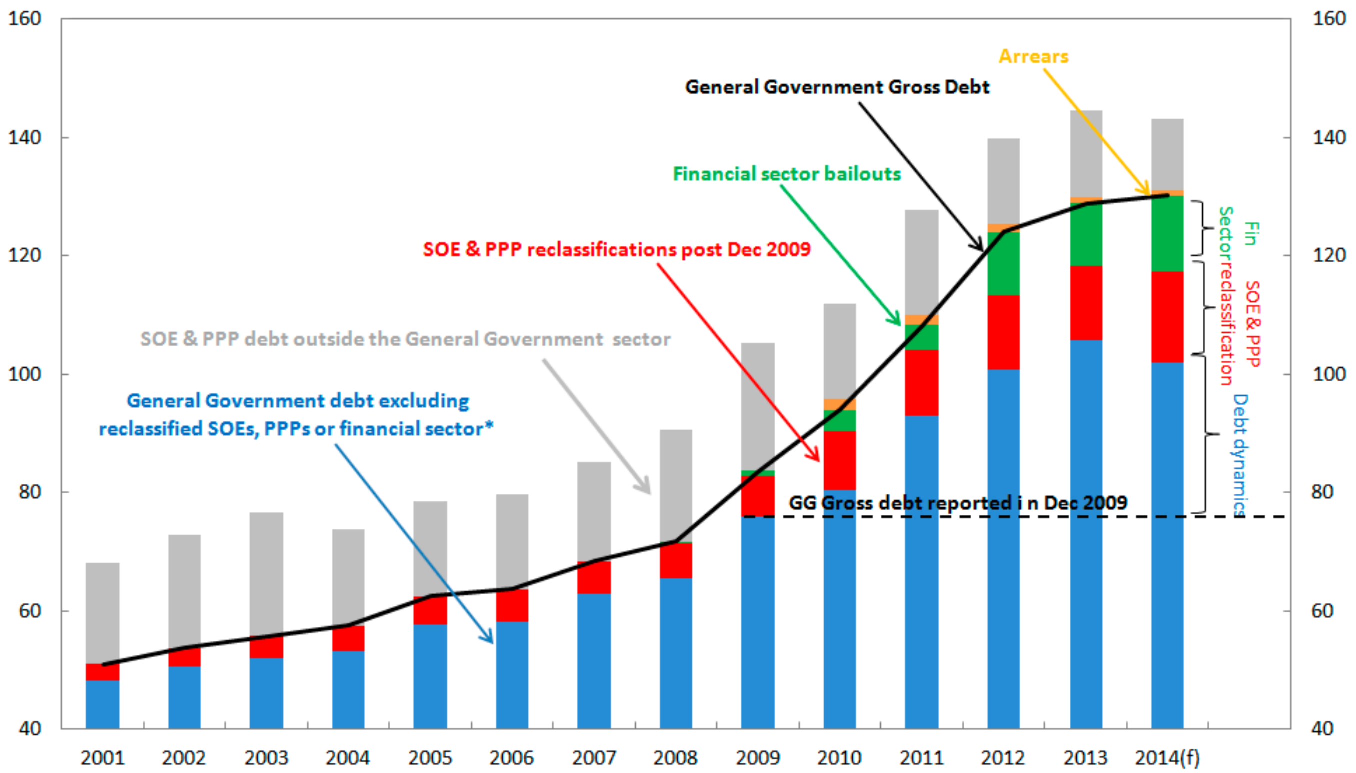


Bolivia: Year-ahead Expenditure Forecast Errors
(Percent of total forecast expenditure2010-11)



Fiscal risks can come from a variety of sources

Portugal: Sources of Increase in General Government Debt
(Percent of GDP)



III. New Fiscal Transparency Evaluation:
e. Targeted Recommendations - Examples

Russia: Summary Assessment of Fiscal Reporting

PRINCIPLE		ASSESSMENT	IMPORTANCE	REC
1.1	**Coverage of Institutions**	**Good:** Fiscal reports consolidate all general government units	**High:** Public corporations with expenditure of 28% of GDP in 2012 outside consolidated fiscal reports	1
1.2	**Coverage of Stocks**	**Good:** Fiscal reports cover all conventional financial and non-financial assets and liabilities	**High:** Subsoil assets of 200% of GDP and pensions liabilities of 285% of GDP not included in balance sheets.	2,3
1.3	**Coverage of Flows**	**Good:** Fiscal reports cover cash and accrued revenues and expenditures	**Medium:** Non-recognized non-recoverable claims of 0.4% of GDP reduce reliability of the fiscal balances	3
1.4	**Tax Expenditures**	**Basic:** There is annual disclosure of revenue loss due to some tax reliefs subsidies	**Medium:** Estimated 1-2% of GDP in annual revenue foregone due to tax expenditures.	4
2.1	**Frequency of In-year Fiscal Reports**	**Advanced:** Cash-based budget execution reports are published on a monthly basis	**Low:** Monthly fiscal reports are published within 30 days	
2.2	**Timeliness of Annual Financial Statements**	**Advanced:** Annual financial statements are published in a timely manner	**Low:** Annual reports are published within 5 months of the end of the financial year	
3.1	**Classification**	**Good:** Fiscal reports include an administrative, economic and functional, classifications comparable with international standards	**Medium:** Inconsistent classifications of some transactions lead to different levels of the fiscal balances	
3.2	…	…	…	

