



# USC GLOBAL LEADERSHIP SUMMIT 2016

## *Twenty Years of Fiscal Transparency: An Economist's Reflection*

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**Government Financial Accountability & the European Economic Crisis:  
Paths to Prosperity**

*Sponsored by:*

University of Southern California Martens Economic History Forum,  
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# Outline of the presentation

- A brief historical excursus: ebbs and tides
- Define fiscal transparency and role of information
- Why earlier attempts did not deliver?
- Why does it matter? Why now?
- Revising the transparency code—de-constructing the problem?
- Concluding remarks

# **A BRIEF HISTORICAL EXCURSUS**

# Ebbs and tides

- Fiscal transparency and accountability have had alternate phases of success.
- Transparency declined during absolutism but recovered in 1600-1700s—England’s Bill of Rights (1689), Sweden’s Freedom of Information Act (1766), Necker publishes first budget (1781), US Constitution (1787), France’s Declaration of the Rights of Man and Citizen (1789)
- Cycles have become increasingly short.
- Soviet Union dissolution; 1994 New Zealand Fiscal Responsibility Act.
- 1998 Kopits and Craig “Transparency in Government Operations.”
- A concerted effort to improve fiscal transparency since the late 1990s following the Asian crisis, which highlighted weakness in both public and private financial reporting and risks associated with undisclosed linkages between the two.

# Fast forward

- The decade preceding the 2008 financial crisis saw an initial demand for transparency but ...
- .....followed by rapid slowdown in spite of many initiatives, such as...
- ...Transparency International, Revenue Watch, Open Budget Partnership and a plethora of related governance, doing business, and corruption indexes which by and large tackle very similar aspects.
- Study to the test syndrome—form over substance.
- Do we know how to measure success?

# **DEFINITION(S)**

# Kopits and Craig, 1998

“Fiscal transparency is defined as:

–Openness toward the public at large about government structure and functions, fiscal policy intentions, public sector accounts, and projections.

–It involves ready access to reliable, comprehensive, timely, understandable, and internationally comparable information on government activities,—whether undertaken inside or outside the government sector.

–Its ultimate purpose that the electorate and financial markets can accurately assess the government’s financial position and the true costs and benefits of government activities, including their present and future economic and social implications.”

# Alt and Lassen, 2006

Fiscal transparency implies

- “More information in fewer documents”
- “a [greater] commitment to nonarbitrary language: words and classifications should have clear, shared, unequivocal meanings” (e.g., use of GAAP)
- Greater possibility of “independent verification” of information
- “More justification”



# IMF 2012

- **Fiscal transparency:** the clarity, reliability, frequency, timeliness and relevance of public fiscal reporting and the openness to the public of the government's fiscal policy-making process.
- **Public fiscal reporting:** the publication and dissemination of summary information about the past, present, and future state of the public finances to citizens in the form of:
  - fiscal forecasts and budgets;
  - government finance statistics; and
  - government financial statements or accounts
- **Fiscal risks:** factors that lead to differences between a government's forecast and actual fiscal position

# Role of information

- Lack of transparency (information), first element of fiscal risk.
- Government often do not know their true financial position or implications of today's decision or the risks they may face.
- To affect behaviors, governments must change the information available to participants and how it is processed.
- Dumping extremely detailed and large amount of data may create a veil that fogs rather than sheds light on fiscal events.
- Information has to be vetted—with some degree of autonomy and independence—to make it comprehensive, reliable, timely, and most of all reliable.

## ***Caveats:***

- Not all information is essential, some is useful, some less so, but in any event it is costly, may lead to overload or an end by itself rather than a means to an end, and may generate conflict.
- Limited capacity to process information.

**WHY EARLIER ATTEMPTS DID NOT  
DELIVER AS EXPECTED?**

# Empirical evidence not overwhelming

- **Success: what do we measure?**
  - On average, more transparent countries have better fiscal outcomes, but does transparency cause the improvement in fiscal outcomes?
  - Or are countries with better fiscal outcomes more inclined to publish information on public finances?
  - Or do other, underlying differences among countries lead to differences in both fiscal outcomes and transparency?
- **Causality**
  - Some studies find evidence that fiscal transparency leads to better outcomes, but causality remains an issue:
    - Alt and Lassen (2006): transparency leads to lower debt, controlling for other influences
    - Arbatli and Escolano (2012): transparency improves credit ratings, directly and indirectly
  - But it is possible to develop models in which transparency is actually harmful (see Justin Fox, 2006)

# Did we get the right incentives?

- Transparency (a positive message) confused with anti-corruption/good governance campaign (less positive).
- A moral category instead of a means to an end—fiscal responsibility and accountability.
- ROSCs run out of steam as very rarely became subject of surveillance/conditionality...
- ...although they did flag the right issues, perhaps in a somewhat cryptic way.
- Other (too many?) diagnostic tools emphasized more the form over the substance—best practices bias.
- ***Are we being too naïve or purist, thus lacking a more pragmatic approach?***

# More complex than it seems?

- Known knowns, things we know we know.
- Known unknowns, things we know we do not know...
- .....or we rather we do not like to know....
- Unknown unknowns, things we don't know we don't know.
- Unknown known, things we intentionally refuse to acknowledge that we know.

