BETTER POLICIES FOR BETTER LIVES

Fiscal Governance & Fiscal Risks: "Transparency" and other tools

Ronnie Downes, Deputy Head
Budgeting and Public Expenditure Division
Public Governance Directorate

Riga, Ministry of Finance Conference, 6 June 2013

Fiscal Governance

- Practices, Processes and Procedures by which national fiscal policy is formulated, presented, considered and executed

- That's a neutral definition

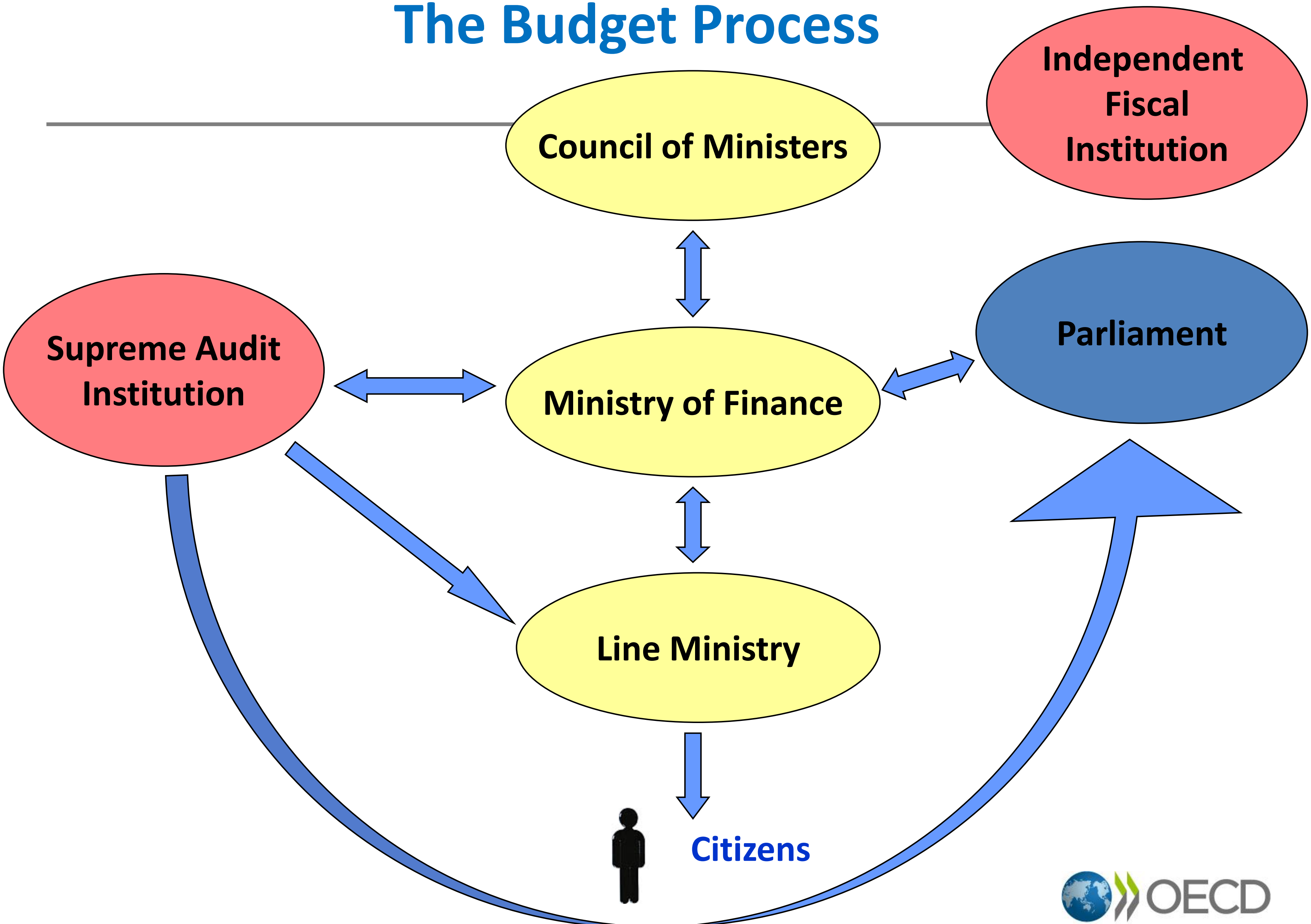
- What makes for 'good' and 'bad' fiscal governance?

