# OXFORD ANALYTICA

## PERMISSIBLE MARKETS PROJECT

## FISCAL TRANSPARENCY REPORTS 2003

**Prepared for**

**CalPERS**

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# FISCAL TRANSPARENCY 2003

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# OXFORD ANALYTICA

## ARGENTINA

## FISCAL TRANSPARENCY

**Country Report 2003**

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# ARGENTINA

## COMPLIANCE RATINGS

| *Fiscal transparency* | *2003* | *2002* |
|---|---|---|
| Clarity of roles | ●●● | ●●● |
| Availability of information | ●●●● | ●●● |
| Budget preparation | ●●● | ●●● |
| Accountability | ●●● | ●●●● |
| **Score** | 3.25 | 3.25 |

## OUTLOOK & COMMENTARY

Argentina has a very comprehensive legislative framework for fiscal transparency, in line with international standards. Although some improvements occurred during 2003, mainly in the timely disclosure of fiscal information, the country still needs to improve the enforcement of laws in order to achieve higher standards of compliance.

Reaching a new revenue-sharing agreement with the provinces will remain a key challenge for the national government during 2004, in order to enhance fiscal transparency at a sub-national level. Another major issue will be the efforts to create a Congressional Budget Office that would study budget proposals and monitor implementation. This move will be closely analysed, as it would increase the effective powers of Congress. Moreover, special attention needs to be paid to future budget laws, to see whether the powers granted to the cabinet chief to reassign budget funds will become regular practice.

# EXECUTIVE SUMMARY

## 3.25 Enacted

Argentina complies with many of the standards set out in the IMF's 'Code of Good Practices on Fiscal Transparency'. The structure, roles and responsibilities of the government are clearly established in the country's legal framework, and the Law of Fiscal Responsibility provides a clear administrative framework for fiscal management. Although the 2001 financial crisis affected the transparency of fiscal information, standards of publicly available information have improved during 2003.

Budget documentation specifies clear fiscal objectives and is presented within a consistent macroeconomic framework. Argentina complies with the IMF's Special Data Dissemination Standard (SDDS), and publishes a comprehensive range of central government fiscal information, mainly through the Ministry of Economy website. Although some progress has been made during 2003, transparency at the provincial level remains weak, with different standards of reporting being used by the provinces. In addition, the agencies in charge of performing independent audits of the public sector have a well-established legal framework to conduct their work, but their role in scrutinising fiscal information could be enhanced.

A major concern for fiscal transparency is the powers granted by the 2004 Budget Law to the cabinet chief to reassign budget funds without congressional approval, and to increase total public spending if revenues are available. Other practices that weakness the country's transparency practices include the extensive use of off-budget fiduciary funds (which are not subject to budgetary controls), the lack of estimates of contingent liabilities, and the lack of assessment of fiscal risks.

Argentina's overall score is unchanged from last year.

## 1. Clarity of Roles, Responsibilities, and Objectives

●●● Enacted

**The government sector should be distinguished from the rest of the public sector and from the rest of the economy, and policy and management roles within the public sector should be clear and publicly disclosed.**

**Structure, functions, and responsibilities of government**

The structure, functions and responsibilities of the government are clearly explained on the website of the Under-Secretariat for Public Administration, which has a detailed outline of authorities, functions and objectives of executive power, including the cabinet chief, ministries and independent government agencies.[1] The National Constitution, reformed in 1994, also sets out the division of responsibilities between the central government, provincial governments and municipalities.[2]

Argentina is a federal state and, under the terms of the Constitution, the federal government provides for national expenditures through funds from the National Treasury. The federal government has little constitutional authority to control provincial spending. However, as the provinces have legally devolved much of their tax-collection capacity to the nation, a system of revenue sharing known as 'co-participation' has been in force since the 1930s, under which the federal government collects a range of taxes which are then distributed to the provinces to cover their own spending requirements.

The current co-participation structure gives some 42% of those revenues to the national government and nearly 57% to the provinces. The percentages disbursed to each province (secondary distribution) have remained the same since the implementation of the now-expired Law 23.548 in 1988.[3] However, the percentages received by each province were calculated on the basis of political, rather than economic or social, criteria and the system does not function in an efficient manner. While some provinces generate around 50% of their own revenues, others depend on co-participated revenues for up to 90% of their spending. As these are not collected locally, there is little pressure for responsible public spending from local voters.

Although a new co-participation accord has been pending since 1994, successive governments have been reluctant to tackle such a sensitive issue. More recently, the political circumstances following the 2001 crisis, notably the establishing of a provisional government without enough power to achieve significant action in this area, have made progress even less likely. Despite this, some changes to the co-participation system occurred after the economic crisis, mainly through the elimination of a monthly guaranteed minimum of funds to be transferred to the provinces.

During 2003, the government has reached bilateral agreements with a number of provinces aimed at strengthening their financial position. These so-called "orderly financing programmes" -- involving an estimated total of 20 billion pesos in deficit financing to the provinces this year -- also impose spending limits on provinces by stipulating that any overspending will result in the loss of the national government's assistance in financing the offending province's deficit. Although these bilateral accords have improved provincial finances and emphasised the importance of fiscal policy transparency, they are difficult to monitor, mainly because they only last one year and are conducted on a province-by-province basis.[4]

The national government has recently announced its intentions to reach a new co-participation accord by mid 2004, and to strengthen the information system between the central government and the provinces. This new system will have to be ratified by law and will have to be followed by a fiscal responsibility law. Until a new accord is agreed, the government will continue to rely on bilateral agreements. However, commentators expressed doubts regarding the feasibility of a new accord being reached so soon.[5]

The federal government's constitutional inability to dictate controls over provincial spending means that it is unable to limit deficit spending at that level; the total provincial deficit in 2001 reached around 5.1 billion US dollars. However, in the aftermath of the economic crisis, some progress has been made. In 2002, an agreement was reached that imposed the obligation on provinces to cut spending and reduce the deficit by 60%. In the event, the target was exceeded -- the total reduction in the provincial deficit reached 72% last year. In addition, the 2003 target for provincial spending is also likely to be met.[6]

**Coordination and management of budgetary activities**

The coordination and management of budgetary activities is set forth in Articles 99 and 100 of the Constitution, in Law 24.156 on financial administration, and in Law 25.152 on fiscal responsibility (1999).[7] The National Budget Office at the Ministry of Economy (MEcon) is responsible for preparing and publishing the national budget according to a fixed timetable. Provincial governments prepare their own budgets, although these are not necessarily made fully public or presented to the MEcon. A congressional committee is charged with reviewing and controlling tax and budget information, but in practice these controls are only partial.

The government has recently announced its intentions to create a Fiscal Federal Office. The rationale behind the creation of this new government department is to coordinate the implementation of the future new system of revenue sharing and solve potential conflicts between the provinces and the central government. Through this office, the central government will also try to persuade sub-national levels of government to improve budgetary execution and reduce the provincial fiscal deficit.

**Relations between government and public sector agencies**

The principal public sector agencies falling outside the national government are the central bank (BCRA) and, to some extent, the tax administration.[8] The BCRA is in principle autonomous, and it now exercises control over monetary policy. However, the MEcon has considerable influence in the choice of the BCRA's president -- although only unofficially, as the president chooses the BCRA's president. The BCRA may advance funds to the federal government on a temporary basis up to 12% of the monetary base or 10% of tax collection. The BCRA advises the Ministry of Economy and Congress, to which it must report quarterly, on exchange policy.

The National Inland Revenue Office (AFIP) is responsible for national tax collection and administration. It is one of the major departments of the national government, and is directly responsible to the Ministry of Economy. Its director is appointed for four years, one year after the president and Congress take office, and the president cannot dismiss him. The legal framework strengthening AFIP's autonomy has recently been improved. However, it does not have statutory protection against political interference and dismissals.

**Government involvement in the private sector**

Government involvement in most of the private sector is minimal, following the extensive process of privatisation and deregulation that took place in the 1990s. The state holds small percentages in some 'residual companies' and has a regulatory function through bodies such as the regulators of the telecoms and gas sectors (*Comision Nacional de Comunicaciones* and *Ente Nacional Regulador del Gas*). Two of the largest banks, *Banco Nacion* and *Banco de*

*la Provincia de Buenos Aires*, continue to be state-owned and are likely to remain so in the light of strong opposition to their privatisation; the majority of other provincial banks were privatised in the 1990s.

## There should be a clear legal and administrative framework for fiscal management

**Legal framework for budgetary activities**

Law 25.152 on fiscal responsibility aims to reduce the public deficit and improve the operation of the public sector, including better public availability of information.[9] There is a comprehensive budget law.

The preparation procedures for the national budget and information on its administrative rules are publicly available on the MEcon website.[10] The country's legal framework for budgetary activities is perceived as adequate, but concerns remain regarding the actual implementation of that framework.[11]

**Legal framework for taxation**

The legal framework for taxation is perceived as unclear, mainly because of the numerous regulations in place. As a consequence of this, some provisions of the tax law may not be fully implemented.

Article Four of the Constitution establishes the principle that Congress must levy taxes equitably and proportionally on the population. The website of the AFIP has a comprehensive, updated and easily accessible system of information regarding tax laws, including a specific section aimed at facilitating understanding of the tax and customs system. However, tax evasion is estimated at nearly 50% of total revenues. While investigations aiming to reduce it have increased during 2003, prosecution of evaders is still rare. The AFIP's budget forms part of the national consolidated budget.

Some 'disruptive' taxes introduced to cope with the country's economic crisis are scheduled to be eliminated once the Congress approves an 'anti-evasion' package sent by the government in mid-2003. The new measures are intended to improve the efficiency of tax collection mechanisms and decrease the high level of tax evasion. However, the extent and scope of these regulations are not entirely clear to the public and have not been properly explained.[12]

**Ethical standards for public servants**

Ethical standards for public servants are set forth in *the Code of Conduct for Public Officials* established through Law 25.188.[13] However, a report for Transparency International indicates that there is a considerable degree of discretion on the part of public servants in carrying out their duties which facilitates corrupt practices within the public administration.[14] There is also a special *Code of Conduct for Public Officials* employed in the AFIP. However, auditing controls are aimed primarily at staff above managerial level and, as such, controls on lower staff levels are rather limited. In addition, there are no incentives for staff to work well.

## 2. PUBLIC AVAILABILITY OF INFORMATION

●●●● Compliance in progress

**The public should be provided with full information on the past, current, and projected fiscal activity of government.**

Public provision of information on fiscal activity is adequate at the national level, although the standards of provincial information are variable, and the figures that are executed at the provincial level are not necessarily the figures that are later presented to the MEcon. At the national level, the standards of data presentation by different ministries have been harmonised, although some programmes provide greater detail of activities than others. The MEcon publishes a wide range of fiscal information on its website, while the National Budget Office publishes drafts, proposals and consolidated reports on national budgets. During 2003, improvements in the availability of information have been made, including data on provincial finances and national debt. The 2003 consolidated budget includes statements on fiscal and quasi-fiscal activities of the public administration, as well as budgetary information on social security and other public institutions.

**Central government operations**

There are officially no extrabudgetary funds in the budget, although 'off-budget' spending items have been reported in recent years. This is particularly the case at the provincial level, where fiduciary funds allow the local authorities to evade fiscal controls on extrabudgetary spending.

The use of fiduciary funds involves some 5 billion US dollars that are not subject to budgetary controls. In the 2002 budget law, the fiduciary funds were given the same status as public companies. Most are within the jurisdiction of the MEcon and the Planning Ministry, and are created by law. The consolidated budget is approved by Congress, but this is purely a formality, with the legislature exercising no real control. Even when the budget includes some information about the fiduciary funds, there are many others that are excluded, with no alternative disclosure of the way they are used.[15]

The first multi-year budget was presented to Congress in 1999, for the period 1999-2001, but there is no public document explaining the extent to which the goals declared therein have been met. There was no multi-year budget published for 2002-04 as a result of the crisis, but the 2003-05 budget has been presented and it is publicly available.[16] Because of the 2001 crisis, the relationship between the projections of the 2000-03 budget and 2003 budget has been limited. Congress approves only the budget for the coming year, with the subsequent two years representing projections.[17]

Published information on tax expenditures has in the past been partial, although this information is now included in the budget. Information on changes in fiscal legislation is also contained in the budget documentation, as well as in the digest of administrative norms and systems for the public sector on the MEcon website. However, information on contingent liabilities are never published.

**Public sector operations**

Data are disseminated on the operations of the non-financial public sector, including central government (central administration, decentralised bodies and social security institutions), the provincial and municipal governments (to

the extent available) and non-financial public enterprises. Data for provincial governments include information on the operations of centralised and decentralised administrations, but not on operations by social security institutions. Data are provided by the Ministries of Finance and of Economic and Regional Planning and are based on the accounting records of all units.

## A commitment should be made to the timely publication of fiscal information.

**Debt reporting**

Argentina subscribes to the IMF's Special Data Dissemination Standard (SDDS), which requires timely publication of debt information.[18] Debt and fiscal information are published on a regularly updated basis, including on the MEcon website. During 2003, the MEcon website has included a detailed section on the country's public debt, which is periodically updated according to the government proposals for its debt restructuring.[19] Information on provincial indebtedness is also publicly available at the MEcon website.[20]

Following provisions included in the 2004 budget, the Ministry of Economy will be permitted in future to modify the amount and terms of public debt issues approved by Congress, and merely to inform Congress of any such action within 30 days. It remains to be seen whether this provision will affect the timely publication of debt information. Funds included in the budget for interest payments on public debt will fall from 7.6 billion pesos in 2003 to 6.8 billion in 2004.

**Advance release calendars**

An advance release calendar is updated every month and published on the MEcon website to show the data-release dates for the following four months. A notice on the website indicates that the calendar meets the SDDS requirements. Article 8 of Law 25.152 provides for the legal requirement to publish this information online, together with other information on fiscal laws and the national budget since 1999. Some provisions regarding the fiscal management of the country are also published in the country's *Official Bulletin*.

## 3. Open Budget Preparation, Execution and Reporting

●●● Enacted

### Fiscal policy objectives, macroeconomic framework, and risks

**Fiscal policy objectives**

The Argentine authorities have made significant efforts to modernise the budgetary and accounting system, and Law 24.156 on financial administration brought the national budgetary system into line with international standards. Budget documentation specifies clear fiscal objectives, and is presented within a consistent macroeconomic framework. The budget process has in recent years moved towards a multi-year framework, which establishes macroeconomic and fiscal projections for a two-year period beyond the term of the budget. This practice was temporarily interrupted by the 2001 crisis, but it has now been reinstated. Budget documentation for 2001, 2002 and 2003 is publicly available on the National Budget Office website, including macroeconomic projections and deficit and debt targets.[21]

**Macroeconomic framework**

The economic crisis had a serious impact on the 2002 budget, which was not adopted until March and necessarily based on estimated revenue, GDP and inflation figures. However, the situation has now improved. Congress approved the 2003 budget in late 2002 and the MEcon submitted to Congress the 2004 budget in September 2003, which was subsequently approved according to legal requirements. In 2003, representatives from the Ministry of Economy attended a joint session of the budgetary and finance commissions of the lower chamber of Congress in order to explain the budgetary goals for 2004 and set out its macroeconomic framework.

Macroeconomic projections for the period 2004-2006 were made publicly available by the MEcon in September 2003 and widely published in the local press. The information contains estimates on GDP, investment, exports and imports. The 2004 budget includes projections for the period 2004-2006, with an estimated growth of 4%. Moreover, it also includes medium-term objectives, in line with the September 2003 agreement with the IMF. However, private sector scrutiny of the forecasts does not exist.

In a recent study on budget transparency, coordinated by the International Budget Project in ten Latin American countries, the quality of information on macroeconomic criteria in Argentina received better scores than most of the countries under study.[22]

**Fiscal risks**

Argentine budgetary documentation does not provide an assessment of fiscal risks, and no steps have been taken to identify and quantify those risks. Moreover, fiscal risks such as a rise in rates or fall in GDP are not quantified.

**Fiscal sustainability**

During the mid-1990's, fiscal sustainability was harmed by over-optimistic projections of the country's incomes. This situation produced a lack of equilibrium in public finances, with increasing fiscal deficits over the years. Assessments of fiscal sustainability were not provided for the 2002 and 2003 budgets. However, the 2004 Budget

Law contains general information on fiscal sustainability, which is in line with the Letter of Intent submitted to the IMF in September 2003.

The government has set a primary surplus target for 2004 of 3% of GDP. This new approach is perceived by some analysts as more realistic, given the state of the economy during most of 2003, and could allow the country to achieve better results than in the past.[23] If this target is achieved, it will be the largest primary surplus for at least 20 years. This will be achieved through a continuing freeze on public sector salaries and pensions, rather than through structural reforms. Targets for 2005 and 2006 will be defined according to the level of compliance with the 2004 targets.

According to budget expectations, total revenues will rise by 13.7% year-on-year to reach 79.4 billion pesos (27.3 billion US dollars), while total public spending will rise by 4.8 billion pesos to reach 59.7 billion in 2004. The increase in tax collection will arise from a crackdown on evasion -- estimated to raise 10.5 billion pesos -- and from the effects of growth and inflation; no tax increases are envisaged. Despite the fact that this information is publicly available, budget documentation does not provide detailed analysis of fiscal indicators (e.g. where spending will be cut if revenues fall, or where to increase spending if tax collection rises).

The proposal to renegotiate defaulted privately-held debt, presented in late September 2003, implies delaying payment commitments over time, so allowing the government to seek a low primary fiscal surplus during its term (ending in 2007) and leaving future administrations to resolve the payment problem. The proposal envisages a 75% nominal 'haircut' and commits the multilateral lenders to postpone net payments falling due over the next decade. The 2004 budget approved by Congress does not include funds for interest payments on the pre-2002 debt. This implies either that an initial grace period will be sought, or that the government anticipates that negotiations will continue throughout 2004 and into 2005. In 2005, new debt -- including 'Boden' bonds issued to compensate depositor losses and guaranteed loans -- will also begin to mature.

## Budget presentation

Detailed information about the budget is available on the MEcon website, and documentation available for the 2001, 2002, and 2003 budgets distinguishes revenue, expenditure and financing. The classification of budget revenues and expenditures is compatible with the IMF's Government Finance Statistics (GFS) methodology. Publicly available information for the 2003 budget is more detailed than in previous years, and includes macroeconomic projections and more analytical information regarding the fiscal position of the country.

The National Budget Office collects information on revenues and expenditures of some budget programmes, including a description of the core objectives of them. However, the quality of information is not homogeneous for all programmes.