But we can find simple ways to explain:

- the unknown by the more unknown--***ignotum per ignotius***
- the unknown by the equally unknown--***gnotum per æque ignotum***

# Layers of transparency?

- “Sunlight is the most powerful of all disinfectants” (Brandeis)
- “There may be trade-offs between the value of sunlight and the danger of over-exposure” (Heald)
- One can look at two levels of transparency:
  - The most important one is for decision makers to realize their true (and fair) fiscal (financial) position.
  - The fact that such information should be publicly available goes without saying but belong to a different—equally important—level.
- Transparency is also a prerequisite (necessary but not sufficient) for:
  - Accountability, which requires clear objectives and responsibility
  - Participation, within cabinet, between executive and legislature, civil society, but causality not obvious

**WHY NOW?**



# Why Transparency now?

- 2008 financial crisis...but it happened before...
- Fiscal adjustment may become an illusion
- Governments tend to disappear because of:
  - *hidden borrowing: pension schemes*
  - *disinvestment: privatization, securitization*
  - *deferred spending: cash/accruals, leases, PPPs*
  - *foregone depreciation/investment*
- Financial markets also seem to care—which will provide further incentives for sound fiscal policies

# Lessons from the Recent Crisis

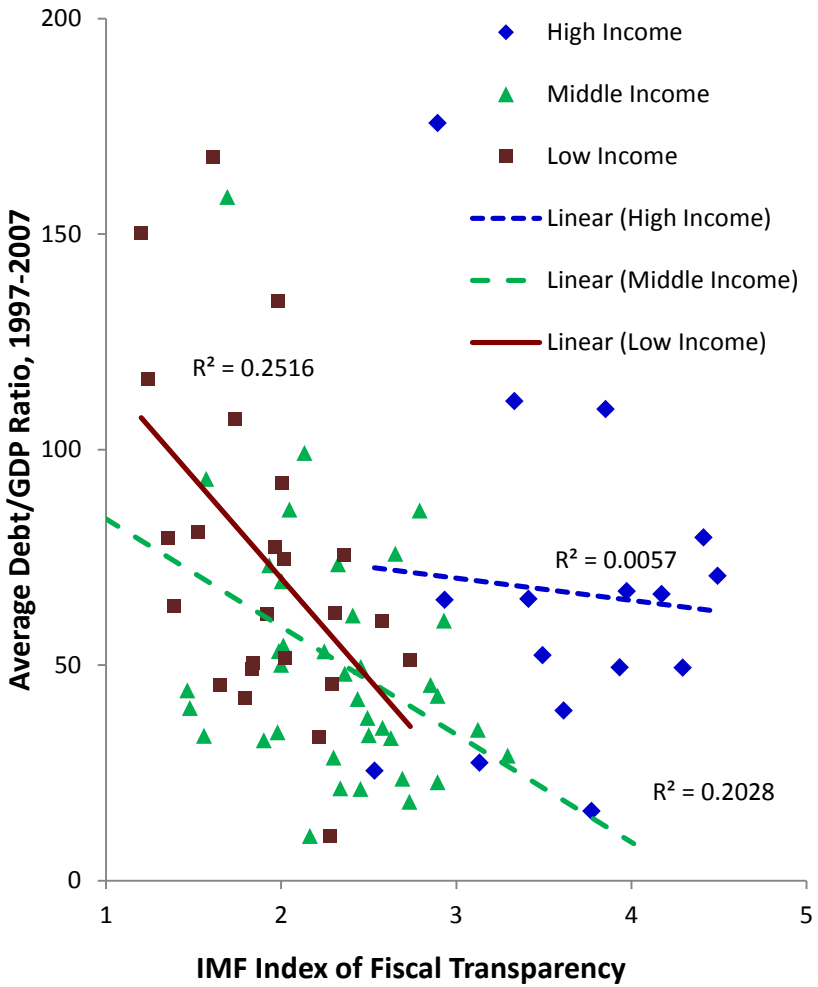
Sources of Unexpected Increase in General Government Debt  
(percent of GDP, 2007-2010)