  – 'Good' at what?
  – 'Bad' at what?

- Need to go back to fundamentals…

Declaration of Human and Citizens' Rights
France - 1789

The Budget Process

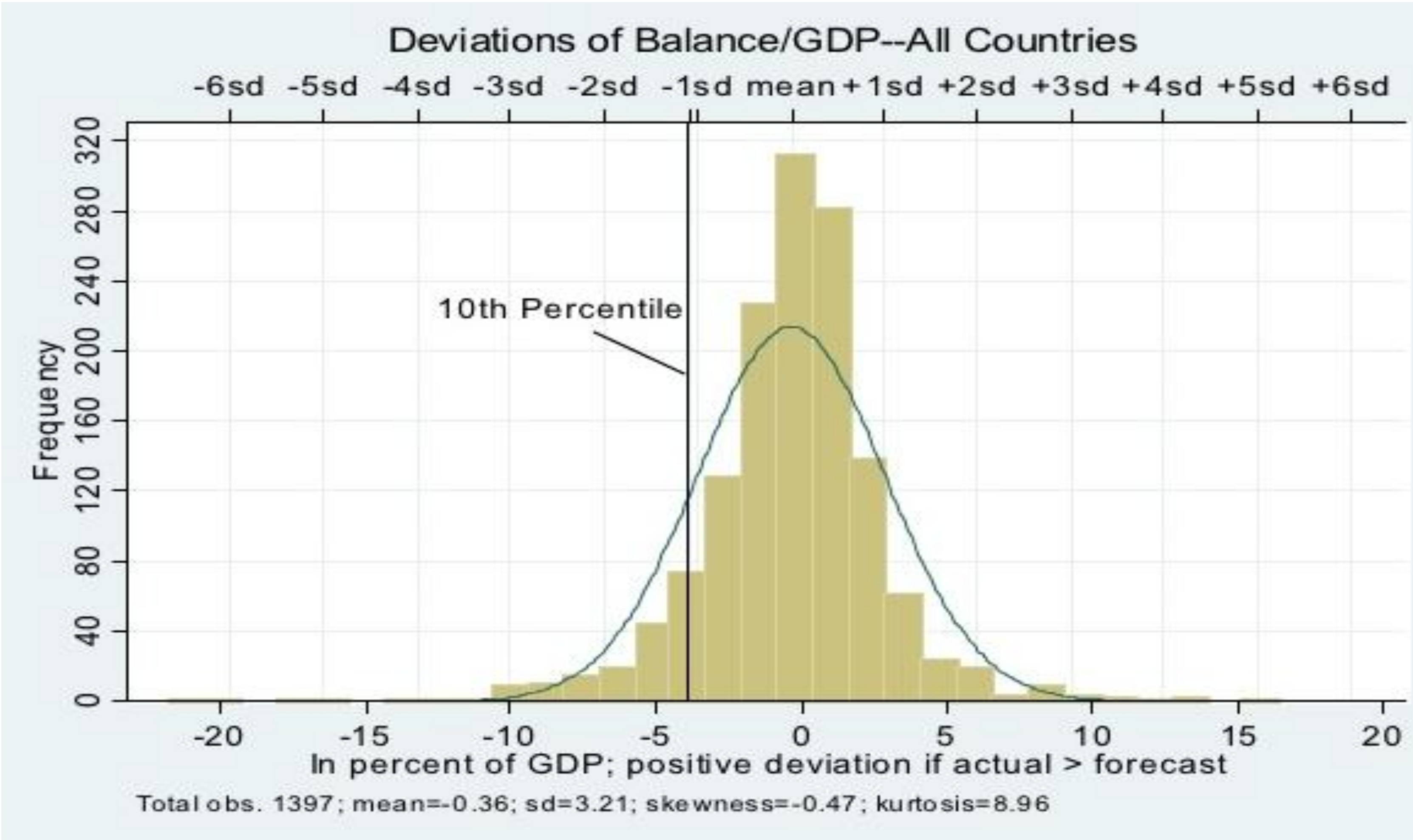


BETTER POLICIES FOR BETTER LIVES

Fiscal Risks

- Risks to the achievement of fiscal objectives, either in short, medium or long term
- Net-zero risks (could go either way)
  - Forecast errors; global economic conditions; market sentiment
- Non-zero risks (known or expected to be either positive or negative)