The deliberate vagueness of the 2004 budget in areas like social spending and with respect to planned public works investments, appears designed to show that spending on socially significant projects will rise by a greater extent than is in fact the case. At the same time, the lack of transparency in spending policy once the overall budget is approved is likely to be exacerbated by the pro-government majority in Congress, which cannot be expected to mount a strong challenge to the executive in this respect.[24]

### Data reporting

Data from the central government is considered reliable by independent experts. The MEcon website regularly updates its information, and releases a periodical bulletin with the country's economic indicators.[25] Publicly available information on budgetary documentation is comprehensive. The quality and timeliness of information is of

a lower standard at the provincial level than at the national level, as are the standards of disclosure. The National Budget Office prepares the budget, disaggregated in resources for the executive, central government, decentralised institutions and social security (presented to Congress by 15 September); budgets for public companies must be presented by 30 September and approved by the executive by 31 December. The consolidated budget goes to Congress for its information before 31 March.

## Budget execution and monitoring

Even when the information available is very comprehensive, there is no comparison between budget execution and the budget approved by Congress every year. Consequently, there is no systematic analysis of budgetary changes introduced by the government during the fiscal year. Moreover, there is no evaluation of efficiency in spending.

In recent years, the government has made numerous reallocations of money within budget programmes, with consequent distortions of the budget approved by Congress. The cabinet can modify individual budgetary allocations, although the total amount of the budget cannot legally be modified. In practice, despite this provision, the cabinet chief made significant modifications to the total amount of the 2002 budget after the Congress approved it. The 2003 Budget Law granted the cabinet chief powers to make alterations to budgetary allocations,[26] providing that the total amount approved by Congress remained identical.[27]

The 2004 Budget Law contains changes to the administration of public funds which will give rise to renewed concerns over transparency. Under the terms of the law, the cabinet chief will again be allowed to reassign budget funds without congressional approval, and will be able to increase total public spending if revenues are available. In addition, the level of detail in reporting to Congress on public spending will be sharply reduced, allowing for more generalised reports without specific data on how funds are spent. This will reduce the already limited compliance with existing laws on financial administration and fiscal responsibility, in particular given that discretional increases to the total budget were previously forbidden. The powers granted to the cabinet chief have been widely criticised by independent experts and by opposition parties in Congress, and are likely to affect transparency in budget execution and monitoring.

### Accounting basis

The government accounting system is established in Law 25.156 on financial administration, which sets forth clear procedures and objectives common to all levels of the national public sector. The law also establishes the functions of the National Accounting Office (NAO).[28] Argentina uses an accrual accounting system for spending, while maintaining a cash-based system for incomes.

The NAO maintains records of the central government's accounts and of its operational, economic and financial results, as well as of budgetary execution. Since 1993, the NAO publishes annually a detailed report on government accounts. This report provides information on saving investment financing accounts; financial statements of the central administration (including the general balance sheet, statement of results, statement of origin and application of funds and statements of changes in net position); and consolidated financial performance of the non-financial national public sector. However, commentators have suggested that the NAO's role in carrying out internal audits is limited.[29]

### Procurement and employment

Procurement and employment for the national government is centralised in the National Procurement Office, which since 2000 has operated under the cabinet chief.[30] Decree No. 1023/2001 approves the national system of procurement, which is based on the principle of transparency for public sector contracts.

Information about procurement is publicly available through the National Procurement Office website, which also includes a recent list of contracts for goods and services. In practice, however, established procurement and employment policies are not always followed.

The National Civil Service Career System (SINAPA) has a very good reputation. However, most of the recruitment for state employees is conducted outside SINAPA's procedures. In addition, each state agency has its own norms for contracting personnel. This is a particularly significant problem at the provincial level, where the majority of public employees are contracted. As a consequence, the public has little information on the rules for selection of public servants, and the monitoring system to evaluate their performance is weak.

## Fiscal reporting

Under Law 24.156, the government must present a preliminary report on the execution of the budget to Congress by 30 June. This information must include data on the degree of compliance with objectives and goals. At the same time, monthly, quarterly and cumulative data on budget execution at the national level are published every three months in the *Fiscal Bulletin*. Information on final public accounts is submitted to Congress and also published on the MEcon website.

Government decrees through which budget funds are reallocated to different programmes are usually published in the *Official Bulletin*. However, the information publicly available does not contain the annexes of those resolutions, where the most important information is usually available.

There is no legal obligation for the government to submit mid-year reports to Congress, but the MEcon usually does it in June each year. However, the role of the Congress in budget execution and monitoring is very limited. This is partly due to the lack of proper skills and resources. At present, there is no budget office in the Congress. However, mainly due to the pressure from non-governmental organisations, efforts are under way to create one along the lines of the US Congressional Budget Office.

## 4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY

●●● Enacted

### Data quality standards

The National Budget Office publishes assessments for budgetary execution of previous years since 1998. The information publicly available has improved in recent years, including more detailed methodological aspects, a more functional approach and a jurisdictional detail of execution, previously unavailable. [31] However, some delays in the release of information are still noticeable.[32]

Budget data specify clear fiscal objectives within a consistent macroeconomic framework. However, there is no systematic mechanism to assess compliance with fiscal goals, or to determine the efficiency of spending. Although the national government continues to improve fiscal policy formulation and implementation, the constitutional limits on national power over provincial administrations means that consistency cannot be guaranteed at the sub-national level. In order to encourage a more homogeneous approach, the National Budget Office has been developing detailed guidelines that are publicly available.[33] During 2003, there have been some efforts to standardise provincial budgets but there is still much room for improvement.[34]

Law 24.156 on financial administration provides that the national budget must include revenue and expenditure trends and an explanation of the information used in those calculations. The manual of budgetary classifications published by the MEcon governs the formulation and execution of the budget. Fiscal data is disseminated and regularly updated on the MEcon website in accordance with Argentina's SDDS commitment. However, publicly available information remains, in general, descriptive rather than analytical.

### Independent scrutiny of fiscal information

**Independent Audit**

The National General Auditor's office (AGN) undertakes independent auditing of the public sector and have a well-established legal framework to conduct their work. The latter is a technical advisory body of Congress and in principle has functional autonomy, although in practice its activities may be informed by political considerations. The AGN is charged with controlling the legal aspects, management and auditing of all activities of the centralised and decentralised government agencies, and takes part in approving or rejecting the revenue and investment accounts of public funds.

AGN reports are provided to Congress, which may then pass resolutions recommending that the audited entities adopt measures to implement the AGN's recommendations. Commentators suggested that the AGN does not carry out its functions adequately. In addition the study on budget transparency in ten Latin American countries identified the mechanisms of control of fiscal policy as an important weakness in the country.[35]

There is little performance auditing and no independent critiquing or reporting on the quality of macroeconomic forecasts. The law requires such forecasts to be based on official data, although comparisons may be made with private consultants' projections.[36]

**National Statistics Agency**

The National Statistics Institute (INDEC) is responsible for the methodological design, organisation and management of national data through censuses and surveys; the development of basic social and economic indicators; and the production of other basic statistics, all of which can be found on its website.[37] INDEC has technical independence, meets SDDS standards for data integrity and quality, and has a very good reputation for its reliability and independence.[38] Projections made by INDEC for 2002 have been better that the ones conducted by private consultants. INDEC does not possess auditing functions to verify the government's financial statistics.

## INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to Argentina between 11 and 17 November 2003:

### Ministry of Economy (MEcon)

**12 November 2003**

| | | |
|---|---|---|
| Mario Saccone | Analyst | National Budget Office |

### Central Bank of Argentina

**14 November 2003**

| | | |
|---|---|---|
| Guillermo Escude | Manager | Economic and Financial Research Department |

## ADDITIONAL INTERVIEWS

**11 November 2003**

| | | |
|---|---|---|
| Nestor Lavergne | Analyst | National Statistics Institute (INDEC) |
| Virginia Lencina | Programme Coordinator | Citizen Power Foundation - Argentine Chapter of Transparency International |

**12 November 2003**

| | | |
|---|---|---|
| David Prodger | Head of Trade & Investment | British Embassy in Buenos Aires |
| Andres Borenstein | Economic Officer | British Embassy in Buenos Aires |
| Luis Cubedu | Resident Representative | International Monetary Fund |
| Lorenzo Giorgianni | Senior Economist | International Monetary Fund |

**13 November 2003**

| | | |
|---|---|---|
| Sergio Berensztein | Professor | University Torcuato Di Tella |
| Paula Gosis | Research Fellow | Latin American Faculty of Social Sciences (FLACSO) |
| Daniel Oks | Senior Economist | World Bank Regional Delegation |

| | | |
|---|---|---|
| Jorge Schvarzer | Director | University of Buenos Aires – Economics Research Department |
| Rodrigo Calderon | Journalist | *Buenos Aires Herald* Newspaper |

**14 November 2003**

| | | |
|---|---|---|
| Luciana Diaz Frers | Fiscal Policy Programme | Centre for the Implementation of Public Policies Promoting Equity and Growth |
| Eugenio Raul Zaffaroni | Minister | National Supreme Court |
| Tom Scheetz | Consultant | United Nations Development Program |

**17 November 2003**

| | | |
|---|---|---|
| Silvina Vatnick | Director | Centre for Financial Stability |
| Martin Kanenguiser | Journalist | *La Nacion* Newspaper |

## NOTES

[1] See www.sfp.gov.ar
[2] National Constitution, 1853 (last amended 1994).
[3] Law No. 23.548, which established the revenue-sharing mechanism between the federal government and the provinces, and other laws on the fiscal management of the country can be found (in Spanish only) at the Ministry of Economy (MEcon) website at www.mecon.gov.ar and at http://infoleg.mecon.gov.ar
[4] Interviews in Buenos Aires, 11-17 November, 2003.
[5] Interviews in Buenos Aires, 11-17 November, 2003.
[6] Results for the first half of 2003 exceeded this year's target.
[7] Law on Financial Administration and Control Mechanisms No. 24.156, October 1992 (includes general rules for budget preparation, approval and execution.)
[8] See Central Bank of Argentina website at www.bcra.gov.ar and Argentine Inland Revenue Office (AFIP) website (in Spanish only) at www.afip.gov.ar
[9] Law on Fiscal Responsibility No.25.152, September 1999 (in Spanish only) at http://infoleg.mecon.gov.ar
[10] Available at www.mecon.gov.ar/onp/html/index.html
[11] Interviews in Buenos Aires, 11-17 November, 2003.
[12] Interviews in Buenos Aires, 11-17 November, 2003.
[13] Law No. 25.188 establishing a Code of Conduct for Public Officials, September 1999 (in Spanish only) at http://infoleg.mecon.gov.ar
[14] 'National Systems of Integrity: Report on Argentina for Transparency International', Center for the Implementation of Public Policies Promoting Equity and Growth (CIPPEC), March 2001 (in Spanish only).
[15] Interviews in Buenos Aires, 11-17 November, 2003.
[16] See www.mecon.gov.ar/onp/html/ley-2003/plurianual0305/indiceplu2003.htm
[17] The multi-year budget is informal, in the sense that it does not represent a formal assignment of funds to specific areas or programmes.
[18] IMF Special Dissemination Standard (SDDS) - Argentina, at http://dsbb.imf.org/country/argcats.htm
[19] See www.mecon.gov.ar/finanzas/
[20] See www.mecon.gov.ar/hacienda/info_ende.htm
[21] National Budget Office website (in Spanish only) at http://www.mecon.gov.ar/onp/html/index.html
[22] However, in overall terms, the study ranked Argentina, with an overall score of 44.1 out of 100, in eighth place out of ten countries assessed. 'The Latin American Index of Budget Transparency 2003', The International Budget Project, 2003, available at www.internationalbudget.org/themes/BudTrans/LA03.htm.
[23] Interviews in Buenos Aires, 11-17 November, 2003.
[24] Interviews in Buenos Aires, 11-17 November, 2003.
[25] The *Economic Indicators Bulletin* is available, both in Spanish and in English at www.mecon.gov.ar/default_english.htm
[26] Law 25.725, Article 16.
[27] During the first semester of 2003, numerous budget reallocations took place, with an increase in budget allocations for electoral purposes and public works.
[28] National Accounting Office at www.mecon.gov.ar; see also National Budget Execution website at http://sg.mecon.ar/ejecucion/
[29] Interviews in Buenos Aires, 11-17 November, 2003.
[30] National Procurement Office at http://onc.mecon.gov.ar/
[31] Budget execution information, available at www.mecon.gov.ar/onp/html/fisica_presupuesto/html/2003.htm
[32] As of December 2003, only information for the first quarter of 2003 was publicly available.
[33] Available (in Spanish only) at: http://capacitacion.mecon.gov.ar/manuales.htm#1
[34] Interviews in Buenos Aires, 11-17 November, 2003.
[35] 'The Latin American Index of Budget Transparency 2003', The International Budget Project, 2003, available at www.internationalbudget.org/themes/BudTrans/LA03.htm.
[36] The government takes into account the reports published by consultants in establishing a macroeconomic framework, although it does so informally.
[37] See www.indec.gov.ar
[38] Interviews in Buenos Aires, 11-17 November, 2003.

# OXFORD ANALYTICA

## BRAZIL

## FISCAL TRANSPARENCY

**Country Report 2003**

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# BRAZIL

## COMPLIANCE RATINGS

| *Fiscal transparency* | *2003* | *2001* |
|---|---|---|
| Clarity of roles | •••• | •••• |
| Availability of information | •••• | •••• |
| Budget preparation | •••• | ••• |
| Accountability | •••• | ••••• |
| **Score** | 4.00 | 4.00 |

## OUTLOOK & COMMENTARY

Brazil is poised to keep building on the 2000 Fiscal Responsibility Law (LRF), which significantly raised transparency requirements in the fiscal governance framework. The central and state governments will continue to work their way up the learning curve of reporting requirements set by the LRF. The government of President Lula da Silva appears to be strongly committed to continuing the transparency reforms of his predecessor, and he is personally committed to increasing the level of public participation in setting budget objectives. Lula has made tax reform a top priority, but his ability to change the arcane and politically sensitive tax structure should not be overestimated.

The biggest transparency challenges for Brazil will be incorporating any remaining hidden liabilities into the budget, improving coordination and consistency between budgetary laws and documents, and reducing duplication and overlap of fiscal responsibilities between central and state governments.

# EXECUTIVE SUMMARY

## 4.00 Compliance in progress

Three years have elapsed since the passage of the 2000 Fiscal Transparency Law (LRF), a key piece of legislation which greatly enhanced the quality and quantity of Brazil's fiscal data at all levels of government. The federal and sub-national governments are currently entering their third cycle of fiscal reporting under the LRF, and the quality and sophistication of their reporting has improved significantly in the last three years. Particularly welcome have been efforts to report and quantify fiscal risks and contingent liabilities. Reporting of previously unrecorded liabilities, popularly known as "skeletons", has also progressed considerably in the past two years, although the process is not yet complete.

The Brazilian government has also continued to expand on its impressive system for disseminating fiscal information through the internet. Indeed, a 2003 survey of perceptions of fiscal transparency found that Brazil performs better than most Latin American countries for the overall quality of its fiscal statistics. However, much of the information on the websites of the ministries of planning and finance is not available in English.

A few areas for improvement remain. Duplication and overlapping of expenditure responsibilities of the federal and state governments is still a source of fiscal confusion. Also, the coordination of spending objectives in the three main budget-planning instruments needs fine-tuning, and a system of public spending evaluation is still absent. However, the federal government at present appears committed to tackling these and other issues of fiscal transparency.

Brazil's overall score remains unchanged from last year.

## 1. Clarity of roles, Responsibilities and Objectives

●●●● Compliance in progress

**The government sector should be distinguished from the rest of the public sector and from the rest of the economy, and policy and management roles within the public sector should be clear and publicly disclosed.**

**Structure, functions, and responsibilities of government**

The Brazilian public sector is relatively well distinguished from the private sector, both in legislation and in the production of fiscal data. General government data is divided into three groups: central government (including the National Treasury and Social Security), 27 state governments, and a representative sample of 250 (of the 5,560) municipal governments.

Brazil is a highly decentralised federation, with sub-national entities accounting for over one-third of total government spending and revenue collection. The responsibilities of each level of government are defined in the 1988 Constitution of Brazil. All regional authorities have their own directly elected legislative and executive branches, and an independent judiciary. The federal government has limited control over sub-national tax administration, budget formulation, execution, and oversight, and has limited say in wage and investment policies.

The constitution also defines clearly the roles and responsibilities of the executive, judicial, and legislative branches of all levels of government in the budgetary process. At the federal level, the Constitution requires the preparation of three budgetary instruments: the Multi-Year Plans (PPAs), Budget Directives Laws (LDOs), and Annual Budgets Laws (LOAs).[1] Drafts of these documents are prepared by the executive branch and submitted to the legislature. Congress reviews and discusses the drafts and may amend them as necessary. Finally, the judiciary plays a role in budget oversight.

**Coordination and management of budgetary activities**

The coordination of budgetary activities, and particularly the distribution of tax and expenditure powers, is addressed under Article VI of the National Constitution. However, there is a lack of clarity in some areas, as some expenditure responsibilities have been devolved unsystematically. In particular, there remains significant overlapping and duplication in various areas of public spending such as transport, water and sanitation. According to Planning Ministry officials, a coordination pact ("Pacto do Concertação") to be approved along with this year's Multi-Year Plan will be step towards eliminating duplication.[2]

**Relations between government and public sector agencies**

The relationship between government and non-governmental public sector agencies is set out in the constitution. A Committee for the Management of Federal Public Financial Institutions, which is subordinate to the Ministry of Finance (MoF), is in charge of state-owned financial institutions.[3] State-owned enterprises (SOEs), including Petrobras, the last major federally owned company and the national oil producer, are under the supervision of the Department of Coordination and Management of State-Owned Enterprises in the Ministry of Planning, Budget, and Management. This department is in charge of supervising and regulating the SOEs as well as disclosing financial information about their performance.[4]

Relations between the government and the central bank -- Banco Central do Brasil (BCB) -- are governed by Law No. 4595 of 1964 and its subsequent amendments. Brazil's central bank is not legally independent, but in practice enjoys substantial operational autonomy.

**Government involvement in the private sector**

The Brazilian government retains significant equity holdings in some sectors, particularly the oil sector and electricity generation, water and sanitation, and airport administration, as well as the financial sector (Banco do Brasil, Caixa Econômica Federal, Banco Nacional de Desenvolvimiento Econônico, among others.) Government equity ownership is reported in the annual reports of these companies, but there is no single comprehensive list of all government equity holdings. A detailed account of the National Treasury's equity holdings is found on its website.