	FRA	DEU	NLD	ESP	PRT	GBR	USA	GRC	IRL	ISL	AVE*	Issues Revealed by the Crisis
<b>Underlying fiscal position</b>	<b>1.7</b>	<b>3.2</b>	<b>-2.4</b>	<b>1.8</b>	<b>11.3</b>	<b>3.7</b>	<b>8.1</b>	<b>16.3</b>	<b>1.3</b>	<b>10.9</b>	<b>6.0</b>	
Revisions to 2007 deficit & debt	1.7	1.8	-0.9	-0.1	0.1	1.5	7.1	2.5	1.6	4.0	4.7	Unreported Deficits
Changes to government boundary	-0.7	1.4	-0.2	0.6	9.4	1.9	0.9	11.2	-0.1	2.5	1.1	SoEs & PPPs
Cash-accrual adjustments	0.7	0.0	-1.3	1.3	1.7	0.3	0.0	2.6	-0.2	4.5	0.2	Arrears
<b>Exogenous shocks</b>	<b>8.4</b>	<b>12.8</b>	<b>14.2</b>	<b>15.4</b>	<b>8.1</b>	<b>17.0</b>	<b>6.3</b>	<b>40.0</b>	<b>60.2</b>	<b>39.5</b>	<b>9.8</b>	
Macroeconomic shocks	8.3	4.7	5.2	13.0	4.4	8.9	3.8	38.4	35.7	-3.3	6.0	Macroeconomic Risks
Financial sector interventions	0.0	8.1	9.0	2.5	3.6	8.1	2.5	1.6	24.5	42.8	3.8	Contingent Liabilities
<b>Policy changes</b>	<b>2.3</b>	<b>3.8</b>	<b>1.9</b>	<b>4.9</b>	<b>4.7</b>	<b>1.1</b>	<b>6.4</b>	<b>-8.0</b>	<b>-9.9</b>	<b>-4.3</b>	<b>4.7</b>	Stimulus / Consolidation
<b>Other factors</b>	<b>2.1</b>	<b>-0.3</b>	<b>6.5</b>	<b>1.9</b>	<b>3.7</b>	<b>6.2</b>	<b>8.3</b>	<b>-6.7</b>	<b>7.5</b>	<b>21.6</b>	<b>5.9</b>	
<b>Total Unforecast Increase in Debt</b>	<b>14.4</b>	<b>19.5</b>	<b>20.2</b>	<b>24.0</b>	<b>27.8</b>	<b>28.0</b>	<b>29.1</b>	<b>41.7</b>	<b>59.1</b>	<b>67.7</b>	<b>26.4</b>	