  - contingent liabilities
  - 'deficit bias'
- Is existing fiscal governance capable of managing these risks?

Outturns versus Forecasts



Are fiscal risks a 'problem'?

- Unless adequately managed, forecasts will always be a poor reflection of reality
  - Imperfect information
  - Sub-optimal decision-making and resource allocation
  - Worse outcomes for citizens

- How to manage, control and limit fiscal risks?

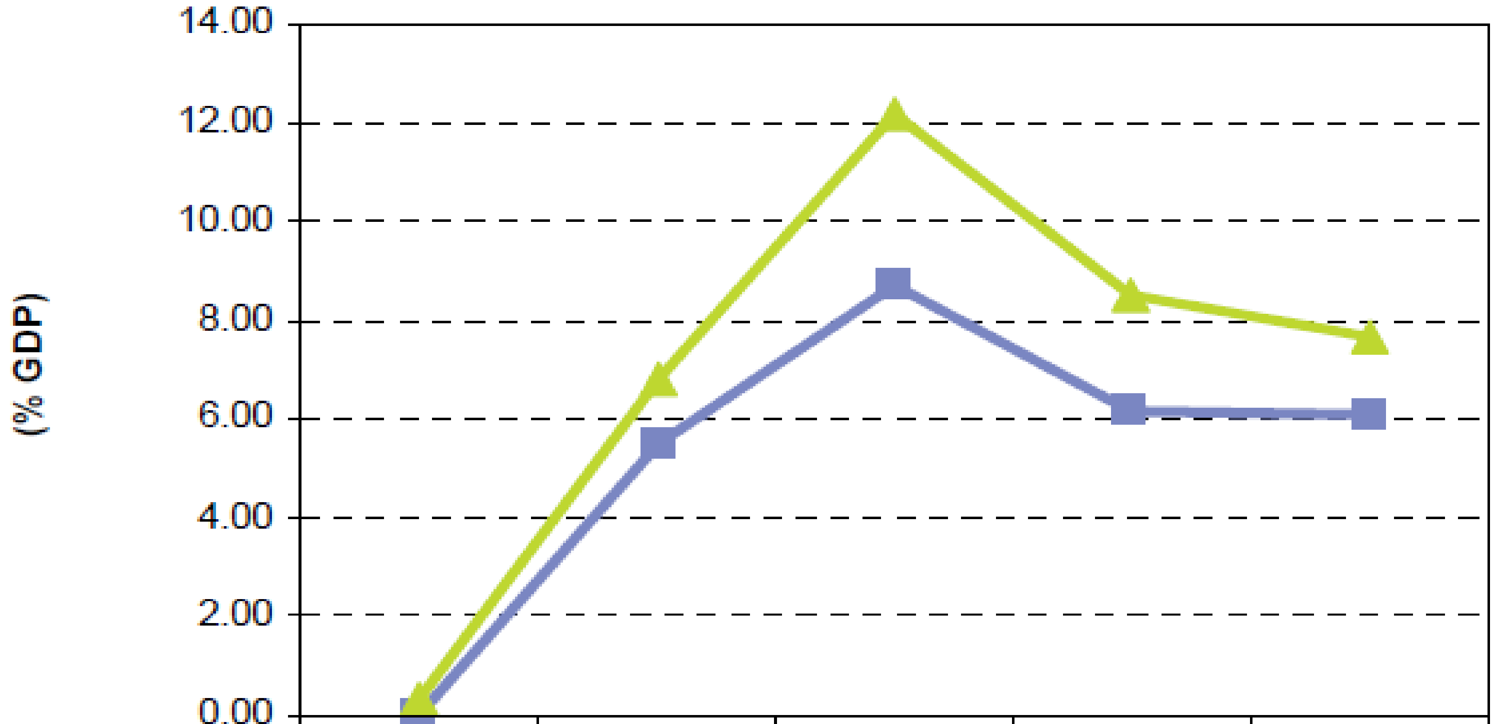
Focus on "contingent liabilities"