From 1991 to 2001, the Brazilian government privatized over $84 billion in state-owned assets as part of its National Privatisation Programme (PND). According to the IMF, all privatisations were carried out according to a comprehensive legal framework and through standardised and transparent procedures.[5]

## There should be a clear legal and administrative framework for fiscal management

**Legal framework for budgetary activities**

There is a clear administrative framework for fiscal management in Brazil, provided by the 1988 Constitution and by the Fiscal Responsibility Law (LRF). The LRF regulates intergovernmental fiscal relations, and contains guidelines on the management of state revenues, imposes limitations on sub-national government spending, and prohibits certain fiscal activities, such as the issue of central bank debt securities and credit or rescheduling operations among the various levels of government.

Budgetary and administrative rules are openly available in the websites of the MoF and the Ministry of Planning, Budget, and Management.

**Legal framework for taxation**

Article 153 of the constitution defines the federal government's power of taxation, while Article 154 allows for addition taxes to be instituted.[6] The constitution is explicit about the division of tax revenues, assigning specific tax bases to each level of government and creating a system of tax sharing that redistributes revenue among levels of governments and among regions. Under the National Tax Code, each tax must have an explicit legal basis. Also, all contributions, fees, and duties require an explicit legal basis.

Tax reform has been one of the top priorities of the new administration. The government's proposed tax reform has now been approved by the Chamber of Deputies and is expected to be approved by the Senate without major changes.[7] The magnitude of the tax reform should not be overestimated, as the government has limited room for changing the tax code without a constitutional amendment.

In terms of transparency, the tax reform has had limited impact in simplifying Brazil's notoriously complex tax code. Most importantly, the tax law has consolidated a value-added tax on goods and services (ICMS) imposed by the states -- which before was governed by 27 separate laws (one for each state) -- into just five, uniform tax rates. Although much room remains for simplification of the tax code, there are indications that tax efficiency has improved markedly.[8]

Information on tax legislation and a wide range of taxpayer services is provided on the website of the National Treasury.[9] Information on state and municipal tax revenues is available on an annual basis from the Treasury.

Brazil's tax authority, the Secretariat for National Revenue, maintains a high-quality web page with information on tax identification, tax declarations, and a taxpayer's guide.[10]

**Ethical standards for public servants**

Ethical standards for public servants are outlined in various pieces of legislation. The 1994 Code of Professional Ethics for Federal Public Servants is publicly available and regulates professional behavioural standards for all civil servants. In addition, the 1990 Statute for Civil Servants, applicable to all public employees, sets out individual rights and responsibilities and establishes disciplinary procedures. Sanctions and penalties for officials are further detailed in the Fiscal Crimes Law of 2000. This law applies to officials from all branches of government and, among other measures, details penalties for individuals who engage in credit operations without due legislative authorisation, who extend loan guarantees without adequate collateral, or who increase personal expenditures in the last 180 days of their period in office.

Also, the government has established a Code of Conduct for senior federal government officials (CCAAF), which is applicable to about 700 government officials who manage public debt. The Code clarifies ethical rules for this category of officials, establishes rules regarding conflicts of interest, and places limitations on professional activities undertaken after leaving office. A Public Ethics Commission (CEP) was set up under the Presidency to implement the CCAAF. Upon entry into service, all public officials must also supply a declaration of assets as required by the CCAAF. A General Corrector's Office (CGU) has also been instituted to investigate any infractions by public officials against federal funds or assets.

## 2. PUBLIC AVAILABILITY OF INFORMATION

●●●● Compliance in progress

**The public should be provided with full information on the past, current and projected fiscal activity of government.**

**Central government operations**

Three years have elapsed since the passage of the Fiscal Transparency Law (LRF), which greatly increased the quality and quantity of fiscal data that all levels of government are required to report. Fiscal data is disseminated for revenues, expenditures, financing (divided into external financing and domestic financing), and also for various other aggregates generated by the activity of public administrations in each region of the Federation. The official Brazilian statistics exclude privatisation revenues from total revenues. The primary fiscal balance is consolidated and calculated for each level of government. Data are prepared by the National Treasury's Secretariat and are disseminated online in Portuguese.[11] Aggregate central government data are published in a monthly press release and in the *Central Bank Bulletin*.

Reporting of previously unrecorded liabilities, popularly known as "skeletons", has progressed considerably in the past two years. The most important past liabilities recognized include those accumulated by the Housing Mortgage/Insurance Subsidy Fund (FCVS) and those related to the recapitalization of federal banks on account of past losses resulting from quasi-fiscal activities. The recognition of these "skeletons" has added about 2.3% of GDP to the national debt in the last two years. By 2006, additional hidden liabilities will be incorporated into official debt figures and will add at least 0.7% of GDP per year to the debt.[12] However, some analysts warn that ongoing plans for public-private partnerships -- ventures in which state and central governments will take on financial risk to encourage private sector investment -- could become "a new cradle for skeletons."[13]

The government has also announced plans to reform the trade unions and trade associations. Reforms in this area are not expected until next year at the earliest.[14]

Contingent liabilities have been reported by all levels of government in the *Fiscal Risks Annex* of the annual Budget Directives Law since 2001. The Fiscal Responsibility Law requires governments to assess the likelihood that those liabilities will turn into actual ones. The bulk of contingent liabilities relate to pending court cases involving issues such as losses incurred by several sectors due to government-imposed price freezes under past stabilization plans and interest penalties paid on tax arrears since 1996.

**Public sector operations**

There are no extra-budgetary funds or expenditures in Brazil, since budgets include the operations of all non-financial public sector institutions.[15] Quasi-fiscal operations of state-owned enterprises are reported by the entities concerned, and these have declined substantially in recent years.

Quasi-fiscal activities (QFAs) have been largely eliminated, and in those that remain, the subsidy component is now captured in the budget through explicit transfers.[16] Transparency is lower at the sub-national level, but those QFAs that remain are very limited.[17] This is because almost all the state banks -- the primary source of sub-national QFAs -- have been privatised. Of the remaining four state banks, two are scheduled to be privatised next year.

Despite the efforts to assess and report the government's liabilities, it is ironic that little has been done to improve the valuation and reporting of national assets. All levels of government possess a variety of real assets, including real estate, construction, and even works of art, which have not been accurately valued and are not yet reflected in national accounts.[18]

**Sub-national governments**

The state of sub-national accounts is of special importance in a highly decentralised federation such as Brazil. During the 1990s, sub-national fiscal behaviour contributed to the deterioration of public sector accounts. In 1997, a programme was launched to rescue the states' bonded debt. After consolidating the liabilities of 25 (out of 26) state governments and the Federal District, the federal government assumed these liabilities through the issuance of federal securities. Rigorous fiscal discipline and increased transparency was then imposed on the states through the Fiscal Responsibility Law and through debt restructuring agreements between the central government and each individual state.

As a result, the frequency and quality of fiscal reporting by sub-national governments has improved considerably over the past two years. Since 2001, the National Treasury has published consolidated public sector accounts based on the submissions of states and municipalities. Together, these records provide for the first time an official account of the public sector's overall consolidated revenues and expenditures. The most recent consolidated accounts include federal government accounts and those of the 26 state governments (plus the Federal District) and 4,500 municipalities (85% of all municipal governments).[19]

Two ongoing programmes sponsored by international donors -- the Modernization Programme for States Fiscal Administration (PNAFE) and the Modernization Programme for Municipal Fiscal Administration (PNAFM) -- are helping to improve sub-national fiscal management, including auditing and internal control of sub-national fiscal accounts.[20] Information on payments by the states to the central government under the restructuring agreements is not publicly available, but failures to pay are usually reported in the media.

Of the constituent states of the federation, Sao Paolo and Rio de Janeiro provide the most complete and reliable data, while the quality of data from Minas Gerais is also of a good standard. In other regions, there is still considerable room for improvement. Important gaps remain in municipalities' fiscal data, particularly in the case of smaller municipalities.[21] Additional information on sub-national fiscal activities is provided on the Treasury's website in a special section for the States and Municipalities.

## A commitment should be made to the timely publication of fiscal information.

Brazil's Fiscal Transparency Law legally requires the government to "widely disclose, even in electronic public media," a series of key documents containing fiscal information.[22] These include: plans, budgets, and Budgetary Directives Laws; rendering of accounts and respective prior statements of opinion; Summary Budget Execution Reports and Fiscal Management Reports; and the simplified versions of these documents. Almost all the information contained on the BCB website is available in both English and Portuguese, while the information on the ministries of planning and finance is available only in Portuguese.

**Debt Reporting**

Under the Fiscal Responsibility Law, the MoF is required to maintain a centralized and updated electronic record of internal and external public debt and must guarantee public access to the information. This information must include charges and contracting conditions as well as updated balances and limits for consolidated and securities debt, credit operations, and guarantees.[23] In addition, the MoF must disclose on a monthly basis the list of states and municipalities that have exceeded the established limits of consolidated and securities debt.[24]

The BCB publishes, on a monthly basis, detailed information on the level and composition of the net debt of the general government, as well as indicators of average maturity and duration of the securitized debt stock issued

by the National Treasury and the central bank by type. The central bank has also begun to publish on a monthly basis statistics on the on the uses and sources of financing of government operations, for all levels of government and the consolidated public sector.

Since March 2001, Brazil has subscribed to the IMF Special Data Dissemination Standard (SDDS), which requires timely publication of debt information. The publication of such data is a legal obligation in Brazil, and the statistics are available from a variety of sources, including the website of the National Treasury. This site also provides information on the accounting standards and methods used by the authorities in the compilation of debt data.

It should be noted that a recent survey of the perceptions of 164 Brazilian legislators, academics, and journalists gave relatively low marks to the government's disclosure of foreign debt data. According to the survey, a majority of those interviewed believe that the publicly available external debt data is a "black box" and believe that the information released on the external debt and external debt negotiations is rare and not easily understandable by the general public. Those surveyed would like to see more information available on the debt broken down by currency and maturity periods and data on total government-backed debt.[25] At least one government official interviewed agreed that, despite the large volume of fiscal information publicly available, it is presented in technical language and is therefore not easily understandable by the general population.[26]

**Advance release calendars**

In accordance with its commitment to the IMF SDDS, the BCB and the MoF disseminate advance release calendars for fiscal information. These provide approximate publication dates for one year ahead, and precise release dates one quarter in advance.

## 3. Open Budget Preparation, Execution and Reporting

●●●● Compliance in progress

### Fiscal policy objectives, macroeconomic framework and risks

**Fiscal policy objectives**

Brazil has increasingly moved towards multi-year, output-oriented budgeting. A document known as the Government's Multi-Year Plan (PPA) is designed to integrate the government's long-term development goals with short- and medium-term objectives. The PPA has a three-year outlook, and it is revised yearly to reflect any changes in macroeconomic projections. At the time of writing, the 2004-2007 PPA had been submitted to the Congress and was awaiting approval.

The spending requirements and objectives of the PPA are supposed to be reflected in the yearly Budget Directives Law (LDO), which provides guidelines and direction for the final yearly budget and is presented to the Congress six months before the government's draft budget. The LDO contains important fiscal information, including annexes on fiscal risks and on fiscal revenue and expenditure targets for the current and subsequent two years. Finally, the Annual Budget Law (LOA) contains the details of the budget programme for the year. All of these documents are available on the websites of the MoF and the Ministry of Planning, Budget, and Management.

While legislation requires that the LOA be consistent with the objectives of the PPA and with the Budget Directives Law, informed observers believe that, in practice, this consistency is less than adequate.[27] Also, the IMF and other analysts have observed that actual budgetary appropriations have frequently been lower than those specified in the budget programme, thus weakening the correspondence between approved budgets and actual disbursements.[28]

A high priority for the new government is increasing the levels of public participation in the setting of budget objectives and priorities.[29] The government is trying to build three networks -- a deliberative network inside the government, an action network that will include public managers, and a civil society network which will include representatives from academia and the media. How these networks will interact in the budget process will become clearer when the project advances further.

**Macroeconomic framework**

The broad macroeconomic framework is partially described in the presentations section of the MoF's website and on the macroeconomic section of the Ministry of Planning, Budget and Management website. New budget programmes are clearly identified on these websites, with that of the Ministry of Planning, Budget and Management providing comprehensive and detailed sectoral information.

**Fiscal Risks**

The Fiscal Responsibility Law requires that all levels of government evaluate contingent liabilities and other risks that may affect public accounts. They must also detail the measures to be taken should these risks materialize. The risks assessments are contained in the Fiscal Risk Annex of the annual Budget Directives Law (LDO). Since the requirement was instituted in 2001, the quality of fiscal risk analysis has improved considerably, and the methodologies used to assess risk have become more sophisticated.[30]

However, concerns remain about insufficient coordination and integration between the Fiscal Risks Annex of the LDO and the final budget law. While the inclusion of fiscal risks assessment is a positive step, the implications of the fiscal risks identified are not yet reflected in the budget document itself.[31] The World Bank has suggested that the contingency fund in the budget (which is required by the LRF) be used as a stabilization fund in which every year some resources could be saved and used in case contingent liabilities turn into actual obligations.

**Fiscal Sustainability**

Assessments of fiscal sustainability are not provided with the annual budget. However, both the National Treasury and the BCB have prepared studies on fiscal sustainability. One of these studies is available on the BCB's website.[32] World Bank documents also provide detailed discussions of Brazil's fiscal sustainability.[33]

## Budget Presentation

**Data reporting**

Budget data in Brazil meet the requirements of IMF's SDDS. The budget and accounts classification distinguishes between revenue, expenditure, and financing. Expenditure is further classified by economic, functional, administrative categories. Although a detailed description of programme objectives is not provided in the budget presentation, these are set out on the Ministry of Planning, Budget and Management website.[34]

## Budget Execution and monitoring

Procedures for the execution and monitoring of revenue and expenditure are clearly specified in the Fiscal Responsibility Law (Section IV) and on the MoF website.[35]

**Accounting basis**

The Treasury website provides a detailed description of Brazil's Integrated Financial Administration System (SIAFI), the accounting system of the federal government. Monitoring of government transactions has increased over the last few years, due in part to increasing utilisation of information technology. An updated version of SIAFI is being developed to allow better monitoring of the multi-year, programme-based budgetary process currently in operation.

Internal audit procedures are outlined on the website of the Federal Internal Supervision Secretariat, the agency responsible for auditing and programme evaluation. Central government accounts are compiled on a cash-basis, whereas state and municipal data are compiled on a cash-basis for revenues and on an accrual basis for expenditures.

**Procurement and employment**

Goods and services are purchased by the government according to comprehensive procurement regulations outlined in Law 8666 of June 1993. Details of all relevant legislation, auction results, and procedures for electronic auctions are available on the internet.[36] According to the IMF, the risk of fraud in procurement still exists because of exemptions in specific tenders, which may call for certain technical requirements and may indirectly determine the choice of a particular supplier.[37]

The MoF website includes details of human resource management objectives and programmes.

## Fiscal Reporting

The authorities regularly report to the legislature and the public on budgetary and extra-budgetary out-turns. Under the terms of the Brazilian Constitution (Article 166) and the Fiscal Responsibility Law, the executive branch of government is required to present and evaluate the compliance with fiscal targets every four months in a public hearing before the legislature. The hearings are held in May, September, and February of each year. State and municipal governments must also appear before their legislative bodies and present similar reports.[38] However, informed analysts point out that these reports do not constitute rigorous evaluations of public spending, and that no institutionalized public spending review system is in place yet.[39]

The MoF website includes details of these presentations, as do the online budgets presented on the website of the Ministry of Planning. Final budgetary accounts are presented to the legislature in the annual "Message to Congress".

## 4. ACCOUNTABILITY AND ASSURANCE OF INTEGRITY

●●●● Compliance in progress

### Data quality standards

The quality of Brazilian fiscal data has been positively reviewed by commentators and international organisations. The World Bank's Country Financial Accountability Assessment concluded last year that "the Brazilian system of public financial management provides reliable information."[40] Also, a recent survey of perceptions of fiscal transparency in Latin America rated the quality of Brazil's fiscal and statistical information above the other nine Latin American countries surveyed except Chile and Argentina.[41]

Fiscal data disseminated by the BCB in accordance with Brazil's SDDS commitment is internally cross-checked by the National Treasury Secretariat. Information on the public sector borrowing requirement prepared by the BCB can also be compared with budgetary data produced by the Brazilian Institute of National Statistics and Geography (IBGE) and consolidated by the Treasury.

Under budget framework Law No. 4320 and the Fiscal Responsibility Law, revenues are registered on a cash basis and expenditures and commitments on an accrual basis. Capital expenditures are treated as ordinary expenditure and there is no capitalisation or depreciation of assets.

### Independent scrutiny of fiscal information

**Independent Audit**

External auditing of fiscal activity is undertaken at the federal level by the National Audit Court (TCU). The TCU enjoys a reputation for probity, with the President appointing three of its nine members, and Congress appointing the remainder. The TCU has constitutional power to judge and impose penalties on budget organizations for irregularities, errors, abuses, mismanagement, and waste of public resources. Audit reports are sent to Congress, as well as to the Attorney General's Office for prosecution, if appropriate, and are published in the Official Gazette[42] and on the TCU website.[43]

At the regional level, fiscal reports are audited by state and municipal audit courts. In addition, a lottery system is in place, whereby twenty municipalities selected at random are audited by the TCU every year. Independent analysis of fiscal forecasts is encouraged, and the BCB publishes and rates third-party projections by investment banks and analysts.[44]

However, it should be noted that in 2001 the IMF called for the clearer definition of the responsibilities of the various agencies involved in external and internal auditing, and also recommended more systematic follow-up of the reports of those agencies.[45]

**National Statistics Agency**

The Brazilian Institute of National Statistics and Geography compiles a wide variety of statistical information, including fiscal and macroeconomic data. Legislation establishing its legal foundation is available to the public in Portuguese via the website of the Presidency of the Republic. It reports to the Ministry of Planning, Budget and Management, but enjoys effective operational autonomy. Its legal framework establishes that the IBGE should make all its statistical information available free of charge. Fiscal data published by the IBGE is limited to the broad categories of the annual national income accounts.

## INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to Brazil between 11 and 14 November 2003:

### Ministry of Planning, Budget and Management

**11 November 2003**

| | | |
|---|---|---|
| José Carlos Miranda | Chief Economic Advisor | |
| André A. Pompeia Cavalcanti | Project Head | Office for Strategic Investments |
| Beatrice Valle | Deputy Secretary | Office for Strategic Investments |

### National Treasury, Ministry of Finance

**12 November 2003**

| | | |
|---|---|---|
| Fernando E. de P. Garrido | Head of Department | Department of Public Debt Operations Management |
| Otavio Ladeira de Medeiros | Deputy Head of Department | Public Debt Strategic Planning Department |

### Banco Central do Brasil

| | | |
|---|---|---|
| Luiz Sampaio Malan | Deputy Director | Department of Economics |
| Katherine Hennings | Advisor | |
| Eduardo Loyo | Deputy Governor for Special Studies | |

## ADDITIONAL INTERVIEWS

**13 November 2003**

| | | |
|---|---|---|
| Fernando A. Blanco Cossio | Economist | World Bank Brasilia Office |
| Juarez de Souza | Legislative Consultant | Brazilian Senate |
| Mauricio Mota Saboya Pinheiro | Economist | Institute for Applied Economic Research |
| Bolívar Pêgo Filho | Economist | Institute for Applied Economic Research |
| José Hamilton Bizarria | Economist | Institute for Applied Economic Research |
| Julieta Verleun | Programme Officer | United Nations Development Programme Government & Technology Unit |

**14 November 2003**

| | | |
|---|---|---|
| Letícia Schawrz | Advisor | Ministry of Planning, Budget and Management |
| Matthew Lownds | First Secretary | British Embassy in Brasilia |

**NOTES**

[1] Federal Constitution of 1988, Article 165.
[2] Interviews in Brasilia, 11-14 November, 2003.
[3] Public sector financial agencies include the Caixa Econômica Federal, Casa da Moeda do Brasil, Serviço Federal de Processamento de Dados, Banco do Brasil S/A, Banco da Amazônia S/A, Banco do Estado de Goiás. S/A, Banco do Estado do Amazonas S/A, Banco do Estado do Ceará S/A, Banco do Nordeste do Brasil S/A, and the IRB - Brasil Resseguros S/A.
[4] See www.planejamento.gov.br/controle_estatais/conteudo/competencia/dest.htm
[5] 'Brazil: Report on Observance of Standards and Codes (ROSC) – Fiscal Transparency Module', International Monetary Fund, December 2001; Interviews in Brasilia, November 11-14, 2003, p.15.
[6] Federal Constitution of 1988, Articles 153-4.
[7] Interviews in Brasilia, 11-14 November 2003.
[8] Interviews in Brasilia, 11-14 November, 2003.
[9] 'Brazil: Report on Observance of Standards and Codes (ROSC) – Fiscal Transparency Module', International Monetary Fund, December 2001 and Interviews in Brasilia, November 11-14, 2003, p.24.
[10] Secretariat of National Revenue. (2001). Available at: www.receita.fazenda.gov.br
[11] See www.tesouro.fazenda.gov.br
[12] "Programme Document for a Proposed Second Programmematic Fiscal Reform Loan (Fiscal Responsibility and Tax Reform)", World Bank, May 14, 2003, and Interviews in Brasilia, 11-14 November, 2003.
[13] Interviews in Brasilia, 11-14 November, 2003.
[14] Interviews in Brasilia, 11-14 November, 2003.
[15] 'Brazil: Report on Observance of Standards and Codes (ROSC) – Fiscal Transparency Module', International Monetary Fund, December 2001, p.12; Interviews in Brasilia, November 11-14, 2003.
[16] 'Brazil: Report on Observance of Standards and Codes (ROSC) – Fiscal Transparency Module', International Monetary Fund, December 2001 and Interviews in Brasilia, November 11-14, 2003.
[17] Interviews in Brasilia, 11-14 November, 2003.
[18] Interviews in Brasilia, 11-14 November, 2003.
[19] "Programme Document for a Proposed Second Programmatic Fiscal Reform Loan (Fiscal Responsibility and Tax Reform)", World Bank, May 14, 2003, and Interviews in Brasilia, 11-14 November, 2003.
[20] Interviews in Brasilia, 11-14 November, 2003.
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# OXFORD ANALYTICA

## CHILE

## FISCAL TRANSPARENCY

**Country Report 2003**

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# CHILE

## COMPLIANCE RATINGS

| *Fiscal transparency* | *2003* | *2002* | *2001* |
|---|---|---|---|
| Clarity of roles | ●●●● | ●●●● | ●●●● |
| Availability of information | ●●●● | ●●● | ●●●● |
| Budget preparation | ●●●● | ●●● | ●●●● |
| Accountability | ●●●● | ●●●● | ●●● |
| **Score** | 4.00 | 3.50 | 3.75 |

## OUTLOOK & COMMENTARY

Chile's commitments to meet the highest international standards for fiscal transparency practices will continue in the near future. During 2004, the government will study the recommendations made by independent reports on the country's fiscal transparency operations, in order to make the necessary changes to its practices.

A key factor in the country's compliance will be to monitor the effectiveness of the advances achieved in fiscal transparency practices. Public sector reforms like the new procurement law, the operations of the recently created National Civil Service Directorate, the effective role of the Congress Special Budget Commission, and the legal limitations imposed on the use of the so-called "reserved spendings" are among the most important issues to review in the near future.

# EXECUTIVE SUMMARY

## 4.00 Compliance in progress

Chile has one of the most sophisticated budget preparation processes in Latin America. During 2003, the country carried out further improvements in its fiscal transparency practices. Changes to the legislative framework have increased fiscal transparency. The new permanent status granted to the Congress Special Budget Commission is expected to enhance national government's accountability regarding fiscal accounts, and to balance the currently broad powers that the executive has in the budgetary process.

Chile complies with the IMF's Special Data Dissemination Standard (SDDS), and publishes a comprehensive range of fiscal information. Law 19,896 of September 2003 established the legal obligation to publish a *Public Finance Report* on an annual basis. This report contains information on fiscal policy, macroeconomic forecasts, performance criteria for budgetary programmes, contingent liabilities, tax expenditures, and quasi-fiscal activities. During the past year, Chile has started to release information on central government budget execution on a monthly basis. Results of major budget programmes and impact evaluation are submitted to Congress annually.

The new Law 19,863 has increased the transparency of the so-called "reserved spendings" of the government. However, budget documentation does not provide detailed information on this, or on resources under the *Reserved Law of Copper*. Fiscal transparency could also be enhanced through establishing a standardised methodology to report fiscal risks.

Chile's overall score has improved from 3.50 in 2002 to 4.00.

## 1. Clarity of Roles, Responsibilities and Objectives

●●●● Compliance in progress

**The government sector should be distinguished from the rest of the public sector and from the rest of the economy, and policy and management roles within the public sector should be clear and publicly disclosed.**

**Structure, functions and responsibilities of government**

The 1980 Political Constitution, the 1986 Organic Constitutional Law of General Principles for State Management (LOCBGAE), and Organic Decree Law 1,263 of the State's Financial Management (LAFE) set out the structure of Chile's public sector and government.[1] The distribution of functions among the different levels of government and intergovernmental fiscal relations are clearly defined. Chile is a unitary decentralised republic, constituting 13 regional governments, with clear separation of executive, legislative and judiciary powers. In addition to these, Chile has a number of autonomous and independent public institutions, such as the Central Bank of Chile (BCC), the Office of the Comptroller General (CGR), the Attorney General, and the Superintendence of Banks and Financial Institutions (SBIF).

The Budget Law covers all institutions that are normally included in the IMF's Government Finance Statistics (GFS) Manual's definition of central government. In 2004, the government will start to disseminate fiscal information in compliance with the GFS Manual 2001.

The relationship between regional bodies and the national government is also clearly defined in the constitution. Each regional government is formed by a number of provinces that, in turn, comprise diverse municipalities. The Budget Law also includes the regions' budgets, which are classified as part of the decentralised government in the LOCBGAE. The municipalities -- being managerially and financially autonomous -- are not incorporated into the Budget Law, but their budgetary procedures adhere to the LAFE principles. It is worth noting that municipal governments may not issue debt without authorisation from the Ministry of Finance.

The Organic Law of the Regional Councils of 1987 (amended in 1992) and the Organic Law of the Municipalities of 1993 determine taxation powers for each level of government. The government has submitted to Congress reform proposals for regional taxes (*impuestos territoriales*) and for the *Municipal Common Fund*, which redistributes municipal tax revenues from the wealthiest to those with lower revenue-generating capacity. These reforms, however, are still awaiting congressional approval.

**Coordination and management of budgetary activities**

The LAFE contains principles and guidelines for budget management in Chile. This Law establishes the principle of unified budgeting, and requires all incomes to be included in institutions' budgets on a gross basis. The Ministry of Finance sets up the budgetary and financial schedule, and the National Budget Office (DIPRES) is in charge of drafting the Budget Bill and carrying out budget implementation.[2] The DIPRES also presents general government statistics in its public finance statistics yearbook, which are compatible with GFS except that they exclude universities and research institutes, whose budgets are not approved by Congress. The CGR is responsible for the supervision and accounting of the budget execution, in addition to its auditing duties on public funds. Grants and

external loans to public institutions have to be approved by the Ministry of Finance. Credits to central government entities are subject to a global debt limit set in the annual budget law.

The undisclosed Law 13,196 of 1958 (as amended in 1985) -- known as the *Reserved Law of Copper* -- authorises the automatic transfer of 10% of sales made by CODELCO (the state's holding copper corporation) to military procurement. However, Law 19,863 of February 2003 authorizes the publication of revenues and expenditures related to the Copper Law. Although this item will continue to represent the only significant extra-budgetary activity in the country, commentators highlighted the progress represented by this new law.[3]

There are a few 'above the line' government operations. For example, withdrawals from the *Copper Revenue Compensation Fund* are recorded as revenues, while deposits from CODELCO into the fund are not registered in government accounts.[4] Other operations, like transactions to and from the *Oil Compensation Fund*, are not recorded as revenue/expenditure at all. Central government data include information on these funds only as memorandum items.

**Relations between government and public sector agencies**

The Central Bank of Chile (BCC) is independent from the government, as established in the 1980 Constitution and the BCC's Organic Law. It may not perform lending operations to the government, except in a state of emergency. Moreover, the BCC cannot engage in transactions with the non-financial private sector. Following the 1985 banking crisis, the central bank purchased a substantial amount of public debt and banking assets, which have led it to incur approximately 1% GDP of losses. This is due to imbalances on interest payments and revenues, where the government pays out less than BCC's interest payments of its outstanding liabilities. However, Congress has authorised the BCC to change that debt's denomination from dollars to pesos, which should eventually align the structure of its credits and liabilities.

The regulatory framework for the financial system is based on internationally accepted criteria. The SBIF is independent and has administrative autonomy[5], and the Constitution and the General Law of Banks regulate it.[6] Chile's president appoints the SBIF's executive director. The SBIF authorizes the creation of new banks and has wide powers to interpret and enforce regulations.

**Government involvement in the private sector**

The government's commercial and non-commercial activities have separate budget processes and are covered by different legal procedures. A qualified majority of Congress is required to create new public enterprises or expand their activity. Commercial activities are often subject to oversight and control like any other private institution, adhering to commercial law and regulations governing private enterprises. The government disseminates the activities, balance sheets, and financial statement of its enterprises. In 2003, the government has started to publish information on quasi-fiscal operations of public enterprises.

There are two types of state-owned enterprises, depending on the level of government ownership. The *Production Development Corporation* (CORFO, established in 1939) is the vehicle through which the government invests and has equity holdings in different industries -- such as health institutions, service providers, the national lottery, and coal industry. These companies, subject to the same supervision guidelines for private firms, are managed by the holding *System of Enterprises* (SEP) [7], and have to issue financial reports to the public once a year. Moreover, the budget law requires the executive to release semi-annual financial reports to Congress for these firms. The SEP was created in June 2001 replacing the *Enterprise Management System* (SAE). Quasi-fiscal operations undertaken by CORFO enterprises are funded with government transfers registered in the Budget Law.

Additionally, the government has majority ownership in enterprises like CODELCO and others that are left out of the SEP scheme. These enterprises follow their own budgetary procedures, not necessarily following the LAFE guidelines, but are subject to the Ministry of Finance's approval. Similarly, budgets for public universities are not governed by the LAFE and are not included in the annual budget law.

There are a few public financial institutions, *Banco del Estado* being the most important. These institutions are regulated by the BCC and supervised by the SBIF. *Banco del Estado* has a market share of around 12% and performs quasi-fiscal activities. The banks is not covered by the LAFE, nor included in the budget law.

## There should be a clear legal and administrative framework for fiscal management

**Legal framework for budgetary activities**

The Constitution endorses the executive, through the Ministry of Finance, to present a Budget Bill to Congress which only has the power to reduce or eliminate expenses. Moreover, if Congress does not approve the Budget Law within 60 days after submission by the President, the draft automatically comes into force. Congress discusses the budget in a special joint commission, whose report goes to the chamber of deputies and senate for approval. The LAFE centralises the fiscal process in the Ministry of Finance, which gathers budgets of other ministries, agencies, and regional governments to assemble the bill. Moreover, the LAFE also regulates accounting, the management of funds, financial control, and public credit.

The approved Budget Law therefore includes all government revenues and expenses, with the exceptions described above. The law is introduced together with a financial statement that considers the previous year's budgetary execution, and also the new financial requirements necessary to meet both the annual fiscal targets and the medium term financial plans.

Recent amendments to the regulatory framework have increased the transparency of the budget regulatory framework, reducing the number of provisions. In September 2003, Congress passed Law 19,896, giving permanent legal status to different regulations that were previously included in each year's budget law. This law also establishes the obligation to publish annually a *Public Finance Report* (PFR).[8] This law has been proposed by the central government and includes a number of legal contents that the PFR must have, unifying in one core document previously decentralized information. The first report published under this law was released in October 2003.[9]

The Ministry of Finance has broad powers to meet fiscal targets, including the authority to overview and authorise any actions that would require future disbursements. It also has capacities to reduce budgeted government spending, and propose extra budgetary increases that require congressional approval (except for economic emergency situations). Some commentators have expressed concerns about the broad powers that the executive has in the budgetary process.

**Legal framework for taxation**

Taxes are determined by law and provide no discretionary powers to the government. The Internal Tax Service (SII) is responsible for general taxes' management, while the National Customs Service (SNA) is responsible for tariffs and other foreign trade duties. The treasury is responsible for managing the tax revenue process. A permanent commission has been established to coordinate their activities, chaired by the head of the SII. Both the SII and the SNA have procedures to challenge tax decisions, and are legally protected from political influence. Tax laws are relatively simpler and the SII and the SNA websites provide information about taxes and tax dispute procedures. Moreover, tax payments can be made via the internet. The customs service is developing a project to permit full internet tracking of imports through to clearance.

Chile's Tax Code contains clear provisions regarding taxpayers' legal rights and arbitration procedures. The Ministry of Finance has sent to Congress a proposal to make first-round tribunals independent of the tax agencies and to create chambers with independent tax expertise within the Court of Appeals. These reforms are expected to come into force in 2004.

**Ethical standards for public servants**

The 1989 Administrative Statute of Law 18,834 sets supervisory controls and conduct conventions for all public sector employees. The Administrative Statute also establishes principles of probity, confidentiality in legally restricted affairs, and prompt reporting of any knowledge of irregularities. Complementary legislation for government staff's code of conduct is set by the *Administrative Probity Statute* established in Law 18,575 (of 1986) and Law 19,653 (of 1999).

## 2. PUBLIC AVAILABILITY OF INFORMATION

●●●● Compliance in progress

**The public should be provided with full information on the past, current and projected fiscal activity of government.**

Chile has very efficient budgeting procedures, and the public has access to comprehensive and timely fiscal reports.

The recently introduced annual *Public Finance Review* (PFR) is considered a substantial advance for public availability of information. The 2003 version includes information on fiscal policy, government statistics, projections of the structural balance, and performance criteria for budgetary programmes. Information on contingent liabilities, tax expenditures, and quasi-fiscal activities, are also reported in this publication.

The DIPRES includes in the Budget Bill a *Report on the State of the Public Finances*, and the *Report on the Public Finances*.[10] These include a detailed disclosure of the previous four years' fiscal activity, a three-year forward financial plan, the structural surplus targets, and the assumptions and guidelines used to make the projections. The Budget Bill itself includes an analysis of general macroeconomic conditions to explain the assumptions and guidelines used to estimate government revenues and expenses. The *Public Finance Statistics* yearbook includes consolidated figures for central government, general government, and the non-financial public sector for the previous ten years.

**Central government operations**

The DIPRES submits to Congress and publishes on its website monthly, quarterly, biannual, and annual reports on budget execution, and audited annual balances and quarterly financial statements of public companies. The DIPRES reports central government operations on a quarterly and annual basis. The results of quarterly budget-execution reports are compared with the relevant Budget Law and with previous years' performance. Annual reporting not only includes the year's budget accounts, but also the functional execution of the budget. Execution of central government agencies (at the programme level) is published quarterly.

Despite Chile's progress in enhancing fiscal transparency, there is still a need to clarify and disseminate information on some areas. Budget documentation does not provide detailed information on resources under the *Reserved Law of Copper* and the so-called "reserved spendings". The latter are a reserved expenditure line in some ministries, mainly security-related, which are reported globally but not itemized. Law 19,863, the first law in seventy years to regulate the government's use of discretionary funds, has increased the transparency of these spendings, decreasing the amount, limiting the purposes they can be used for and making them accountable to the CGR.[11] Reserved spendings for the 2004 budget represent 0.06% of total expenditures, a reduction of 30% in real terms from the 2003 budget.

An important gap in Chile's fiscal statistics is the omission of some military activity from budget documentation.[12] Since 2002, the government reports the transfer of 10% of CODELCO's sales to the armed forces, which constitute roughly 85% of the CODELCO's transferred revenue to the public sector.[13] However, fiscal accounts do not include lending activities by the military or financial operations by certain military factories.

**Public sector operations**

The DIPRES reports on the general government, including municipalities and decentralised public institutions on a regular basis. Municipalities are subject to the same standards of fiscal accounting as the central government. Even though there is still some room for improvement, the quality and periodicity of information from municipalities have been increasing during the past five years. Their financial activities are overseen by the CGR, which prepares quarterly consolidated statements on their budgets, finances, and assets on the basis of monthly reports from them. The DIPRES also reports budget execution and financial performance of state-owned enterprises on a quarterly basis. Reports on the non-financial public sector are published annually. These reports include information on net debt.

The CGR releases information on public financial institutions and the BCC in its *Financial Management Report of the Public Sector*. Recently, the government has started to disclose a consolidated balance of state-owned enterprises on a quarterly basis and information on quasi-fiscal operations and contingent liabilities.