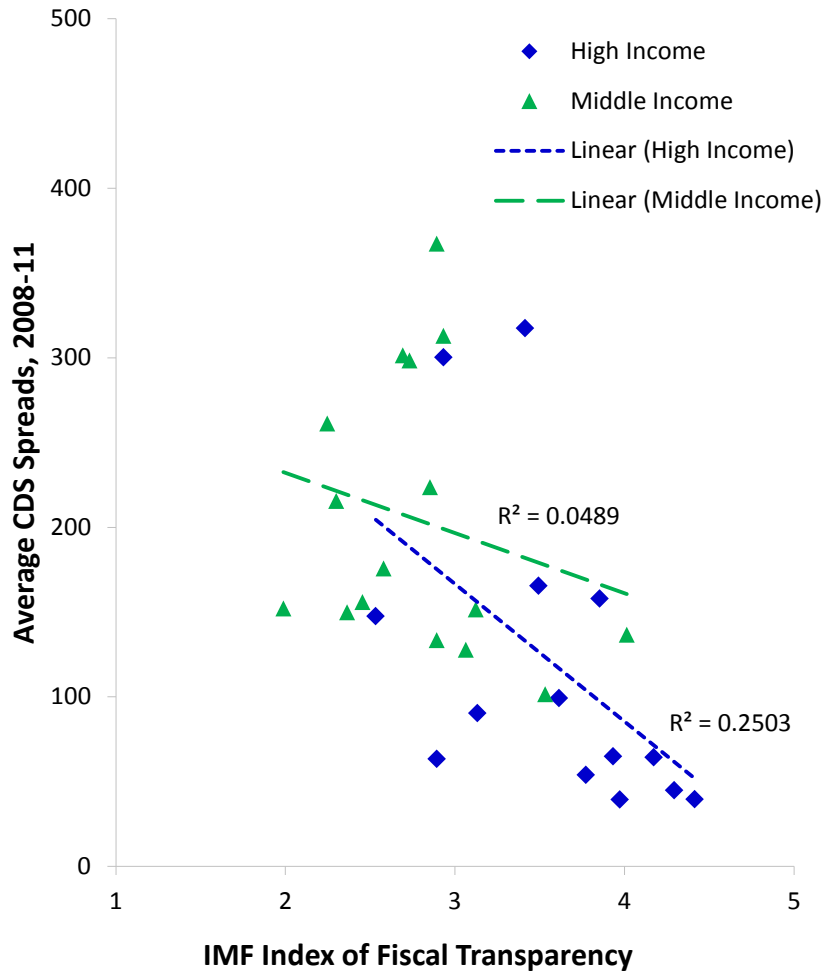
\* GDP-weighted average

# Markets seem to care .....

### Fiscal Transparency & Fiscal Performance

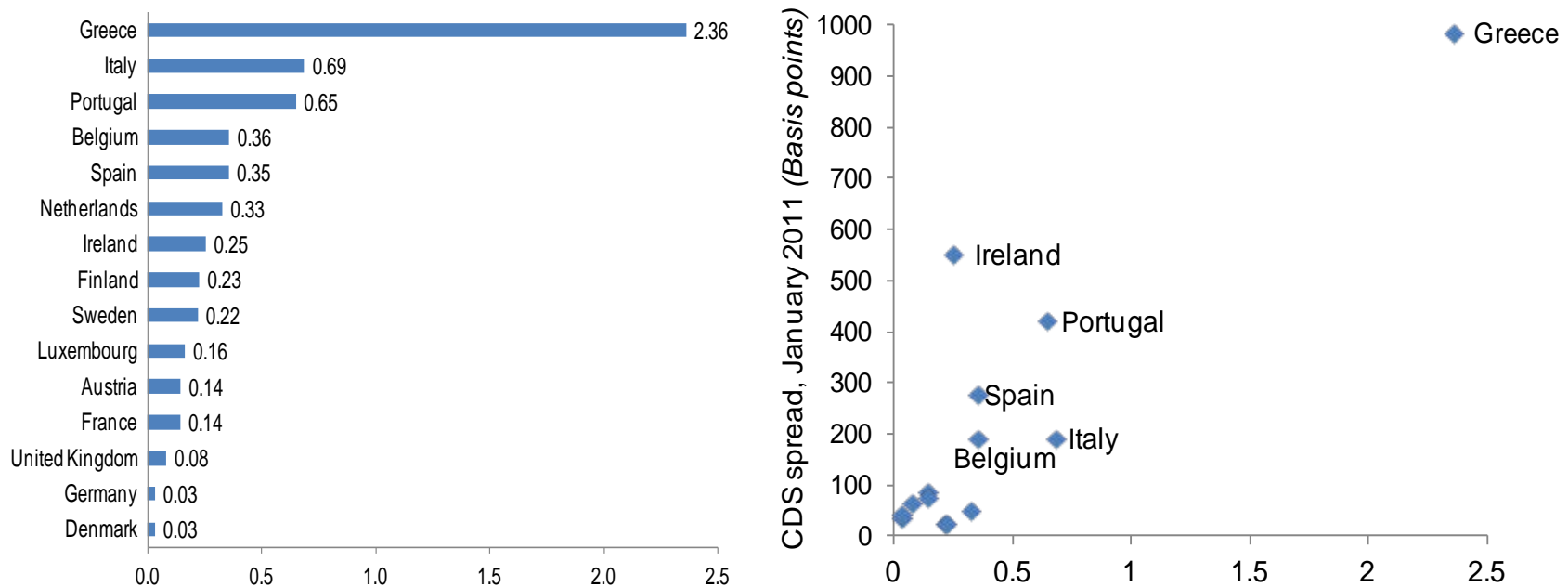


### Fiscal Transparency & Fiscal Credibility



# .....and do not seem to forget

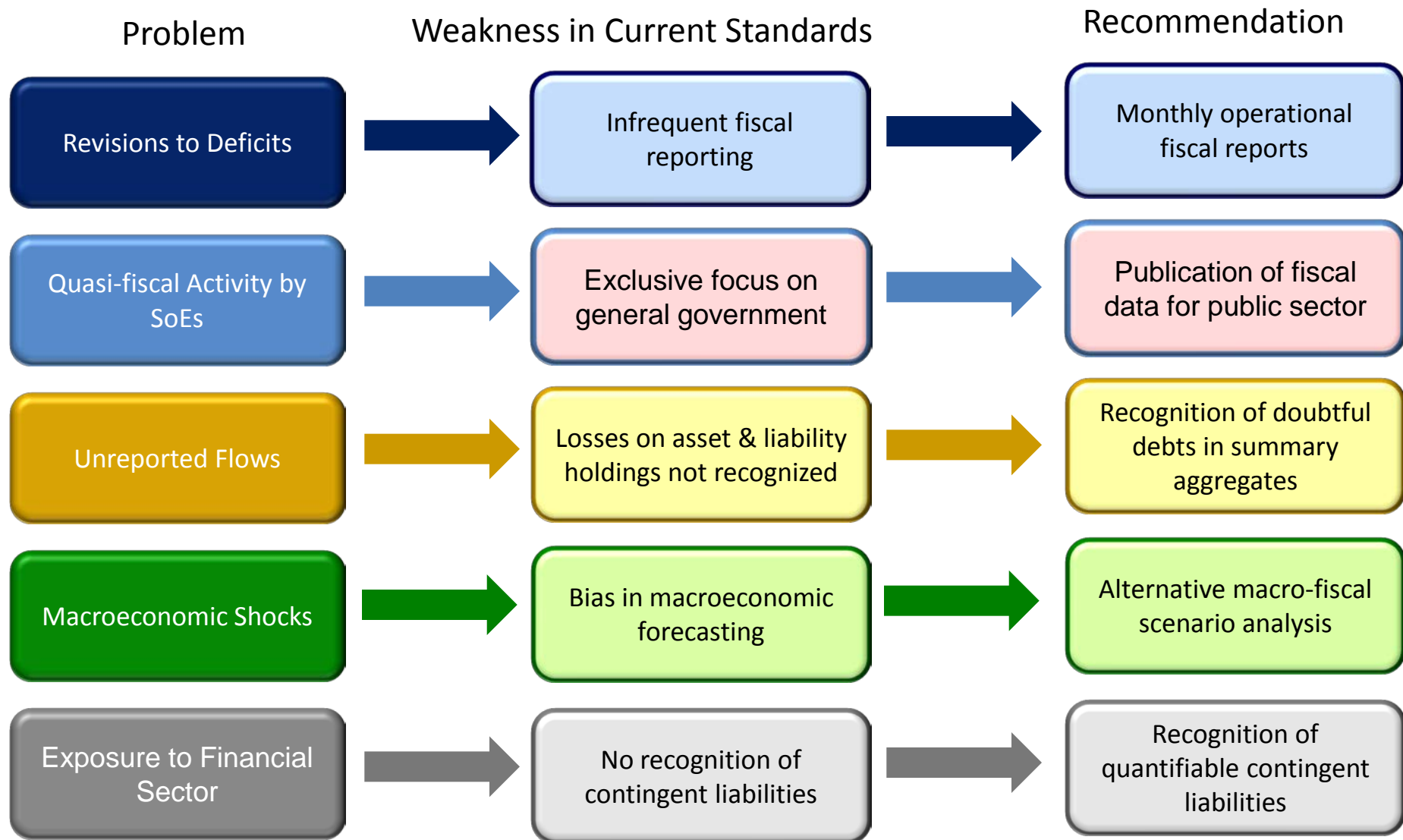
**Average Annual Impact of “Fiscal Gimmicks and One-off Measures” in Europe (1993–2003; Percent of GDP), and relationship to CDS Spreads in January 2011**