III. New Fiscal Transparency Evaluation:
f. Sequenced Action Plan - Examples

Ireland: Fiscal Transparency Action Plan

Action	2013	2014	2015	2016	2017
1. Expand Institutional Coverage of Budgets, Statistics, and Accounts					
a. Present all gross revenues and expenditures of central government entities in budget documentation		Incorporate NPRF into budget documentation	Incorporate Non-Commercial Semi-State Bodies into budget documentation	Incorporate all central government entities in budget documentation	Integrate non-commercial semi-state bodies into departmental votes
b. Combine Finance and Appropriation Accounts into a consolidated Central Government Financial Statement	Combine the information in the notes to the Appropriation Accounts to produce a summary report	Combine Finance and Appropriation Accounts into a partial Central Government Financial Statement based on existing accounting policies	Incorporate SIF and NPRF into partial Central Government Financial Statement	Incorporate Non-Commercial Semi-State Bodies into consolidated provisional Central Government Financial Statement	Prepare comprehensive consolidated Central Government Financial Statement for audit by C&AG
c. Provide an overview of the gross revenues and expenditures of the general government and its subsectors	Reconcile gross revenues and expenditures of Exchequer and general government in budget	Provide summary of gross revenues and expenditures of central government in budget	Provide summary of gross revenues and expenditures of central, local, and general government in budget	Publish quarterly statistics on gross revenues and expenditures of central, local, and general government sectors	Publish monthly statistics on gross revenues and expenditures of central, local, and general government sectors

III. New Fiscal Transparency Evaluation:
g. Lessons Learnt So Far

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- **FTEs are work intensive** because of the emphasis on quantitative indicators. FTE requires quite a bit of preparatory work.
- **There seems to be more data than expected**, even in LICs. Countries have more information than they think or know of. While taking a few shortcuts, producing an approximate and preliminary balance sheet for the public sector is not impossible.
- **Fiscal risk management is still in its infancy**. All FTEs so far confirm that identification and measurement of fiscal risks, their disclosure, and management remain in its infancy.
- **FTEs point to uncharted waters**. FTEs are pushing the envelope as accounting/ reporting standards may not be applied or even exists for certain transaction.

IV. Natural Resource Management (Pillar IV):
a. To be finalized by Spring 2015

- **Pillar IV of Code - dedicated to Natural Resource Management and fully integrated in Fund's fiscal transparency framework (12 principles)**
- **New Guide on Resource Revenue Transparency and Accountability & Reporting Template for Natural Resource Revenue Statistic**
- **Why needed?**
  - Changing commercial structure of extractive industries (increased recognition of commodity pricing challenges; new sources (e.g., shale oil/gas, oil sands, rare earths); new commercial structures (e.g., oil service companies)
  - Changing International Fiscal Architecture (e.g., base erosion and profit shifting; tax treaties, transfer pricing); increasing recognition of need for transparency (e.g., for taxing purposes)
  - New International Standards (new institutions like EITI, new standards for reporting on environmental matters; new 'home country' reporting requirements)

IV. Natural Resource Management (Pillar IV):
b. Approach & Principles

Guiding Approach

- **Follows structure and approach of the first three pillars:**
  - Measurable output rather than process
  - Take account of different levels of country capacity
  - Greater emphasis on fiscal risk disclosure and management
  - Align with recent advances in standards and practices (e.g. EITI)
- **Provides unique Natural Resource-specific elements**
- **Used in combination with first three pillars to give a comprehensive picture**

Pillar Structure

Legal and Fiscal Regime
Legal framework
Allocation of resource rights
Fiscal regime
Assessment and collection of revenues

Fiscal Reporting
Resource holdings
Company reporting
Integrity of data

Fiscal Forecasting and Budgeting
Resource Revenue Management Objectives
Use of Revenues
Natural Resource Funds

Fiscal Risks Analysis and Management
Social and Environmental Impact
Operational Risks

V. Next Steps

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DATE	ACTION
October 2014	Consultation on Pillar IV on Natural Resource Management
Winter 2015	Consultation on Fiscal Transparency Manual Vol . 1 (Pillars I-III)
Spring 2015	Finalization of Pillar IV on Natural Resource Management
Summer 2015	Consultation on Fiscal Transparency Manual Vol 2 (Pillar IV)
Winter 2015	Finalization of Fiscal Transparency Code (Pillars I-IV) & Manuals (Vols. 1 & 2)
Ongoing	Every year at least 5-6 Fiscal Transparency Evaluations (including pilots of Pillar IV)

VI. FTEs and PFM Reform

a. A Specialized Drill-Down Tool

- **Assesses key problem areas** in fiscal management (e.g., fragmentation of budget, inadequacy of reporting, and contingent liabilities).
- **Highlights linkages between fiscal management and fiscal outcomes:** emphasizes different aspects of fiscal risk, standards of fiscal forecasting, & coverage of public sector, all areas not touched by other diagnostic tools.
- **Provides output focus and quantification:** focus on “size of problem” directs attention to key issues and the contributing factors behind these issues; and guides required remedial actions and prioritization of reforms.
- **Graduated practice:** provide clear development steps to achieving higher compliance with relevant international standards.
- **Basis for PFM reform strategy:** On the basis of FTEs, FAD’s offers countries the option of having the FTE team recommend a sequenced action plan. This would seem particularly useful where detailed reform strategies have not been elaborated, but it could also be used to update and revise existing PFM reform strategies.

VI. FTEs and PFM Reform
b. Serving a Key Reform Objective

- **Fiscal Transparency = PFM Functionality.** Transparency is not merely disclosure; it is a functionality of strong institutions and underlying processes. Achieving transparency is a key PFM objective.
- **FTEs provides assessment basis for improving PFM functionality.** FTEs are particularly useful for countries aspiring to achieve greater openness in fiscal management and highlighting the linkages between institutions and macro-fiscal outcomes. FTEs therefore reinforce the success of reform undertakings.