## A commitment should be made to the timely publication of fiscal information.

Chile subscribes to the IMF's Special Data Dissemination Standard (SDDS).[14] Data are disseminated in millions of Chilean pesos on general government operations. The data cover the budgetary units of central government (which include the Social Security Funds managed by the public sector) and the local governments entities.

Chile has taken a flexibility option for the periodicity and timeliness of reporting on central government data. Detailed quarterly data on revenue and expenditure are published within 60 days of the reference quarter and annual financing data is released within three months of the end of the year. The Budget Law requires the release of quarterly information within 45 days of the end of the period. These deadlines are observed rigorously.

**Debt reporting**

Chile releases a comprehensive amount of debt information. Statistics on public debt and financial assets are compiled and reported by the Ministry of Finance. Reporting of central government debt follows SDDS requirements, including for various classifications of the debt stock. Transparency used to be undermined by the fact that this information was dispersed throughout diverse agencies. However, the DIPRES attempted to resolve this in October 2002, producing a report that consolidates public debt. During this year, the DIPRES has started publishing reports every semester (in co-operation with the BCC) to provide periodic and consistent debt information of the central government, the central bank and public enterprises. Reports on central government debt include information on payment schedules, maturities and lenders. In addition, information on net and gross debt and on public assets has also been included in the DIPRES reports.[15]

**Advance release calendars**

An advance release calendar that provides one-quarter-ahead notice of the precise release dates is disseminated on the DIPRES website.

## 3. Open Budget Preparation, Execution and Reporting

●●●● Compliance in progress

### Fiscal policy objectives, macroeconomic framework and risks

**Fiscal policy objectives**

A statement of fiscal policy objectives is included in the *Public Finance Report.* This publication also includes the government's medium-term fiscal policy objectives and priorities for the following three years; explanation to changes in fiscal rules; and budgetary reallocations for the preceding three years. The PFR released in October 2003 has been praised by fiscal policy experts as a very important tool for fiscal policy reporting.[16]

The budget preparation process makes a distinction between existing commitments and new policies. Since 2001, a new methodology has distinguished between inertial and 'incremental' outlays. The gap between inertial expenditure and the total expenditure permitted by the structural balance target determines a pool of available funds for which competing proposals can be considered. Proposals have to include a clear presentation of objectives, expected results, coverage, resource requirements, and evaluation indicators. [17]

**Macroeconomic framework**

Chile operates medium-term financial plans that include the relevant fiscal year and three years ahead. Income and expenditure forecasts are based on publicly disclosed assumptions on economic growth, inflation, interest and exchange rates, and copper prices. The framework implements formal rolling medium-term expenditure estimates based on forecasts by budget item and programme. The projected outcomes are then compared to the structural surplus rule of 1% to identify any sources of fiscal imbalance.

The structural balance rule is not mandated by legislation, but is a policy commitment of the administration. The government works in close collaboration with independent expert panels in order to establish the determination of critical inputs to the estimation of medium-term forecasts of real copper prices; the labour force; capital accumulation; and total factor productivity. Statements identifying panel members and documenting results are publicly available.

Each year, the Ministry of Finance presents the budget proposal for the following period before the Congress' Special Budgetary Commission. This presentation includes some general remarks regarding macroeconomic forecasts, which are also publicly available through the PFR. One month before this presentation, the BCC has to submit to Congress a report of advances and changes in inflation targets. The BCC's report also includes a section on macroeconomic forecasts. Forecasts prepared by both institutions are generally homogeneous.[18]

**Fiscal risks**

The government does not follow a standardised methodology to report fiscal risks. Analysis of fiscal risks is included in the budget bill when identified, but they are not presented within a systematic methodology. The PFR submitted in October 2003 does not include an analysis of fiscal risks. However, commentators have suggested the intention to include them in the near future.[19]

A general analysis of fiscal risks is usually included in the Budget Director's report to congress at the time of the budget submission. Moreover, the government discloses estimates of contingent liabilities of over 2% GDP with data from a special fund for their provision.

**Fiscal sustainability**

Since 2001, Chile has followed a budgetary process aimed at achieving an annual structural fiscal surplus of 1% GDP. The methodology follows IMF and OECD guidelines to determine revenues and expenses should the economy reach its potential output and copper prices remain within historical trends. The 1% structural fiscal surplus methodology, however, lacks a debt ceiling to ensure fiscal sustainability. Although Chile has met structural fiscal targets, during the past five years budget deficits have accumulated, though these do not currently represent a fiscal sustainability concern. Nonetheless, the government is not impeded from increasing its debt.

The PFR released in October 2003 provides an analysis of fiscal sustainability, including a dynamic evaluation of fiscal policy and the framework of sustainability used by Chile, under its structural fiscal surplus methodology.

Since 2001 the budget has been prepared and presented in a medium-term framework, with two main elements, namely a target for the structural balance and a medium-term financial projection. Fiscal sustainability is monitored on a regular basis. The structural balance estimate is updated and published twice a year. This analysis is complemented with medium-term financial projections published each October. For this purpose, four years of projections are presented for expenditure and revenue, though the exercise does not include details of spending programmes or financing projections.[20]

## Budget presentation

**Data reporting**

The Budget Bill is available in early October of the previous fiscal year. The document includes a detailed presentation of fiscal targets and policies to be implemented in the following fiscal year. The budget is developed according to administrative categories, but also reported broadly on a programme basis. The specification of programme objectives and their link to performance indicators and evaluation procedures is highly developed in the budget presentation. In order to increase transparency, the government is currently working on the formulation of clear guidelines to conduct the evaluation of government programmes. The approved Budget Law is published with a description of appropriations and the cash plan. Previous years' budgets and execution indicator are also publicly available.

A detailed *Financial Management Report of the Public Sector* is available for public consultation 45 days after the end of the fiscal year.

## Budget execution and monitoring

Chile has made considerable progress in monitoring budget execution. The DIPRES and the CGR are implementing a *State Information System of Financial Management* (SIGFE) that includes a complete overhaul of methodology followed by government agencies and municipalities.[21] The core objective of this programme is to establish a system of checks and balances within government departments designed to monitor its spending according to budgetary allocations. The new system, expected to be fully operational in 2005, will allow electronic reporting of fiscal disbursements and budget execution. In the meantime, provisional measures have been taken to increase the control of spending in line with budgetary commitments.

The DIPRES regulates budget execution following a monthly programme. Chile has implemented a financial accounting system that requires all government levels and agencies to report their budget execution (including public investment) as well as meeting specific monitoring criteria. The system includes management incentives that allocate an additional 2% (of their corresponding budget) to the best performing units.

Also, the government has established a Contestable Common Fund to control administrative costs and limit public spending inertia. The fund allocates resources for future programmes on a merit basis, measured in terms of overall efficiency and the programme's social/fiscal impact.

In 2003, Chile has further improved its performance-based budgeting system, increasing efficient budget execution. This system now includes better performance indicators, comprehensive assessments of budgetary programmes, and special programmes to enhance government performance. Assessments of performance indicators from previous years are publicly available.

**Accounting basis**

The general principles of government accounting are established in LAFE, which also gives the Comptroller General responsibility for assessing the public sector accounts. Rules of the public sector accounting system are consistent with international standards. Chile has followed a modified accrual-based accounting system since 1975. The system registers all accrued expenses and income, but does not include stocks and valuations of public assets. During 2003, Chile has made steady progress towards establishing a fully accrual-based accounting system, as established in the GFS Manual of 2001. The change to this system is expected to be completed by 2006.[22]

The accounting methodology does not include the BCC and a number of public financial institutions, since these do not carry out quasi-fiscal operations.[23]

**Procurement and employment**

The constitution and diverse laws regulate procurement as well as appointments and wages of public sector staff. Law No. 18,575 on the General Bases for the Administration of the State establishes general transparency and competitiveness principles for the contracting process. Allegations over obscure government employment and payment practices are not common, and corruption allegations are usually judicially investigated. A new procurement law has been passed in 2003. This law provides homogeneity to procurement procedures, and establishes an independent tribunal to handle appeals by suppliers.[24] Before this law, regulations could differ from sector to sector and were not fully defined for all areas. The Ministry of Finance has a special website where it publishes tenders and public contracts, together with all relevant legislation and recent news in the public procurement area.[25]

Entry to the civil service is based on competition and merit, with some exceptions made for political appointments. As well as creating a National Civil Service Directorate, the new Civil Service Statute, approved by Congress in May, seeks to modernize public administration and to lay the foundations of a professional civil service. As part of a re-design of selection and pay policies, the new Statute emphasizes promotion on a competitive, merit-determined basis, increases performance-based incentives, introduces new incentives for retirement, and establishes a new system for monitoring the performance of top-level officials. As a result of these changes, the number of political appointees in the public administration will drop from approximately 3,500 to around 400.

## Fiscal reporting

The Office of the Comptroller General carries out the *Financial Management Report of the Public Sector* and an audit report of the Treasury Account. The DIPRES reports fiscal activity on an annual and quarterly basis, and publishes it public financial statistics yearbook during the first semester of the year.

Starting in 2003, the government has increased the periodicity of fiscal information. Consequently, information on budgetary execution is now publicly available on a monthly basis; information on revenues and expenditures is updated every three months; and information on the financial position of public enterprises is updated on a quarterly basis. In addition, the PFR has to be published annually. The DIPRES website is updated on a regular basis with all the latest reports released by the government.

The government is committed to publishing a new comprehensive series of fiscal statistics for the 1987-2003 period by March 2004, following the 2001 version of the GFS manual.[26] Next year, and following the scheduled agreed with the IMF, the government will submit to Congress a report of progress on the change of fiscal statistics towards a accrual-based system.

Results of major budget programmes and impact evaluations are submitted to Congress annually. Moreover, the government provides to Congress mid-year reports evaluating the financial conduct of central government. These reports are submitted in July each year and include a complete assessment of the previous fiscal year, and an assessment of the half-year in progress. If necessary, the government might include in these reports amendments to the original projections included in the budget documentation.

Law 19,875 of May 2003 gives permanent status to the Congress Special Budget Commission, made up of members from chambers. In the past, this commission only met on an *ad-hoc* basis, to discuss the budget submitted each year. The core objective of the changes introduced is to give Congress more powers to oversee and control budgetary execution during the fiscal year.[27] Some commentators have suggested that these changes will increase the real power of congress in the budgetary process, increase the accountability of the national government regarding fiscal accounts, and lock in the support of Congress for fiscal discipline.[28]

## 4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY

●●●● Compliance in progress

Chile has continued upgrading its fiscal operation reporting system for government agencies. Once the SIGFE programme becomes fully operational, it will electronically track real-time disbursements, improving the current paper-based arrangements. The system will also allow eliminating differences in methodology, coverage and periodicity of information along different government dependencies.

### Data quality standards

In general, overall budget results have not differed significantly from the original estimates. Supplementary budgets have not been used since the adoption of the LAFE in 1975. The annual budget data published by the DIPRES are on a cash basis. The final accounts published by the CGR are on an accrual basis. Both reports include methodological commentaries which address accounting issues. The DIPRES reconciles the official fiscal statistics it publishes with data horizontally consolidated, published, and audited by the CGR [29]

In a recent study coordinated by the International Budget Project in ten Latin American countries, the quality of information and statistics in Chile received one of the highest scores. [30]

### Independent scrutiny of fiscal information

**Independent Audit**

The Office of the Comptroller General carries out an independent audit on the public sector's fiscal management and budget execution, including sub-national levels of government. The CGR has institutional and administrative autonomy, but it is financially dependent from the Budget Law, subject to the same budgeting procedures for the central government. Once appointed by the President with approval of the Senate, the Comptroller may only be removed through congressional action on an accusation based on a constitutional infringement. CGR also verifies the legality of the administration's transactions, inspects the income and investment of treasury and municipality resources, and develops auditing and internal control. Before April 30th each year, the Comptroller has to submit both to Congress and the president, a *Financial Management Report of the Public Sector* for the previous year. Annual reports prepared by the CGR are publicly available on its website.[31]

CGR's role has been strengthened in recent years and today is perceived as an independent institution, with full institutional and operative capacity. The CGR has the power to pursue the recovery of funds if fiscal mismanagements are found following an audit. However, some commentators suggested that some important investigations conducted by the CGR are not properly communicated to the general public. Consequently, the central government does not feel the pressure of further investigating its findings.[32]

The CGR has established new guidelines to work with internal auditors, for which Congress approved a reform to the Comptroller's Organic Law. These changes authorise the Comptroller Office to perform evaluations on state agencies' internal auditing systems and their monitoring capacities over budget execution.

Independent critiquing or reporting on the quality of macroeconomic forecasts is not a regular practice, although some steps have recently been made in this direction. At present, some variables used to prepare macroeconomic projections are discussed with representatives of the private sector and the civil society.

**National Statistics Agency**

The National Institute of Statistics is the central government authority in charge of statistics, and enjoys prestige and political independence. Social and economic indicators are publicly available on its website.[33] Fiscal information and reporting is performed by the DIPRES and controlled by the CGR. The dependence of the DIPRES on the executive does not undermine the reliability of its fiscal information.[34]

## INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to Chile between 18 and 20 November 2003:

### Ministry of Finance

**20 November 2003**

| | | |
|---|---|---|
| Mario Marcel Cullell | Director | National Budget Office |
| Jaime Crispi Lago | Head, Research Division | National Budget Office |

### Central Bank of Chile

**20 November 2003**

| | | |
|---|---|---|
| Rodrigo Valdes Pulido | General Manager | Department of Economic Research |

## ADDITIONAL INTERVIEWS

**18 November 2003**

| | | |
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| Axel Buchheister Rosas | Legislative Programme Director | Freedom and Development Institute |
| Rosanna Costa | Fellow, Economic Programme | Freedom and Development Institute |
| Diego Grunwald | Deputy Chief Economist | Larrain Vial Consulting |

**19 November 2003**

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| Enrique Marshall Rivera | Superintendent | Superintendence of Banks and Financial Institutions |
| Fernando Valdes Ossa | Correspondent | Superintendence of Banks and Financial Institutions |
| Juan Andres Fontaine | Consultant | Fontaine & Paul Consulting |
| Paul Taylor | First Secretary | British Embassy in Santiago |

## NOTES

[1] Constitution of Chile at www.bcn.cl/imag/pdf/indiceleyes/actualizacion/3464.pdf
Organic Constitutional Law 18,575 of the General Principles for the Administration of the State of 1986 at www.bcn.cl/imag/pdf/indiceleyes/leyes/8575.pdf
Organic Decree Law 1,263 of the Financial Management of the State (LAFE): www.bcn.cl/imag/pdf/indiceleyes/dl/1263.pdf
[2] The National Budget Office (DIPRES), legally established within the Ministry of Finance, has its own website at www.dipres.cl
[3] Interviews in Santiago, 18-20 November, 2003.
[4] *Corporación Nacional del Cobre* (CODELCO) was established by Law Decree 1,350 of 1976 available at www.bcn.cl/imag/pdf/indiceleyes/dl/1350.pdf . See CODELCO at www.codelco.cl
[5] Superintendence of Banks and Financial Institutions (SBIF) at www.sbif.cl
[6] General Law of Banks at www.sbif.cl/documentos/lgb.doc
[7] Chile Enterprise System (SEP) at www.comitesep.cl
[8] The government began publishing this report in 2002 but until this law was passed, there was no legal obligation to do so.
[9] '2003 Public Finance Report', available (in Spanish only) at www.dipres.cl/presupuesto/documentos/Informe_Finanzas_Publicas_2004.html
[10] Available at www.dipres.cl/fr_presupuesto.html
[11] '2002 Financial Evaluation of the Public Sector' (Evaluacion de la Gestion Financiera del Sector Publico en 2002), Budget Office, July 2003, available at www.dipres.cl/publicaciones
[12] 'Chile: Reports on the Observance of Standards and Codes – Fiscal Transparency Module', IMF, August 2003, available at www.imf.org
[13] See IMF Country Report 02155 pp 43 and Macroeconomic Aspects of the Budget 2002 document pp 36.
[14] IMF Special Dissemination Standard (SDDS) - Chile, at http://dsbb.imf.org/country/chlcats.htm
[15] Interviews in Santiago, 18-20 November, 2003.
[16] Interviews in Santiago, 18-20 November, 2003.
[17] 'Chile: Report on the Observance of Standards and Codes – Fiscal Transparency Module', IMF, August 2003.
[18] Interviews in Santiago, 18-20 November, 2003.
[19] Interviews in Santiago, 18-20 November, 2003.
[20] 'Chile: Report on the Observance of Standards and Codes – Fiscal Transparency Module', IMF, August 2003.
[21] Information on the progress of SIGFE is available at http://sigfe.sigfe.cl/
[22] Interviews in Santiago, 18-20 November, 2003.
[23] Chapter II of the 2003 Public Finance Report contains a detailed explanation of accounting practices in Chile, and the time frame that the country has set to implement a fully operational accrual-based system.
[24] Public Procurement Law, available at www.chilecompras.cl/noticias/fr_leydecompras.html
[25] System of Public Procurement, Chile Compra, at www.chilecompras.cl
[26] Interviews in Santiago, 18-20 November, 2003.
[27] This commission also has the power to require budgetary documentation from the government at any given moment during the fiscal year.
[28] Interviews in Santiago, 18-20 November, 2003.
[29] 'Chile: Report on the Observance of Standards and Codes – Fiscal Transparency Module', IMF, August 2003.
[30] 'The Latin American Index of Budget Transparency 2003', The International Budget Project, 2003, available at www.internationalbudget.org/themes/BudTrans/LA03.htm. This study ranked Chile as the highest country in the region in terms of budget transparency, with a rating of 61.8 out of 100.
[31] Office of the Comptroller General (CGR), at www.contraloria.cl
[32] Interviews in Santiago, 18-20 November, 2003.
[33] National Institute of Statistics, available at www.ine.cl
[34] Interviews in Santiago, 18-20 November, 2003.

# OXFORD ANALYTICA

## CHINA

## FISCAL TRANSPARENCY

**Country Report 2003**

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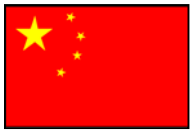
# CHINA



## COMPLIANCE RATINGS

| *Fiscal transparency* | *2003* | *2002* | *2001* |
|---|---|---|---|
| Clarity of roles | • | • | • |
| Availability of information | •• | •• | •• |
| Budget preparation | •• | •• | •• |
| Accountability | • | • | • |
| **Score** | 1.50 | 1.50 | 1.50 |

## OUTLOOK & COMMENTARY

The first year of government by the 'fourth generation' of Chinese leaders has seen stated intentions to advance reforms in several areas, including changes in the budget procedures. Even though there have been some isolated advances, China is still far from having a comprehensive policy to improve its fiscal operations.