Source: Koen and van den Noord (2005, Annex Table A1), Bloomberg, Irwin.

# **REVISING THE FISCAL TRANSPARENCY CODE**

# How to improve fiscal transparency?

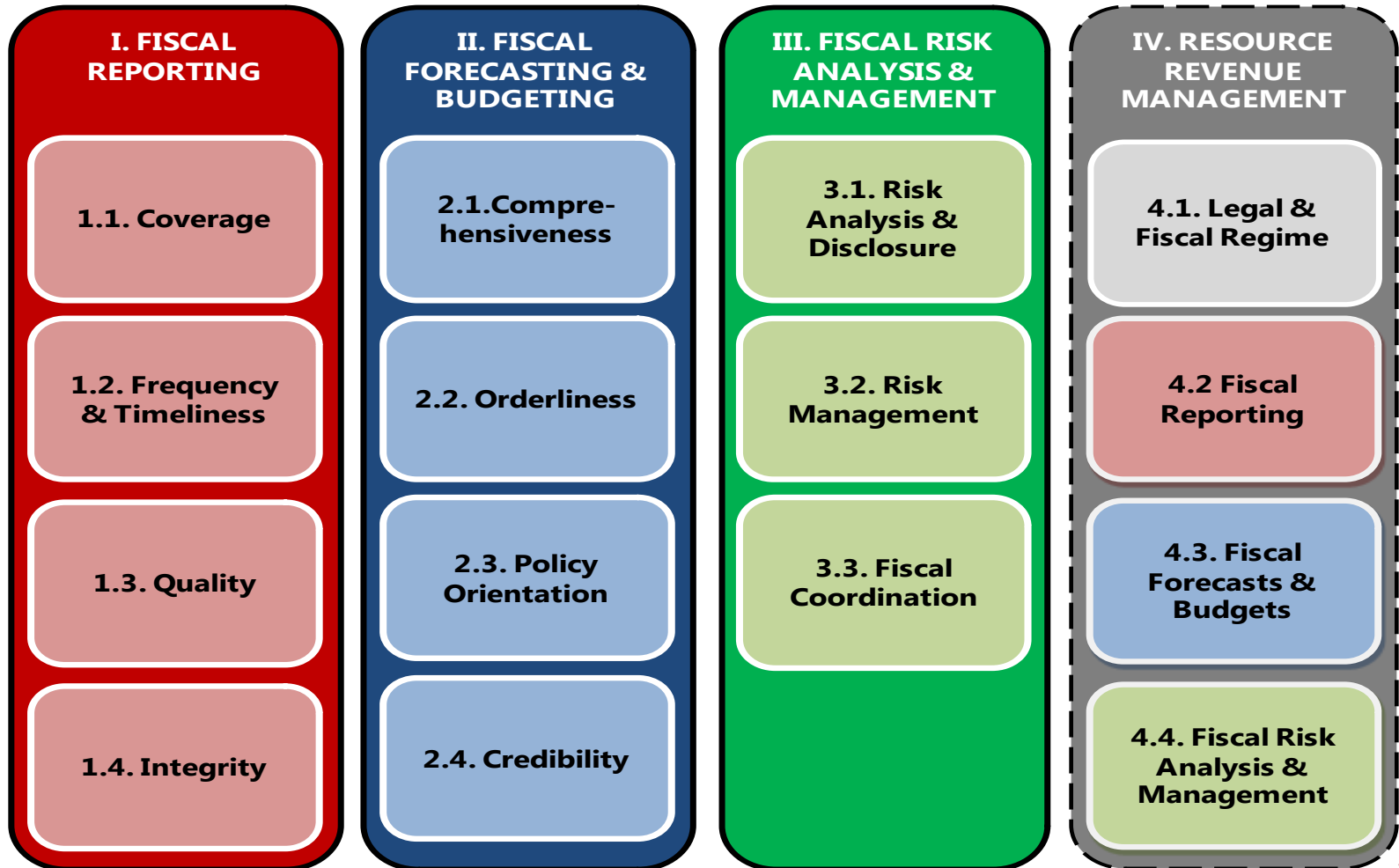


# New Transparency Code Rationale

- Emphasize the quality and reliability of published information rather than clarity of reporting procedures
- Update the principles and practices to reflect the lessons of the recent crisis
- Align the principles and practices with relevant international standards (GFSM 2001, IPSAS, OECD Principles, PEFA)
- Provide countries with a set of achievable milestones on the way towards full compliance with international standards