- OECD 2002: "... budgetary impact is dependent on future events which may or may not occur"
- IAS 37: "... arise from past events" and depend on events "not wholly within the control" of the entity
- Most common:
  - government loan guarantees
  - government insurance programmes
  - legal claims against the government
  - backing (even if unstated) for state-sponsored businesses, key strategic sectors - banks etc.
- EXPLICIT and IMPLICIT

How they are treated now

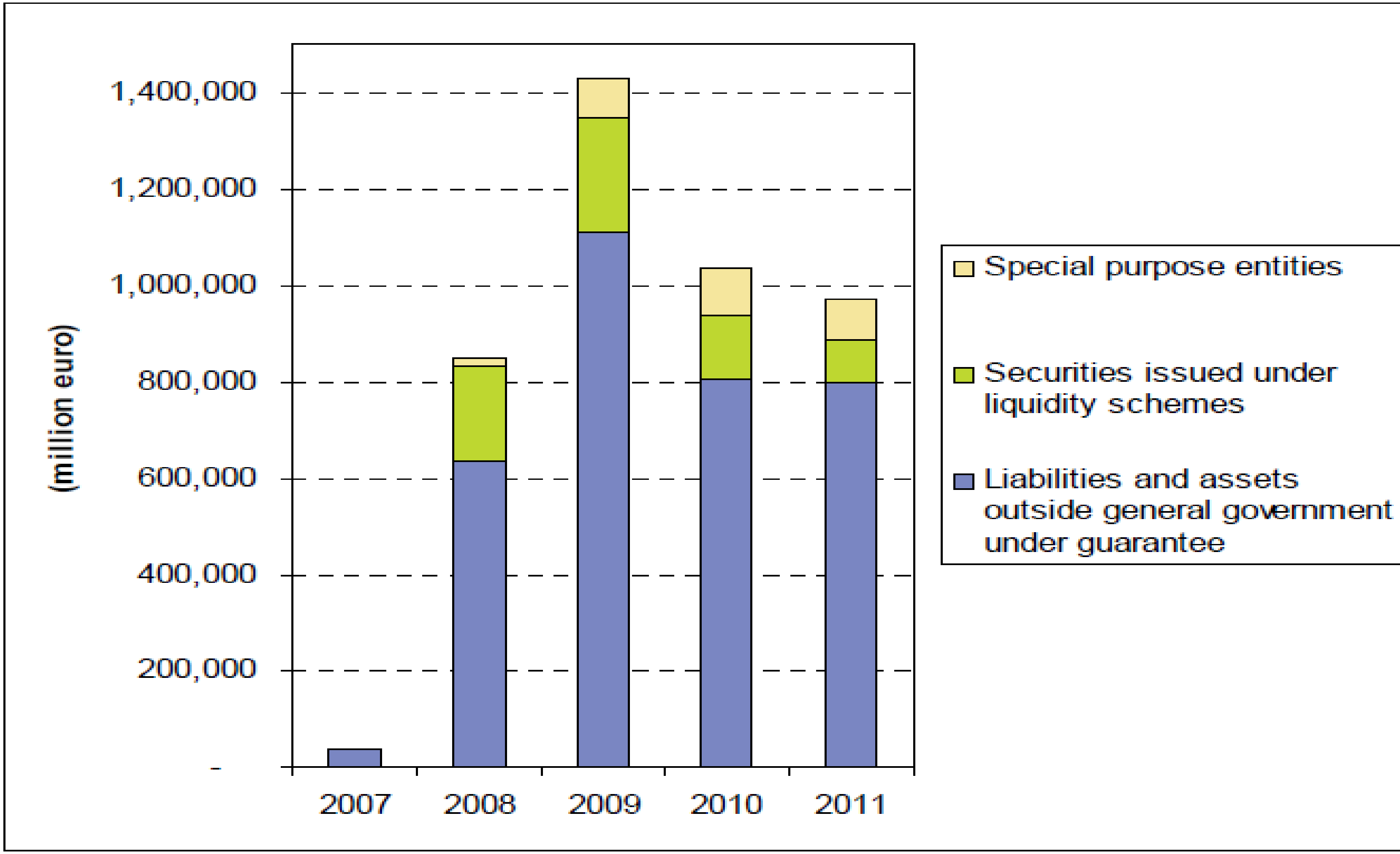
- OECD 2002
  - All significant contingent liabilities should be disclosed
  - "Where feasible", disclose also:-
    - Total amount of contingent liabilities
    - ("listed and described" where not quantifiable)
    - Classified by major category
    - Historical information on defaults in each category
- Note also: EU 2011 – Fiscal Frameworks Directive
  - Member states shall publish "relevant information on contingent liabilities with potentially large impacts … for all sub-sectors of government"
- In practice?