Given the size of the country's economy, the establishment of an overall macroeconomic framework remains among the greatest challenges. The recently created National Development and Reform Commission has made some improvements, but until they become binding, no short-term progress can be expected.

China's long-term goal remains the gradual integration of all extra-budgetary revenues into the budgetary process. Moreover, a more efficient system of fiscal transfer is required, both within the provinces and between the provinces and the centre.

# EXECUTIVE SUMMARY

## 1.50 No Compliance

Fiscal transparency practices in the People's Republic of China (PRC) remain very limited. The relationship and distribution of responsibilities between the government and the rest of the economy are subject to significant shortcomings and an overall lack of transparency. In addition, there is little coordination of budgetary activities performed at the different levels of government, and ambiguities persist in the division of responsibilities between the central and local governments.

In March 2003, the National People's Congress (NPC) introduced organisational changes in some government agencies, aiming to update and increase the government's regulatory capacity. It is expected that this restructuring will have positive implications for regulatory policy and the efficiency of government, as well as intra-governmental cooperation. However, the lack of coordination between various government agencies is still noticeable, affecting the quality of fiscal projections in China.

Following the country's accession to the IMF General Data Dissemination System, data has gradually been improving. The National Bureau of Statistics (NBS) publishes monthly cumulative and quarterly fiscal data. Information on the composition of the government's debt is also available. However, fiscal data quality still suffers from the multiple layers of bureaucracy in China.

Although the Ministry of Finance usually adjust the budget throughout the fiscal year with little consultation, the NPC has been increasing its influence during the parliamentary budget process.

The budget execution and monitoring system of the PRC still bears the imprint of a planned economy. Most importantly, the country lacks a system to measure effective fiscal risk management, and the government does not have complete information on its contingent liabilities. The National Development and Reform Commission and the Ministry of Finance are in charge of establishing fiscal objectives, and providing analyses of the financial situation. However, fiscal policy objectives are not clearly explained in the documentation publicly available.

New measures to strengthen the civil service have been taken since the 1980s. However, corruption in the state bureaucracy remains a serious problem.

China's overall score is unchanged from last year.

## 1. Clarity of roles, Responsibilities and Objectives

● No compliance

**The government sector should be distinguished from the rest of the public sector and from the rest of the economy, and policy and management roles within the public sector should be clear and publicly disclosed.**

**Structure, functions, and responsibilities of government**

The relationship and distribution of responsibilities between the government, the public sector, and the rest of the economy in the People's Republic of China (PRC) are subject to significant shortcomings and an overall lack of transparency. General policy and management roles within the public sector are loosely set out by various government departments or in law. However, actual practice differs significantly from the letter of the law. For administrative purposes, the Constitution divides the country into provinces, autonomous regions, and municipalities.[1] There are 31 provincial-level administrations, including the four provincial-level municipalities of Beijing, Shanghai, Chongqing, and Tianjin; 331 prefectures; 2,109 counties; and nearly 45,000 towns.[2]

The highest organ of state power is the National People's Congress (NPC), whose Standing Committee takes care of NPC matters when the Congress is not in full session. The Congress and Committee are the national legislature. The Constitution specifies the functions and powers of the legislature, conditions for representation in the legislature, and terms of office.[3] The State Council is the executive body of the NPC and the highest organ of state administration. Its functions and powers are set out in the constitution.[4] The judiciary is represented by the people's courts, of which the Supreme People's Court is the highest judicial organ.[5]

The state is charged with responsibility for bringing about the consolidation and growth of the state economy.[6] These provisions suggest a clearly defined structure, but the *de facto* distribution of power and administrative responsibility is more ambiguous owing to the extensive control exerted by the Communist Party in all policy areas. The Politburo's Standing Committee sets and manages long-term policies and responds to external and domestic problems as they arise. The NPC's main role is to endorse decisions made by the Politburo and the Party, and thereby imbue them with official legitimacy. In recent years, the NPC has become more vocal about certain policies, but it still largely endorses policy decisions made by the Communist Party.

In March 2003, the NPC introduced organisational changes in some government agencies, aiming to update and increase the government's regulatory capacity. It is expected that this restructuring will have positive implications for regulatory policy, the efficiency of government and intra-governmental cooperation.[7]

**Coordination and management of budgetary activities**

There is little coordination of budgetary activities performed at the different levels of government. The Ministry of Finance manages only the recurrent budget, while the National Development and Reform Commission (NDRC) -- which has taken over and superseded the functions of the former State Planning and Development Commission (SPDC) -- falls under the State Council, and is in charge of the capital budget.

The NDRC oversees the operation and finances of 517 key state-owned enterprises (SOEs) and tens of thousands of less important SOEs. The NDRC will be the pre-eminent economic agency, with a more tightly focused decision-making structure than its predecessor. However, the NDRC does not have budgetary autonomy, and its budget is part of the Ministry of Finance.

The processes of budget compilation and implementation are highly politicised, involving ongoing negotiations between government departments and the Ministry of Finance, adjustments during the fiscal year, and *ad hoc* arrangements at all levels of government.

Local governments are given budget targets, but these are not binding. As long as they can fund additional spending with additional revenues, the centre will not intervene.[8] Further ambiguities exist in the division of responsibilities between the central and local governments. Formally, the central government is responsible for spending on defence, economic restructuring, and other projects needed to achieve macroeconomic objectives agreed to by the Politburo. Local governments are in charge of the remaining spending, from education to social insurance. Capital spending at the local level is not tightly controlled by the central government, but only influenced by it. However, the central government has increasingly been drawn into aiding local authorities with social welfare outlays, and it made *ad hoc* fiscal transfers to settle outstanding pension obligations in certain provinces in 1998 and 1999.

While there is a legal framework in place for budgetary activities, the budget misses much of the extrabudgetary activities of the government. Non-tax revenues, tax expenditures, payments arrears, quasi-fiscal expenditures through SOEs, and directed credit to SOEs, are not listed in the formal budget.[9] These omissions from the budget limit the usefulness of this document as a reliable indicator of the government's overall fiscal position.

Formally, the Budget Law of 1994 sets out the budgets of all levels of the Chinese government; functions and powers for budget management; the scope of budgetary revenues and expenditures; the compilation of the budget; the examination and approval of budgets; and other related aspects.[10] This resulted in a new framework for budget revenues allocation and expenditure responsibilities assignment between levels of government. The State Council and the Ministry of Finance have also issued a set of regulations with detailed guidelines on the implementation of the budget. However, commentators have indicated that a more efficient system of fiscal transfer is required, both between the provinces and the centre and within the provinces.[11]

**Relations between government and public sector agencies**

In China's hybrid planned and market economy, the line between the government and the rest of the public sector is murky. The formal public sector consists of the central government and its four subordinate tiers of government. However, there are an estimated 300,000 SOEs with more than 51% of the shares held by municipal, provincial, or central government. SOEs are generally perceived as lacking transparency, with weak internal and external controls, accountability systems and appropriate managerial incentives. In 2003, stakes in many SOEs have been prepared for sale to local private or foreign investors and progress is expected during next year. In addition, there are numerous quasi-governmental agencies. In recent years, many Chinese government agencies set up commercial ventures to fund public projects. This could lead to a conflict of interest situation and diminish the agencies' ability to perform their job as the provider of public goods.[12]

The relationship between the government and the central bank is clearly regulated by the Law of the PRC on the People's Bank of China (PBC). In administrative and operational terms, the PBC is subordinated to the State Council and must always ask this body for approval of its interest rate and exchange rate policy. In terms of fiscal autonomy, the PBC Law clearly proscribes the central bank's subscription to primary issues of government debt.[13] This clause was inserted into the PBC Law to eliminate the automatic monetisation of fiscal deficits by the PBC, which had been the case prior to 1995. As a result, the PBC has become more autonomous in the use of its instruments in recent years.

**Government involvement in the private sector**

In the People's Republic of China, the issue of state involvement in the private sector concerns the gradual introduction of private enterprise into an economy based on state ownership and control. In March 1999, the Constitution was amended to elevate the status of private enterprises from a 'complement' to an 'important component' of the economy. In August of that year, the NPC passed the country's first Sole Proprietorship Law that regulates and protects private enterprise. At the 16th Party Congress, held in November 2002, the Constitution was amended to declare that private enterprise represented "advanced productive forces". These amendments provide legal and political protection to the private sector. However, private enterprises still have difficulty getting bank loans and are banned from investing in industries that are classified as 'strategic.'

Moreover, the establishment of modern economic enterprises has created a demand for improving the structure of corporate governance in China. Over the past decade, the country has put into place a basic legal framework to underpin the corporate form, including company, contract, accounting, and securities laws. Anticipating China's accession to the WTO, the China Securities Regulatory Commission and the former SETC issued a Code of Corporate Governance for Listed Companies in January 2001 to strengthen the role of shareholders, boards of directors, and boards of supervisors, and to tighten the requirements for information disclosure and transparency in corporate management.[14] Such legislative changes, coupled with the increasing marketisation of the Chinese economy, will likely create a firmer line of division between the state and the private sector over the medium term. Some progress has recently been made in this area, though there is still much room for improvement. The State Asset Management Commission -- set up in March this year -- is working on corporate governance issues, such as promoting the introduction of effective boards, and the expatriation of nationals to run some SOEs.

## There should be a clear legal and administrative framework for fiscal management.

**Legal framework for budgetary activities**

The 1994 Budget Law governs the budgetary process, and specifies budget roles and responsibilities. Budgets are managed separately at the different levels of government. Altogether, there are five levels of budgets, from the central level downwards. The national budget is composed of the central government budget and local government budgets. The Ministry of Finance and local government finance bureaux prepare the central and local budgets and final accounts, respectively. They are also responsible for the preparation and implementation of budget-adjustment plans.

In 2003, the first year of government by the 'fourth generation' of Chinese leaders, China has seen statements of intent to advance reforms in several areas, including changes in the budgetary procedures. But while some isolated improvements have occurred, the country is still far from having a comprehensive policy to improve its fiscal operations.

**Legal framework for taxation**

In a comprehensive tax reform in 1994, the government introduced a revenue-sharing system that divided revenue sources into central, local, and shared taxes. Taxes assigned to the centre include domestic excise taxes, customs duties, and value-assed tax (VAT) and excise taxes on imports. Local taxes include business tax, urban land use tax, and real estate tax. VAT is shared, with the centre obtaining 75% of the revenue.[15] However, local governments have limited autonomy in taxation matters, despite their substantial expenditure commitments. Falling revenues at the central level and rising expenditure commitments at the sub-national level have pushed both tiers of government to use other means, such as user charges and administrative fees for public services, to raise the necessary funds to

finance expenditures.[16] Moreover, many local governments have started providing tax concessions to investors to raise revenues.

The government has recognised the problems stemming from weak revenue collection and the inadequate implementation of the revenue-sharing arrangement, and has been introducing reforms to strengthen the tax administration through computerisation and judicial reform. The 'Golden Tax' project and the 'Chinese Tax Administration and Information System' (CTAIS) are going through their third stage of implementation, but commentators have suggested that further strengthening of the tax administration is very much needed.[17] At present, an estimated 50% of all corruption in the country takes the form of tax evasion.

The State Administration of Taxation (SAT) was created in 1994. This agency is charged with the rationalisation of tax administration in China, but its effectiveness has been limited by its inadequate technology and shortage of qualified personnel. The SAT functions like a government ministry or agency, but it has no real independence -- and it is often headed by a former vice minister of the Ministry of Finance. The SAT and the Ministry of Finance have been working together in order to develop a better tax legislation framework and improve policy implementation.

There have also been cases of tax officials being subjected to threats, violence, and political intervention while carrying out their work, but they are usually offered adequate protection by the state. The ongoing reform of the tax administration is likely to contribute to increasing transparency over the medium term.

**Ethical standards for public servants**

The Provisional Regulations on Civil Servants, issued by the Ministry of Personnel in 1993, declare that government officials must abide by and execute their duties in accordance with the Constitution and relevant laws and regulations. The government is trying to tackle systemic corruption, by improving the legal environment. In addition, it has initiated several campaigns to crack down on corruption among civil servants, including personnel in the treasury departments. However, corruption among public servants remains high. A major problem in China is the lack of training that both judges and lawyers have, diminishing the enforcement of new legislation. Commentators have suggested that regulatory risks are likely to remain in this area in the coming years.[18]

## 2. PUBLIC AVAILABILITY OF INFORMATION

●● Intent declared

**The public should be provided with full information on the past, current, and projected fiscal activity of government.**

**Central government operations**

In April 2002, China joined the IMF's General Data Dissemination System (GDDS), which requires greater transparency in the provision of macroeconomic statistics. During 2003, some progress has been achieved in upgrading China's economic statistics. However, Chinese data continues to be perceived as poor. No independent surveys are undertaken to glean the data, which is collected in aggregate, facilitating distortions.[19] The Ministry of Finance aims to adopt the economic and functional classifications of the IMF Government Finance Statistics (GFS) Manual for its budget by 2005.[20] Such a commitment, if fulfilled successfully, could have far-reaching consequences for China's allocation of budgetary resources, its management of expenditures, and the process of budgetary approval by the National People's Congress.

The National Bureau of Statistics (NBS) publishes monthly and quarterly fiscal data. These statistics are supplied by the Ministry of Finance and published by the NBS in both English and Chinese in the *China Monthly Economic Indicators Bulletin*. More detailed annual data are available in the *China Statistical Yearbook* from the NBS, and the *China Finance Yearbook* and *China Financial Outlook* from the Ministry of Finance, which are also available on the ministry website.[21]

The Ministry of Finance reports total annual fiscal revenues and expenditures, breaking them down into a few major categories. It provides similar annual figures for the country's 31 provinces and municipalities. Some data on extrabudgetary revenues and expenditures are also available, although they are not as detailed as the national budgetary figures. Extrabudgetary expenditure grew from 2.6% of GDP in 1980 to 5.7% of GDP by 1996, before declining to 4.1% in 1999. Independent audits by the Ministry of Finance and the National Audit Office estimate these funds and fees in the range of 8-10% of GDP. Some commentators have suggested that government efforts are now focused on reducing it to a range between 5-8%. However, little progress has been made in 2003 regarding the integration of extrabudgetary funds. The extrabudgetary revenue-expenditure mismatches force local governments to impose fees that in turn escape budgetary scrutiny, increasing the spread of corruptive practices.

The considerable degree of extrabudgetary activities and quasi-fiscal expenditures through state banks and SOE's is a by-product of the economic reforms that China has implemented in its transition to a market economy since 1979. These economic reforms have opened up a sizeable fiscal gap between falling revenues and unchanged expenditure commitments at the centre, effectively devolving service delivery to the sub-national level. Central revenues fell from 51% to 28% of the total between 1979-1993, while budgetary expenditures at the sub-national level rose to two-thirds of the total by the late 1990s. However, such expenditure commitments have not been coupled with taxation powers at the sub-national level, and tax policies and tax administration at the centre have also failed to keep up with the changing landscape of China's liberalising economy. These issues suggest a substantial shortcoming in the transparency of fiscal activities in China, while possible avenues to reform include the increased decentralisation of taxation powers and a more efficient tax administration.

In its annual budget, the ministry provides the outturn of the preceding fiscal year, but it does not make budgetary forecasts beyond the upcoming fiscal year. The ministry does not describe the nature and fiscal significance of the central government's contingent liabilities and quasi-fiscal activities. It makes some forecasts of its contingent liabilities, but these are not released publicly and are much lower than unofficial estimates. One of our interlocutors suggested this may stem from the difficulty in assessing the full extent of the state's assets, which would have to precede an evaluation of the contingent liabilities of the central government.[22]

The Chinese authorities are working with the IMF towards refining the estimates of quasi-fiscal liabilities, especially those arising from nonperforming loans in the financial system. However, the precise impact of these potential liabilities on the budget is still difficult to assess.

On the positive side, the Ministry of Finance implemented elements of the IMF system of classification based on the GFS Manual of 1986, adding 44 expenditure items to the 2002 budget.[23] Starting in 2001, it has also started compiling a set of data on the country's social security system in addition to the budgetary revenues and expenditures of the central and local governments. However, this information is not publicly available in the formal budget.

**Public sector operations**

China has five levels of budgets at the central, provincial, municipal, county, and township levels. Local budgets are approved by the corresponding level of the People's Congress -- with complete autonomy from the central government -- and submitted to the Ministry of Finance for record and compilation of the state budget.[24] The national Budget Law stipulates that drafts of the central and local budgets, and any amendments, must be reviewed and approved by the NPC and local congresses. In addition, the state budget usually includes three parts, namely the national budget, the central budgets, and local budgets. Local budgets are publicly available (in Chinese only) in the *Finance Yearbook,* on an annual basis. Some sub-provincial budgets are available (in Chinese only) through the local statistical yearbooks.

However, the finances of SOEs and other state-owned assets are not included in the state budget and are dealt with separately by the NDRC. Our interlocutors suggested that the key issue in terms of transparency is the ability of China's different tiers of government to improve governance through reforms in the medium term.[25]

## A commitment should be made to the timely publication of fiscal information.

**Debt reporting**

The People's Bank of China publishes summary quarterly and annual data for the level and composition of the government's debt and financial assets in its *Financial Outlook* and *Annual Report*. The Ministry of Finance employs its publications and website, as well as the NBS, to disseminate more information on the country's debt situation. It publishes summary data on overall debt levels for the past ten years, showing debt dependency of the central government budget, debt outlays as a share of fiscal expenditures, debt income as a share of fiscal revenues, and the country's overall external debt. The data on government debt includes domestic borrowing, foreign borrowing, outstanding debt, and the payment of principals and interest. However, availability of information in English is very limited.

China's intergovernmental system has given rise to dysfunctional behaviour like indirect borrowing. Although forbidden to borrow openly, local governments have attempted to do so through window corporations and banks. As a consequence, the central government is not in a position to monitor or manage gross public debt. [26]

Since 2000, the ministry has been disseminating data on interest payments on its domestic and foreign bonds. In 2001, it made public for the first time its outstanding national debt. With China's participation in the IMF's GDDS, the ministry plans to classify financing and debt according to the IMF GFS Manuals of 1996 and 2001.