# Fiscal Transparency Code, 2014

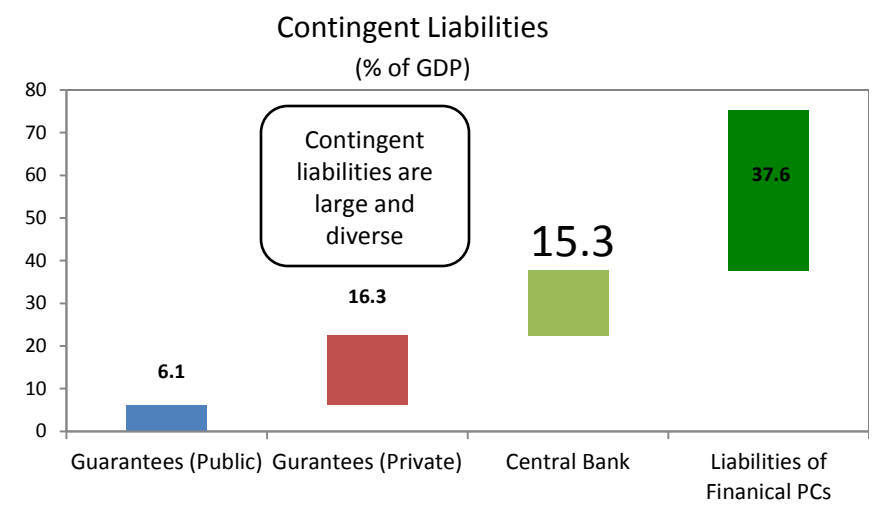
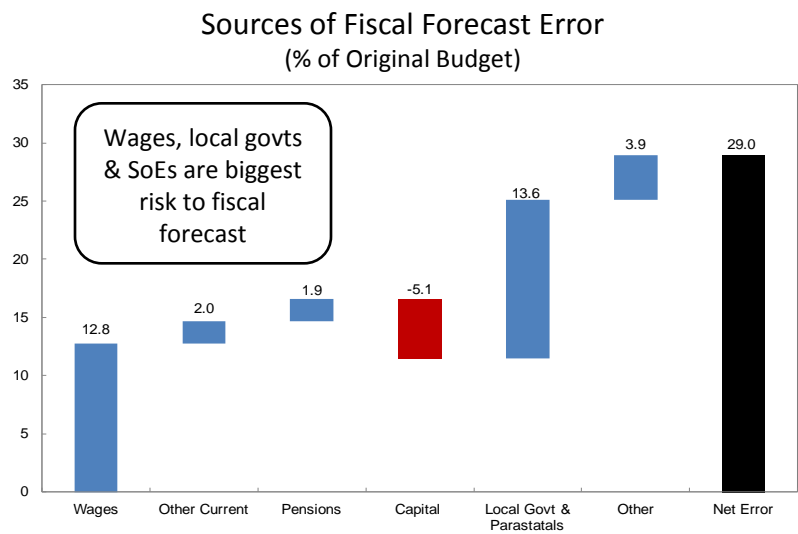
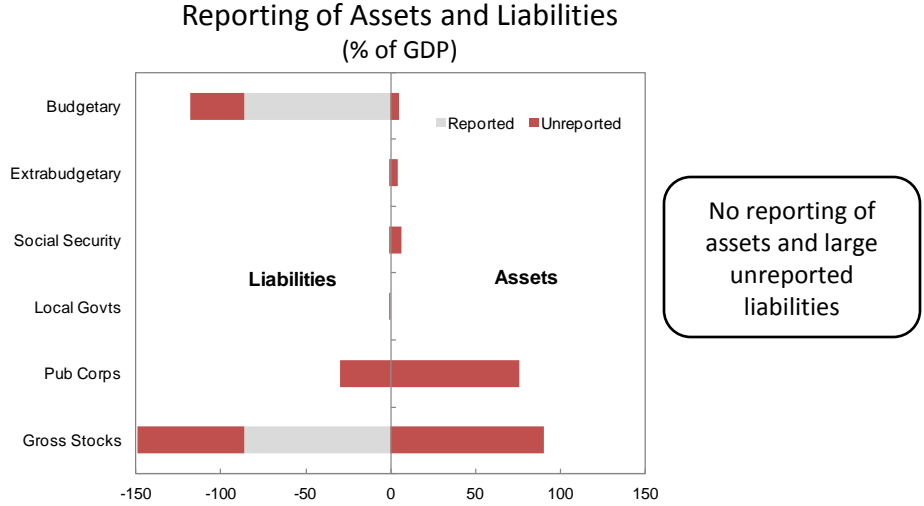
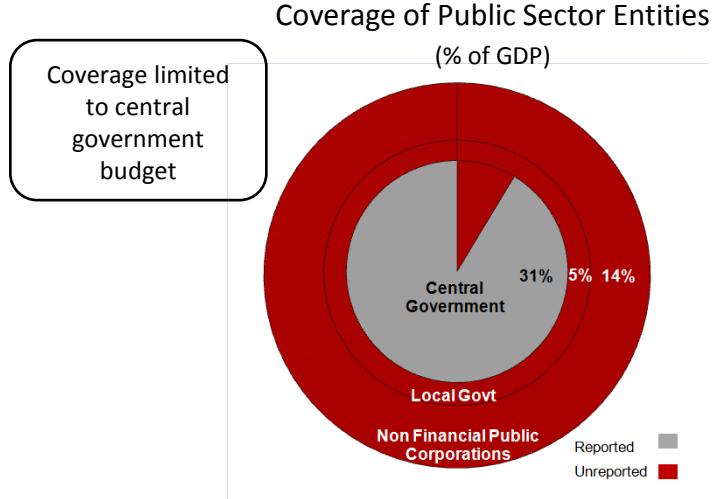
## Four Pillars of the New Code