Level of Contingent Liabilities - EU

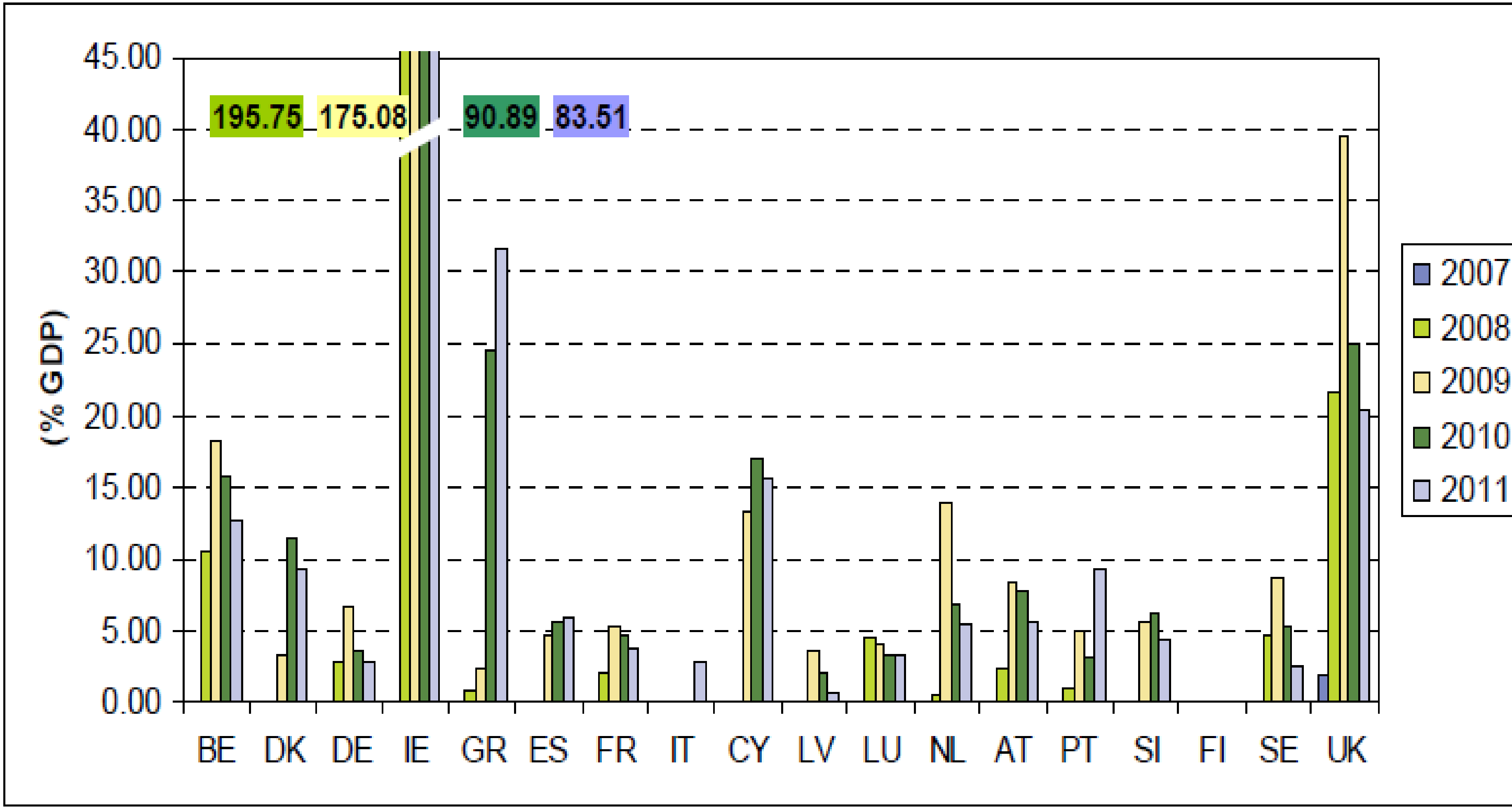


	2007	2008	2009	2010	2011
EA17	0.00	5.51	8.68	6.16	6.06
EU27	0.30	6.81	12.16	8.47	7.67

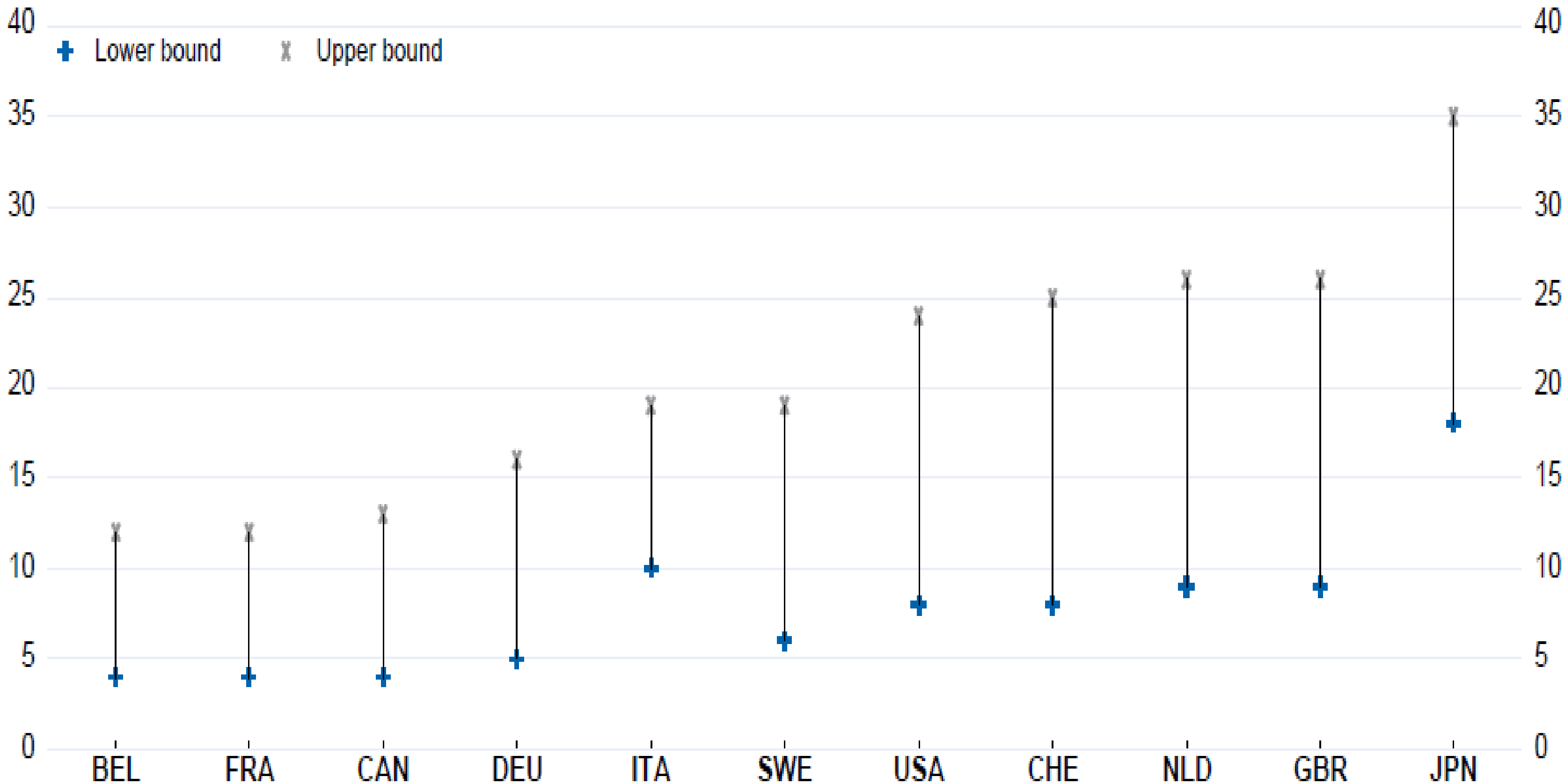
Structure of Contingent Liabilities



Level of Contingent Liabilities by Country



Banking sector contingent liabilities (S&P)



Lessons from this experience?

- Major contingent liabilities existed – they just went unrecognised
- … until they became actual liabilities
- Precipitated by period of crisis
- Maximised, aggravated fiscal vulnerability and uncertainty
- One major cause of collapse of confidence in markets
- Lesson: in absence of TRUST: CREDIBILITY can only be regained through TRANSPARENCY

OECD Best Practices for Budget Transparency 2002

TRANSPARENCY: "openness about policy intentions, formulation and implementation"

- **Part I - Budget Reports**
- **Part II - Specific Disclosures**
- **Part III – Integrity**

Budget Reports

- **The Budget**
- **Pre-Budget Report**
- **In-Year Reporting**
- **Year-End Report**
- **Pre-Election Report**
- **Long-Term Report**