**Advance release calendars**

The Ministry of Finance states that its responsibilities include promoting the distribution of fiscal information.[27] However, the public dissemination of fiscal information is very limited. The ministry does not disseminate an advance release calendar. Meanwhile, the NBS puts out press releases on fiscal aggregates of the central government approximately ten days after the month of reference.

## 3. Open Budget Preparation, Execution and Reporting

●● Intent declared

### Fiscal policy objectives, macroeconomic framework, and risks

**Fiscal policy objectives**

The NDRC and the Ministry of Finance are in charge of establishing fiscal objectives, and providing analyses of the financial situation. Moreover, the NDRC is also tasked with participating in the formulation of fiscal and monetary policies. However, fiscal policy objectives are not clearly explained in the documentation publicly available.

For decades, a key objective of the budget was to channel revenues to state firms, so that they could produce the goods and services needed by the centralised economy and the jobs and social welfare services needed by the urban population. In return, state firms surrendered most of their profits to the treasury. However, as the importance of the state sector shrank, the budget gradually moved away from funding the state sector to financing newly established social services for redundant workers, poor farmers, and pensioners. Since 1998, the budget has taken on a new role, namely the promotion of economic growth through government spending. The Ministry of Finance has issued renminbi (Rmb) 150-210 billion of treasury bonds each year to fund government-designated infrastructure projects needed to attain the annual GDP target growth of 7%. It has clearly spelt out this objective in its annual budget in recent years. Occasionally, the Ministry of Finance publishes *ad hoc* statements and updates on its progress in meeting fiscal policy objectives. However, the emphasis of these reports is on how the ministry is meeting its revenue and expenditure targets, rather than the quality and progress of its work.

The government states that it aims to have a balanced budget eventually, a goal difficult to achieve given its persistent budget deficit since 1997. There are also other fiscal rules on mandatory spending increases for under-funded social sectors, such as education, agriculture, health care, science, and environmental protection.

**Macroeconomic framework**

Among the functions of the recently created NDRC is preparation -- on behalf of the State Council -- of the macroeconomic frameworks used in the budget process. However, the targets listed in the plan are not binding and have no operational functions. Moreover, it also has to study and analyse the economic situation and its development both in the country and abroad, study issues concerning national economic security, put forward policy recommendations on macroeconomic management, and coordinate economic and social development.

In addition, macroeconomic forecasting is a joint responsibility of the NDRC and the People's Bank of China. The NDRC also prepares a rolling five-year investment plan. Despite the close relationship between macroeconomic forecasting, fiscal forecasting, investment planning, and budget preparation, the level of consultation between the NDRC, the PBC, and the Ministry of Finance is far from adequate.[28] This lack of coordination between various government agencies may explain the poor quality of fiscal projections in China.

**Fiscal risks and sustainability**

There is currently no system in place for effective fiscal risk management in China. The government does not have complete information on its contingent liabilities stemming from the quasi-fiscal financing of infrastructural projects

through SOEs, the social expenditure needs of SOEs, and the country's under-resourced pension funds. The central budget does not include all government-guaranteed debt and the costs of debt servicing, and this makes it impossible for the Ministry of Finance to report the total level of outstanding debt.

State-directed lending to SOEs by the four major state-owned commercial banks has led to the accumulation of a 23% non-performing loan portfolio (out of these banks' total loans).[29] Some commentators have pointed out that the central bank and the Ministry of Finance are preparing a programme to recapitalise the four state banks, which currently hold more than 60% of the nation's banking assets, but also hold an estimated Rmb 2,000 billion in non-performing loans.[30] The potential recapitalisation of these banks would also burden the state budget. At present, neither the ministry nor the State Council has adequate assessments of the fiscal risks stemming from the costs of restructuring SOEs and loan guarantees given to SOEs.[31] For this reason, no assessments are available of the fiscal sustainability of the budget either.

## Budget presentation

The National Budget Law stipulates that drafts of the central and local budgets and any amendments must be reviewed and approved by the National People's Congress and local congresses.[32] The budget year is the same as the calendar year, starting on 1 January and closing on 31 December. Budget preparation is not fully integrated with the fiscal cycle, taking place late in the fiscal year, and with lack of coordination between the central, provincial and sub-provincial levels.[33] As the NPC only meets in plenary session in March, the budget is not enacted until well into the fiscal year. The Government presents the budget proposal to the NPC at the beginning of the plenary session in March, and the NPC has two weeks to deliberate.[34] Although the NPC can only approve or reject the budget in total and cannot amend it, the Congress has been having an increasing influence during the parliamentary budget process, which starts in January every year. However, the Ministry of Finance usually adjusts the budget throughout the fiscal year with little consultation with the NPC.

### Data reporting

Budget data are reported on a gross basis, differentiating revenues from expenditures. Revenue data given in the *China Statistical Yearbook* refer to revenues actually collected by the central and local governments, and exclude revenues from domestic and foreign borrowings. Since 1999, interest paid on domestic and foreign debts has been included in expenditure statistics, with the interest payment and principal of new debt issues classified under separate headings. Previously, they were grouped together under a single expenditure item.

Budget documentation and final accounts cover all budgetary and some of the extrabudgetary activities of the government. The government prepares a consolidated balance sheet that also includes information on the level and composition of its debt. This information is made public through publications such as the *China Statistics Yearbook*. The NBS states that procedures for the compilation of extrabudgetary revenue and expenditure data are approximately the same as those for final state accounts. Efforts are currently underway to put all extrabudgetary revenues and expenditures into department budgets parallel to the formal budget. Even though all the major extrabudgetary items were included in the 2002 budget, the current lack of inclusion of all extrabudgetary funds in the formal and departmental budgets still weakens the transparency of budget presentation in China.

## Budget execution and monitoring

The budget execution and monitoring system of the People's Republic of China still bears the imprint of a planned economy. Budget execution and monitoring are overseen by a number of departments in the Ministry of Finance. While funding requests are screened vigorously, the effectiveness of expenditure is not monitored properly. The

treasury transfers budget funds to the multiple accounts of the spending units through various layers of bureaucracy, and this makes it difficult to trace the flow of funds through the government sector. The transfer of funds is only reconciled with bank account statements before the compilation of the final accounts.

Owing to the underdeveloped nature of China's internal control system, it is very difficult to trace the flow and use of public funds throughout the government sector. Moreover, the central government lacks the instruments to track expenditures made by sub-national bodies with direct financing from the centre. On top of leakages that occur due to extrabudgetary activities, substantial waste and the misuse of contingency funds also weaken the efficiency of the budgetary process.[35] After the reorganisation of the Ministry of Finance in 2000, the monitoring of budget execution was divided among four departments: Budget, Public Expenditure, Capital Construction, and Fiscal Supervisions. These reforms strengthened the budget monitoring process, but further reforms are needed to improve the transparency of the use of public funds in China.

In 2001, six ministries were selected for a Single Treasury Account (STA) and Centralised Payment System pilot project to improve the transparency and efficiency of government cash flow management. A further 20 were added in 2002. This reform largely followed the practices of OECD countries in the 1980s that required budgetary units to have one single account with the central bank for making budgetary transactions.[36] Local governments are encouraged to implement the STA system as well.

**Accounting basis**

The 1985 Accounting Law and the associated Government Uniform Accounting System regulates government accounting and reporting practices. The accounting system is cash-based. The state budget does not record assets, arrears, or details of the transactions of spending units. The Accounting Department of the Ministry of Finance is responsible for supervising accounting operations nationally; making policy recommendations on accounting reform; and formulating and implementing accounting decrees, regulations, and standards.[37] The ministry has introduced ten new accounting standards since 1997 as it aims to meet international best practices by 2004. All administrative levels are required to implement the standards, which have enhanced bureaucratic accountability. However, uniform implementation across all jurisdictions is still pending.

**Procurement and employment**

On 29 June 2002, China promulgated the Government Procurement Law which sets out the rules and procedures for the purchase of goods, construction works, and services by governmental and quasi-governmental entities. This new law is expected to improve fiscal transparency by eliminating the last vestiges of the compulsory procurement system, which had characterised China under the planned economy. This legislation is also part of a larger government effort, which began in 1998, to reduce corruption through transparent bidding processes; the elimination of improper affiliations between businesses, the government, and the military; and greater accountability for public infrastructure projects.[38]

In order to improve accountability, local governments have started to use performance contracts. Performance evaluation includes various methods (top-down, peer review and bottom-up) and a system of rewards is tied to performance. In addition, the Administrative Licensing Law -- which will come into effect on July 2004 -- is expected to improve the licensing of business by local governments, reducing their discretionary powers and decreasing the scope for corrupt practices. This law is expected to play an important role in introducing a more transparent and efficient administrative system with standardised practices and good coordination.[39]

New measures to strengthen the civil service have been taken since the 1980s. Policies have lowered the average age of government officials while increasing education levels, especially among senior officials. Since 1993, civil service reform has focused on improving the capacity of the bureaucracy through new selection procedures that

emphasize openness and competition. In addition, the government has promoted impartiality and integrity as core values of the civil service, and corruption allegations have been investigated even at a senior level. However, corruption within the state bureaucracy remains a serious problem.[40]

## Fiscal reporting

The Chinese accounting system requires the treasury to report its revenues, expenditures, and account balances to the Ministry of Finance on a daily, monthly, and annual basis. Spending agencies report monthly and annually to their supervising ministries, which compile reports for the Ministry of Finance. The ministry has also developed plans to computerise government budgeting and accounting.[41]

As regards legislative oversight, the National People's Congress has begun to play an increasingly active role in the budgetary process and has even blocked the adoption of a few controversial tax proposals in recent years. However, the NPC's oversight of fiscal accounts has not produced any impact on fiscal transparency in 2003. Final annual accounts must be reviewed and approved by the annual NPC held in March each year, and are made publicly available after a long lag of seven to eight months.[42] Fiscal data are reported during the year through the Ministry of Finance's publications, and the website and press releases of the NBS. The finance minister also reports to the standing committee of the NPC several times a year on the progress of the ministry's work. While the procedures for fiscal reporting are firmly in place, the lack of capacity for effective internal control reduces the transparency and efficiency of fiscal processes in China.

## 4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY

● No compliance

### Data quality standards

Fiscal data quality suffers from the multiple layers of bureaucracy in China. Officials are widely seen as wanting to further their own interests to the detriment of the accuracy of the figures they submit to higher authorities. Local governments have a strong temptation to exaggerate their spending commitments and under-report the revenues they collect. Moreover, the system of fiscal data collection is archaic, and there is a lack of reconciliation of figures from other sources.

The most comprehensive set of fiscal data is found in the National Bureau of Statistics yearbook, which has figures dating back to 1978. The NBS has made several adjustments to the statistics over the years, taking into consideration the impact of recent fiscal reforms. The annual budget and final accounts are cost-based. The standards used in the compilation and presentation of budget data are not revealed publicly. Moreover, there are no specific assurances of the quality of fiscal data. The collection of fiscal data is not sufficiently computerised, and time lags are substantial. However, the World Bank and the IMF have been providing technical assistance to the Ministry of Finance and the People's Bank of China respectively, and this is expected to contribute to the gradual improvement of data quality over time.

### Independent scrutiny of fiscal information

**Independent Audit**

The Chinese National Audit Office is responsible for auditing the revenues and expenditures of all departments under the State Council.[43] The Auditor General, appointed by the prime minister, is a member of the State Council. In recent years, the office has evolved into a zealous watchdog that monitors the use of public funds at all levels of government. In his recent reports to the National People's Congress, the Auditor General criticised treasury officials, especially those at the lower levels, of misappropriating, wasting, and even embezzling public funds. In 2001, state auditors recovered Rmb 10.5 billion (1.27 billion US dollars) in misused budgetary funds and punished 397 finance officials.

The Ministry of Finance has a think tank, the Research Institute of Fiscal Science, whose specialists advise the ministry on fiscal matters. Private economists from leading academic institutions, such as the Chinese Academy of Social Science, also offer their advice publicly and privately to the ministry.

According to a report by the Asian Development Bank, China has drafted accounting and auditing laws and rules that comply with international practice. However, the enforcement of these standards remains weak, and more efforts in terms of implementation should be made. Increasing the intensity of auditing and the professionalism of auditors are among the main issues to address. In addition, the introduction of penalties for non-compliance with the regulations in place will also have to be addressed.[44]

**National Statistics Agency**

The National Statistical Law, adopted in 1983 and revised in 1996, requires statistical work to be carried out in an effective, timely, and accurate manner.[45] In recent years, the statistical system has improved its reliability. However, the NBS has neither sufficient human resources nor the expertise to perform its job effectively in China's increasingly complex fiscal environment.

The NBS is committed to improving its statistics to meet the requirements of the IMF's GDDS, and a special working group for this purpose has been set up within it. Plans include a more effective implementation of the Statistical Law to avoid misreporting of the data, and the strengthening of follow-up audit checks on enterprise data and similar checks on the data provided by provincial statistical offices. Further training is also planned for NBS staff to enhance their awareness of data quality issues pertaining to data integrity and professionalism. However, no detailed timeframe has been provided for these reforms.

## INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to China between 10 and 12 November 2003:

### People's Bank of China, Beijing

**10 November 2003**

| | | |
|---|---|---|
| Wang Zhenying | Director | Macroeconomic Department |
| Xiang Xiaolan | Analyst | Statistics Department |

## ADDITIONAL INTERVIEWS

**11 November 2003**

| | | |
|---|---|---|
| Bruce Murray | Country Director | Asian Development Bank Resident Mission |
| Longyun Peng | Economist | Asian Development Bank Resident Mission |

**12 November 2003**

| | | |
|---|---|---|
| Ray Brooks | Senior Resident Representative | IMF Resident Representative Office |
| Bao Zhenbin | Senior Economist | IMF Resident Representative Office |

### In addition, we discussed monetary transparency practices with a delegation from the National Development and Reform Commission that visited Oxford Analytica's Headquarters on November 17, 2003:

| | | |
|---|---|---|
| Dr Song Li | Director, Associate Professor | Institute of Economic Research, National Development and Reform Commission |
| Dr. Zuo Chuanchang | Associate Professor | Institute of Economic Research, National Development and Reform Commission |
| Ms. Liu Guoyan | Assistant Professor | Institute of Economic Research, National Development and Reform Commission |

## NOTES

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# OXFORD ANALYTICA

## CZECH REPUBLIC

## FISCAL TRANSPARENCY

**Country Report 2003**

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# CZECH REPUBLIC

## COMPLIANCE RATINGS

| *Fiscal transparency* | *2003* |
|---|---|
| Clarity of roles | ●●●● |
| Availability of information | ●●●● |
| Budget preparation | ●●●● |
| Accountability | ●●●● |
| **Score** | 4.00 |

## OUTLOOK & COMMENTARY

Steady progress is expected towards improving fiscal transparency. In accordance with the "Pre-Accession Economic Programme," the government is committed to a systematic overhaul of the fiscal sphere with the objective of fully complying with EU standards. The relatively numerous extra-budgetary funds are being dismantled or incorporated into the central government budget and the government has become very open about existing fiscal risks.

The new system of regional administration remains to be fully tested and there have been some signs of irresponsibility on the part of subnational governments, which continue to be imperfectly monitored. The government has yet to fully address the fiscal pressures arising from the unfavourable demographic profile.

# EXECUTIVE SUMMARY

## 4.00 Compliance in progress

The Czech Republic operates a highly transparent fiscal system, especially after the adoption of new budgetary rules in 2001. A great deal of information is available to the public about various aspects of fiscal policy and its execution. In some instances, the availability of data exceeds international norms, even if much of it is still only released in Czech. The country has an open budget system and an increasingly effective mechanism for auditing.

There are some areas where further progress would be desirable, most notably in the extensive and recently increasing use of extra-budgetary funds which operate under their own regulatory and accounting rules. However, the government is aware of the problem and is working to remedy it. Similarly, the reporting of quasi-fiscal activities continues to fall short of the ideal.

The compilation of general government statistics is still somewhat short of the ideal because of the high degree of autonomy of local governments and the fact that different standards are applied to the central government and its regional and municipal counterparts.

Czech EU membership can be expected to accelerate the process of rectifying the remaining problems.

## 1. Clarity of Roles, Responsibilities, and Objectives

●●●● Compliance in progress

**The government sector should be distinguished from the rest of the public sector and from the rest of the economy, and policy and management roles within the public sector should be clear and publicly disclosed.**

**Structure, functions, and responsibilities of government**

The 1992 Constitution of the Czech Republic and several laws clearly define the responsibilities of the government and set it apart from the private sector. The government consists of the central government in Prague, 13 regions and the capital city, and over 6,500 municipal administrations.

The Czech public sector became unusually fragmented in the late 1990s as a result of the creation of several extrabudgetary funds, currently a total of nine.[1] Plans are under discussion to create an additional Social Security Fund in connection with a proposed pension reform.[2]

**Coordination and management of budgetary activities**

The general government consists of the central government, and regional and municipal governments. General government data is compiled and reported in accordance with the ESA and the IMF's *Government Financial Statistics*.

The Law on Budgetary Rules and related legislation govern the fiscal operations of the central government. Specific laws exist for extra-budgetary funds. Local governments enjoy spending autonomy under the Constitution and the Law on Municipalities. However, local governments are dependent on the central government for the vast majority of their revenues. The Law on Budgetary Rules sets out the provisions for revenue sharing.

There are ongoing efforts to improve budget coordination at the central government level with the ultimate objective of fully merging the extra-budgetary funds with the state budget. The conditions governing the activities of extrabudgetary funds will be harmonized with those of the state budget and their expenditures will be included in the medium-term expenditure framework.[3] The government has agreed to dissolve the National Property Fund by the end of 2005 and the Czech Consolidation Agency will follow by the end of 2007. Plans are being prepared for the dismantling of the Agricultural Fund.[4] The extra-budgetary funds are already integrated in the budgetary process in as much as their budgets are submitted to the parliament simultaneously with the state budget. The extrabudgetary funds will, as of next year, be fully incorporated into the government's medium-term expenditure framework and the medium-term expenditure ceilings fully applied to them.

The fiscal responsibilities of the 14 regional governments created in 2001 have increased significantly as a result of the devolution of important spending items (education, health care, culture) to them. However, while they will receive a greater share of total taxes from the central government, they will not enjoy any independent tax-raising powers. In contrast, they can borrow money. Comparable provisions apply at the municipal level. Although subnational bond issues require Ministry of Finance (MoF) approval, there is limited control over sub-national spending, since local governments enjoy constitutionally enshrined autonomy. As of 2002 there is no central control

over bank borrowing.[5] Two Czech municipalities have recently declared bankruptcy and the state has – at least so far – refused to intervene to help, preferring instead to use them as warning examples to others. The problem does not appear to be viewed as politically urgent, given the relatively low levels of government debt in the Czech Republic.