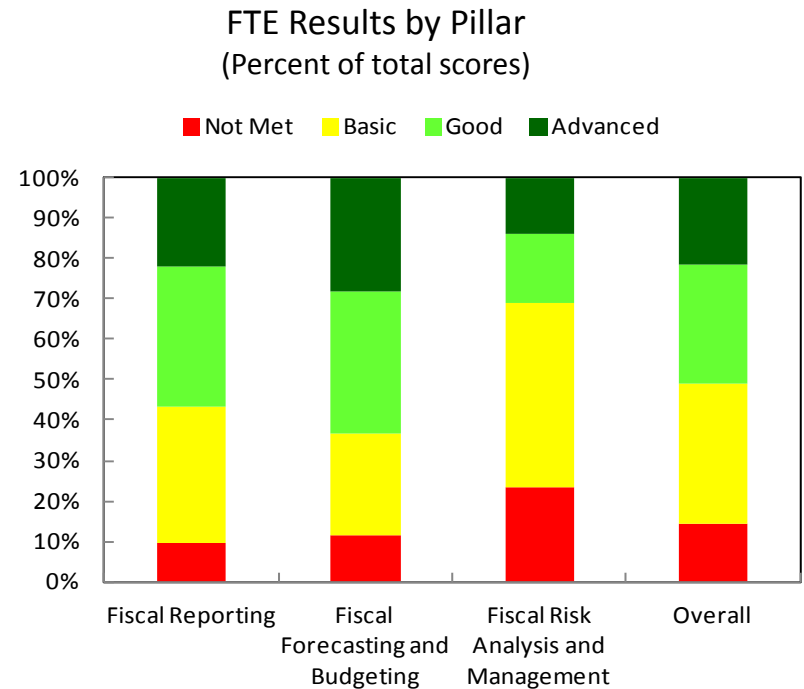
# Fiscal Transparency Indicators

## Sample Fiscal Transparency Indicators



# General lessons from FTE pilots

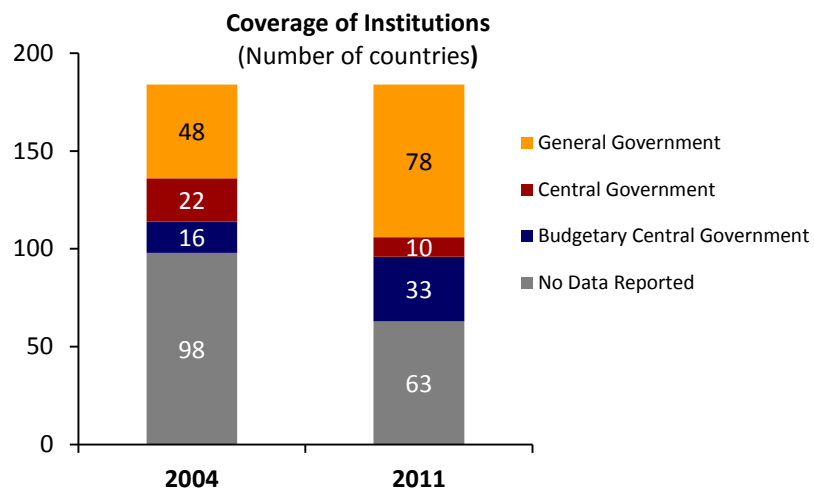
- Assessments always include reds and greens. No matter the level of country development.
- Fiscal risks analysis still in its infancy, in most countries.
- FTEs point to uncharted waters, e.g.,
  - Accounting/ reporting standards may not exist for certain transactions.
  - Probabilistic approach to PPPs/financial sector risks still arbitrary
- Completing an FTE requires to work closely with the authorities. Interactions/collaboration before, during and after missions.