- **RATIONALE: everyone has an interest in making sound budget decisions – so a maximum of visibility, participation, should promote better outcomes**

Does transparency foster good fiscal performance and economic growth?

- **Sound fiscal management—including fiscal transparency—is a key aspect of good governance that contributes to macroeconomic stability and economic growth**

- **"Empirical evidence on the beneficial effects of fiscal transparency ranges from improved budgetary outcomes, to lower sovereign borrowing costs and decreased corruption." (Wehner and Renzio, 2011) – more research needed**

OECD
BETTER POLICIES FOR BETTER LIVES

Beyond Transparency: Tools and Strategies for Managing Fiscal Risks

- "Statement of Fiscal Risks"
- "Fan-charts" to illustrate forecasting margins
  - Sensitivity analysis
- Legal safeguards
  - Identify and apply market-based fee for all State guarantees
  - Caps / ceilings on State support
- Clearer role inseting boundaries for the State
  - Easier to repudiate or limit implicit contingent liabilities
- Contingency reserves / "rainy day funds"
- A role for an independent fiscal council?

Towards a new Fiscal Governance framework

- Senior Budget Officials 3/4 June, Paris:
  - presented Results of OECD Budget Survey
  - OECD mandated to develop "Principles of Good Budgeting Practice for the Future"
  - Major task – will involve all regional SBO networks also?

- OECD objective – promote good practice, respond to political demands for better guidance
- Note also: EU Fiscal Frameworks Directive: link to requirements of economic and monetary union

Towards Good Budgeting Principles

1. Top-down budgeting – setting aggregates first
2. Clear and sensible fiscal rule, or rules
3. Medium-term expenditure framework
4. Transparency – "upgrade" of Best Practices
5. Performance dimension of budgeting
6. Objective and rigorous budgetary forecasts
7. A participative budget formulation process
   - Stronger, year-round engagement with parliament?
   - Role for Independent Fiscal Institutions?
8. A culture of evaluation, prioritisation and value-for-money
   - regular Spending Reviews?
   - PPPs versus traditional capital procurement
9. What should be added? - or what taken away?