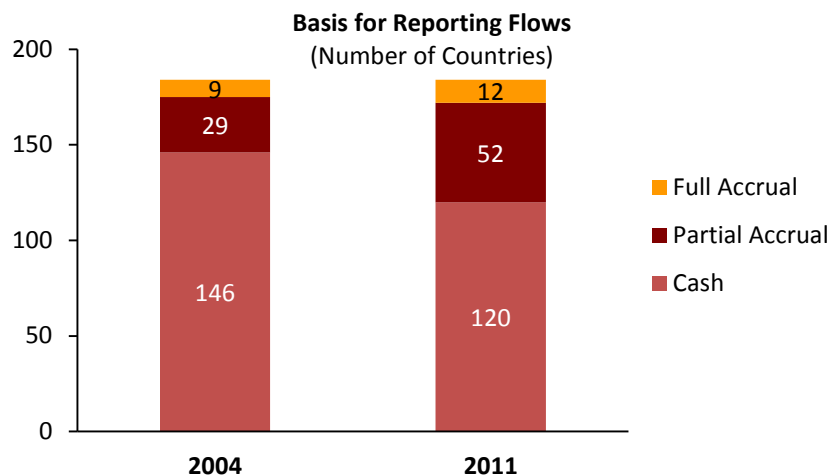
# **CONCLUDING REMARKS**

# Is the glass half full? Or half empty?

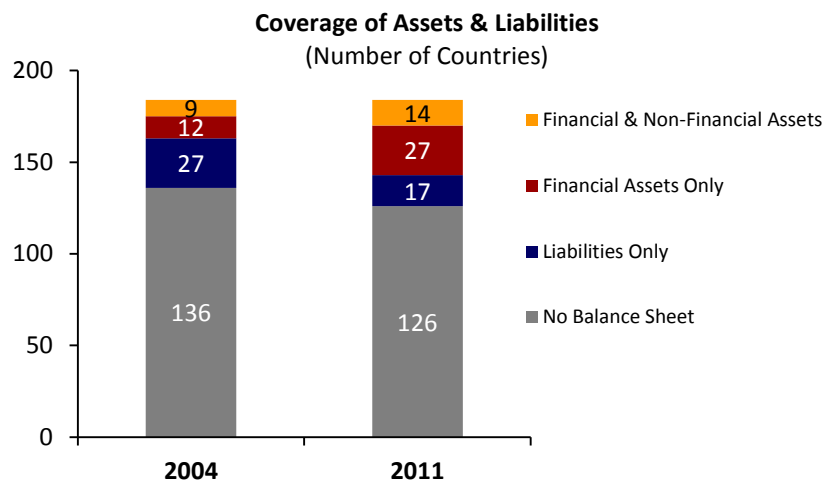
Institutional coverage has expanded...



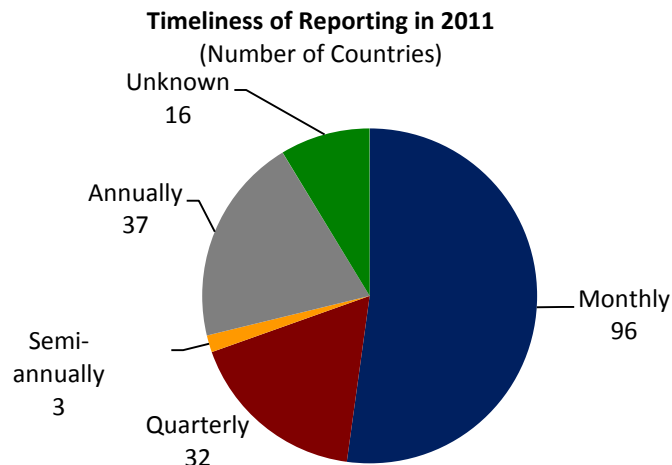
...and the shift from cash to accrual is underway...



...but few countries prepare full balance sheets ...



...and timeliness of reporting is still a problem.



# Good news?

- New fiscal reporting standards have been developed
  - **General:** IMF's Code & Manual on Fiscal Transparency
  - **Budgets:** OECD's 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 have been introduced
  - **Multilateral:** Fiscal & Data ROSCs, PEFA, & GDDS/SDDS
  - **Regional:** Eurostat, WAEMU & CEMAC harmonization of fiscal reporting
  - **Civil Society:** Open Budget Survey and Index
- More interdisciplinary approach and debate but
- Too few FTEs. Why?

# Have problems been fixed?

- Lack of focus on proper set of incentives....
- ..... **one can lead a horse to water, but can't make it drink.....**
- As in most change processes, underestimated cost disruption and strength of incumbents....the tyranny of status quo....
- Remedies not developed quickly enough (e.g., EPSAS).....
- .....but rely heavily on best practices a regulatory approach.
- As result, reforms are largely compliance-oriented exercises, driven by announcements rather than implementation
- *De jure vs. de facto* gaps
- Very little real improvements—let alone reforms—in national systems although many problems (e.g., expenditure arrears) persist....

# Two-handed Conclusions

- On the positive side, we now have:
  - a new set of standards, codes, diagnostics....but who is the jury?
  - ....with emphasis on convergence among key accounting and statistical standards....
  - ....increased and increasing dialogue among economists, accountants, statisticians, *budgeteers*,
  - .....along with a multiplication of international fora and initiatives....
- However:
  - .....problems persist at academic level—fragmented silos, overly specialized journals and syllabi...
  - .....and within governments, with scarce mobility across *cadres* and poor professionalization....
  - ....and in the international community (IFIs and bilateral donors) in advocating reforms and adopting standards that do not necessarily improve the substance of things or address real problems...
  - ....incentives among all the relevant players are often out of sync.....
  - ....success is hard to measure and takes time—much longer than expected.

**Thank You!**

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# Selected references

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