**Relations between government and public sector agencies**

The Czech National Bank and the government have regular consultations on economic policy and the central bank performs some agency roles for the government, most notably in selling and managing government debt and in maintaining treasury accounts. More could be done to clarify relations between the CNB and the government, for instance by means of a contractual service agreement.

The National Property Fund (*Fond národního majetku*) is responsible for the technical implementation of privatisation decisions for state-owned enterprises made by the MoF. In the process, the NPF becomes the holder of the shares of companies to be privatised and is responsible for selling them. The income of the NPF does not form part of the state budget.[6]

**Government involvement in the private sector**

There are some instances where the differentiation between the government and the private sector remains blurred. The government guarantees the obligations of a state-owned development agency, the Czech Consolidation Agency (*Česká konsolidační agentura*).[7] Only transfers from the state to cover CCA losses are reported in the government budget. The activities of the Agricultural Guarantee Support Fund are covered by an implicit government guarantee.

The government holds equity in a large number of enterprises through the *National Property Fund* for the purpose of preparing them for privatisation.[8] There are some other public sector entities, notably the Czech Railways and Transgas, which nonetheless operate under the Commercial Code.

## There should be a clear legal and administrative framework for fiscal management

**Legal framework for budgetary activities**

The new *Law on Budgetary Activities* governs the central government's budgetary process. However, regional and municipal authorities are subject to a different set of so-called "small budgetary rules." Spending by state funds – most notably the Housing Fund and the Transport and Infrastructure Fund – are not governed by regular budgetary rules. Instead, particular laws passed in connection with their creation are applied to their operations. Parliamentary approval is required for above-budget expenditures. Revised budgetary rules submitted last year adjust annual budget rules to permit medium-term forecasting.

**Legal framework for taxation**

All tax laws are published in the *Collection of Laws* and taxpayers receive ample assistance with their returns. The procedures governing tax collection are specified in the 1992 *Act on Administration and Collection of Taxes and Fees*.[9]

The Czech Tax Administration is part of the MoF and has its own informative website which publishes tax codes, regulations, and calendars.[10] Tax collection is carried out by eight financial directorates and 222 financial offices which are allowed to collect information about tax payers and conduct investigations. Equal treatment of taxpayers is guaranteed by law and no substantial irregularities have been observed of late.

**Ethical standards for public servants**

A new Public Service Act was adopted in 2002 with provisions for the status, rights, and duties of civil servants. The objective is to create a stable, depoliticised professional corps. Property disclosures are compulsory for all civil servants. The government has further approved a Code of Ethics for Public Administration Employees. The code addresses the issue of conflicts of interest and bans abuse of public authority.[11] A new Act on Officials of Territorial Public Administration seeks to stabilize and professionalise sub-national public administration. The legislation conforms to West European standards and devotes considerable attention to the further education of government employees. Measures have been adopted to monitor public service and to assess its performance. The Czech Republic joined the Council of Europe's GRECO (Group of States against Corruption) programme on anti-corruption conventions in 2002. The current legislation is deemed sufficient by the Czech government to combat corruption effectively.[12]

Although the Czech Republic has modernised its legislative framework to largely conform with EU standards, corruption remains a concern. The government's May 2003 report on anti-corruption activities concluded that corruption is still widespread and revealed little progress in combating it.[13] The Corruption Perceptions Index of *Transparency International* in 2002 ranked the Czech Republic as 52nd of the 99 countries studied.[14] In particular, the prosecution of corruption cases remains often ineffective.[15] There continue to be generational problems and ineffective enforcement due to inadequate judicial resources. An ongoing judicial reform is expected to gradually improve the situation.

The Czech government introduced a governmental programme on combating corruption in 1999 and each ministry has drawn up its own anti-corruption programme. Since 2002, the requirement has been extended to all other state administrative bodies. The efforts are coordinated by the Ministry of the Interior which is also conducting public awareness campaigns on corruption. In 2002, 332 individuals were charged with abuse of authority of a public official. However, a recent GRECO report expressed concern that corruption might be more widespread than suggested by the official data.[16]

The Ministry of the Interior has set up an anti-corruption commission which monitors corruption among ministry employees and in the police force. A telephone hotline and an e-mail address provide an opportunity for citizens to report complaints. The police units involved in dealing with corruption have been reformed. The Czech Customs Administration is pursuing an Integrity Action Plan and has set up an internal inspection unit.[17]

## 2. PUBLIC AVAILABILITY OF INFORMATION

●●●● Compliance in progress

### The public should be provided with full information on the past, current, and projected fiscal activity of government.

**Central government operations**

The Ministry of Finance releases fiscal information on its website that exceeds the SDDS requirements. Government budget data is classified in accordance with economic, functional, and administrative criteria. The budget includes a policy statement and the underlying macroeconomic and fiscal assumptions. Standard budgetary data for the current and the two preceding years is complemented by data on intergovernmental grants, extra-budgetary revenues and expenditures, and transfers to local governments. The MoF also publishes data on state guarantees. The comprehensive budget document includes budgets prepared by the various ministries, broken down by agency. [18]

Under the *Law on Budgetary Rules*, the government can alter spending from the amounts approved by the parliament by up to 5% of total expenditures in the event of increased revenues.[19]

**Public sector operations**

Some two-fifths, or more, of public spending in the Czech Republic takes place through off-budget funds. This share has been on the increase due to the creation of new large funds, most notably for transport and infrastructure and for housing. The creation of 14 new regional administrations in 2001-2 further increased the share of off-budget spending. This tends to reduce transparency, in spite of the fact that all public spending requires parliamentary approval, since the State Budget is the main focus of attention. Moreover, while monthly data is released on the state budget, some other public sector entities report only once a year. The accounting rules applied to non-budget entities are different from the strict regulatory framework applied to the central government budget.[20]

The state budget contains a projection for the local sector which in turn permits estimates of the general government position. In general, all entities receiving funding from the central budget are required to either produce their individual budgets (full funding) or show their position on a net basis (partial funding). Subnational governments are required to use the same budgetary classification as the central government and they report on their fiscal activities on a monthly basis.

### A commitment should be made to the timely publication of fiscal information.

**Debt reporting**

The Treasury Division of the State Final Account Department is responsible for the issuance and management of debt in the Czech Republic. It is responsible for reporting on the current debt position. The data are published on the MoF website.[21]

While the public sector debt:GDP ratio in the Czech Republic is expected to attain 30.5% by the end of this year, the share of the central government is only roughly two-thirds of this. Most of the rest is accounted for by the Czech Consolidation Agency (*Česká Konsolidační Agentura*).[22]

**Advance release calendars**

The Czech Republic meets the Special Data Dissemination Standard (SDDS) for the dissemination of advance release calendars. These are made public through the IMF website.[23]

## 3. Open Budget Preparation, Execution, and Reporting

●●●● Compliance in progress

### Fiscal policy objectives, macroeconomic framework, and risks

**Fiscal policy objectives**

The official budget document contains a detailed policy statement with a projection of economic fundamentals and the main policy priorities. However, the inclusion of this information is not required by law.

The budget includes an administrative division of existing and new policies.

In addition to its short-term fiscal policy objectives, the Czech government has made a commitment to a medium-term programme of fiscal consolidation with the objective of bringing the public sector deficit down to levels compatible with the Maastricht criteria and the legal obligation to adopt the euro as the national currency. The immediate goal of the programme is through primarily structural measures to reduce the public sector deficit from an expected level this year of 7.6% of GDP to 4% by 2006. The Maastricht criteria are to be met by 2008.[24] However, effective fiscal consolidation will likely depend on a successful reform of the pension, sickness insurance, and related systems, given the dominance of mandatory expenditures. A pension reform draft is currently under discussion but is unlikely to be implemented before 2010. The sickness insurance system will be overhauled as of 2006. The first steps of the fiscal reform plan augur well for at least some consolidation.[25]

As part of this reform, the government will introduce fiscal targeting and medium-term expenditure frameworks. In order to meet the targets, a binding medium-term expenditure framework will be set for central government and extrabudgetary fund expenditure in individual years. The framework can only be amended in exceptional circumstances.[26]

**Macroeconomic framework**

The MoF has a macroeconomic forecasting division which produces and publishes quarterly forecasts. The modelling framework, which is constantly under development, is not publicly known, but the models play only an auxiliary role in formulating projections. Year-to-year changes in the analytical framework are described in the annual *Pre-Accession Economic Programmes*. Forecasts are currently prepared for a two-year period at a time, but the forecasting horizon is being extended to four years in line with EU requirements.[27] While all forecasts are prepared internally, the ministry does hold a semi-annual colloquium bringing together experts from universities and the private and public sectors for the purpose of comparing assessments of the macroeconomic framework.[28] The modelling framework is currently being revised jointly with Dutch experts.

**Fiscal risks**

The government provides data on its hidden debt, although this is not legally required. Hidden debts include fiscal activity which is not otherwise included in the government's fiscal accounts. The government has taken over all the hidden liabilities held by public institutions used to finance the costs of the post-socialists transition. The two main

sources of fiscal risk are (i) state guarantees from government support of development projects and annual subsidies for them, and (ii) bad assets in public sector institutions as result of directed credits and purchases of low quality assets. However, a great deal has been done in recent years to consolidate the sector, most notably through the establishment and incorporation into the government sector of the Czech Consolidation Agency (from the Consolidation Bank) in 2001.[29] Some current problems have resulted from environmental guarantees issued by the National Property Fund in connection with privatisations involving ecological liabilities. Because of the fiscal burden associated with such guarantees, the NPF has asked the government to permit postponing payment of some them.[30]

The use of the government guarantees has become extremely restrictive since 2001 under the new *Law on Budgetary Rules* which stipulates that each guarantee requires both government and parliamentary approval. The law further requires an annual comprehensive statement on guarantees which is used in the preparation of the state budget. The statement assesses the likely cash impact of the existing guarantees in the medium term. The State Budget Final Accounts offer an account of guarantees extended during the preceding year and all calls on existing guarantees. The state budget is required to appropriate monies for expected calls on guarantees. Total existing guarantees stood at KCz295bn at the end of 2002 with maturities extending up to 2028.[31]

The government now provides long-term estimates of the fiscal risks associated with the ageing population.

Fiscal risks arising from exchange rate fluctuations are minimal because of the insignificant level of foreign debt -- only 3.18% of total state debt in May 2003. The share of foreign-currency denominated debt was only 0.96%. No Czech state bonds have been issued at foreign markets thus far. Refinancing risks are created by the fact that nearly one-half of the state debt was payable within one year at the end of 2002. However, this share has been systematically reduced since 2000.[32]

No single administrative body exists at the moment to monitor fiscal risks. The same is true for the local and regional level whose importance has increased a great deal as a result of administrative reforms.

### Fiscal sustainability

Budget decisions have come to be increasingly placed in a medium-term framework. The *Law on Budgetary Rules* proposes the inclusion of medium-term forecasts of the most important revenue and expenditure categories in the annual budget, a standard that is required for EU membership. The MoF now prepares 10-year fiscal forecasts and *ad hoc* long-term strategy studies have been undertaken in particular areas. The MoF calculates structural and cyclical balances and measures of fiscal sustainability.

Public sector debt is expected to keep growing as a proportion of GDP to reach 39.4% by the end of 2006. However, fiscal consolidation, if successful, should begin to reduce the share thereafter.[33]

## Budget presentation

### Data reporting

The MoF prepares a quarterly report on the central government's budget implementation. The government is further obligated to submit biannual reports to the parliament. These documents describe recent fiscal developments and assess the outlook for the rest of the year in light of ongoing economic trends. The government produces a medium-term outlook for two years following the budget year.

No comparable reporting requirements exist on the local level, which complicates the process of compiling general government statistics.

There has been a considerable improvement in data quality since the mid 1990s. The available government data, while still imperfect, is deemed adequate for modelling and forecasting purposes. The lags between initial estimates and final statistics now fully meet the Eurostat norms.[34]

The Czech Republic is a member of GDDS and SDDS and international standards are consequently used in the compilations and publication of statistical information.[35]

Data provided by local governments is fairly good and uses the same budgetary classification as the central government. Subnational governments are required to report on their fiscal position on a monthly basis.

The government provides no data on tax expenditures which, however, are quite extensive, especially in the case of the personal income tax.

## Budget execution and monitoring

### Accounting basis

The MoF uses a national budgetary classification which is similar to the GFS standard and reports cash data. GFS methodology is applied to general government expenditures and revenues. The government presently applies exclusively the cash-based GFS 1986 standard but is planning to introduce the GFS 2001 system which involves partial accrual accounting.[36]

ESA 95 compliant accrual based fiscal statistics are compiled and reported by the Czech Statistical Office in accordance with EU requirements. The MoF only uses the ESA 95 standard in fiscal forecasts.[37]

### Procurement and employment

A procurement law governs purchases by the government. However, corruption is endemic, as revealed by a recent SAO audit. Independent studies have suggested that perhaps even most public sector projects have not fully met legal norms. The Ministry of Interior in 2003 published a report on corruption which pointed out numerous defects in law and public procurement practices.[38] Facilitation payments remain common and the judicial system is often incapable of effectively combating these problems. The existing procurement law does not have very clear selection criteria. A new draft is currently under discussion in parliament and its passage is a precondition for EU funding. A more comprehensive judicial reform is to be completed by the end of 2005.[39]

The government is bound by all private sector labour laws and there is good understanding of the rules governing pay, hiring, and firing.

## Fiscal reporting

There continue to be problems with controlling off-budget activities of ministries. Performance accountability remains minimal.

The relatively high degree of autonomy of local government complicates the task of monitoring general government finances.

However, measures towards consolidating the reporting of fiscal activities are being taken. A particularly important step was the inclusion in 2001 of the debts of the Czech Consolidation Agency in the public sector debt figures.[40]

## 4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY

●●●● Compliance in progress

### Data quality standards

As a subscriber to the SDDS, the Czech Republic meets the IMF standards for the timeliness and quality of fiscal data.[41]

There is constant internal control of budget execution and regular availability of detailed data. The comprehensive final accounts include a reconciliation with bank accounts. The Supreme Audit Office audits the government accounts on an *ad hoc* basis and reports to the parliament and the cabinet. Most observers rate the quality of Czech fiscal data highly and view it as fully compatible with the country's level of economic development.[42]

### Independent scrutiny of fiscal information

**Independent Audit**

The State Audit Office (SAO), which consists of six central and eight regional departments, is an independent organisation with a constitutionally enshrined status.[43] It audits government revenues and expenditures, state property and funds, and the performance of various budgetary programmes on the basis of selective annual programmes. There is no annual financial audit of all organisations, although the legal basis for it exists. The SAO further comments on an *ad hoc* basis on government budget reports, draft regulations, government programmes, and the performance of ministries and agencies. The SAO's audit still consists very heavily of *ex post* compliance control with an exclusive focus on budget execution. However, the use of performance audits is increasing and the organisation intends to move towards more financial auditing. The SAO reports are submitted to the Parliament, the government, and the Czech National Bank, and reproduced in the quarterly SAO Bulletin. Given the constitutional autonomy of subnational authorities, the SAO can only audit their use of state subsidies which, however, account for the vast majority of their revenues.[44]

The SAO carries out its work in line with international standards and with a high level of professionalism. Its role is defined in the Constitution and it is fully independent in its operations. The SAO meets the standards of the Lima Declaration of INTOSAI. The SAO's head and his deputy are nominated by the Parliament and appointed by the President. Somewhat problematically, no institutional mechanism exists to follow up the SAO's recommendations, although all findings are discussed in government which can pass resolutions on them. The SAO usually repeats its audit after two years. The SAO produces a published quarterly, as well as an annual, report.[45]

Municipal and regional governments must have their accounts audited on an annual basis according to MoF instructions. All regional governments are audited by private auditing firms. Most municipalities are audited by private companies, but those with populations below 5,000 have the option of an audit free of change by respective regional governments. Both financial and compliance audits are performed. Any irregularities have to be removed in accordance with the Accounting Act. Fairly substantial fines are imposed in the event of non-compliance.[46]

The Czech Republic has adopted the EU norms on public internal financial control. However, some of the implementing legislation still remains to be passed. Moreover, the quality and quantity of staff at internal audit units

often needs improvement.[47] Following the necessary reforms, the SAO hopes to move towards a more comprehensive system of auditing the entire public sector, as opposed to merely the state. The SAO advocates a universal system of internal audits which would supply the basic information needed to meet the target.

**National Statistics Agency**

The Czech Statistical Office is legally required to collect data and produce statistical information on social, economic, and environmental developments in the Czech Republic. The independence of CSO in enshrined in law and its head is appointed by the president of the Republic. All ministries are included in the Programme of Statistical Surveys by the CSO. They are required to provide the Office with all necessary data in a timely manner and free of charge. The CSO makes the results of its surveys available to the public through its own publications and the mass media.[48]

The quality of the data collected by the CSO is generally high and most statistics are provided within standard lags. However, the resources of the Office are stretched and little attention can be paid to many areas deemed of interest and importance. In particular areas, data collection is hampered by coordination problems between different ministries. Some areas of activity have been adversely affected by recent budget cuts. Full compliance with international regulations is expected within two years. The EU Commission this year deemed the Czech Republic ready to implement the *acquis communautaire* in the area of statistics as from accession. However, it noted the need to improve the timeliness of some government finance statistics.[49]

## INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to the Czech Republic on October 13-17, 2003.

### Ministry of Finance

**14 October 2003**

| | | |
|---|---|---|
| Drahomíra Vašková | Deputy Director | Department of Financial Policy |
| Aleš Krejdl | Official | Department of Financial Policy |
| František Cvengroš | Head | Macroeconomic Forecasting Division |

**16 October 2003**

| | | |
|---|---|---|
| Jiří Franta | Head | Treasury Division |

### Czech National Bank

**13 October 2003**

| | | |
|---|---|---|
| Viktor Kotlán | Director | Monetary Policy Division |
| Petr Procházka | Director | European Union and International Organizations Division; Deputy Executive Director, General Secretariat |
| Petr Sedláček | Official | European Union and International Organizations Division |

**17 October 2003**

| | | |
|---|---|---|
| Ivan Matalík | Director | Monetary Analysis Division |
| Milan Guba | Head of Team, Deputy Director | Monetary Analysis Division |

## ADDITIONAL INTERVIEWS

**14 October 2003**

| | | |
|---|---|---|
| Miroslav Leixner | Chief Director of Audit Section | Supreme Audit Office (*Nejvyšší kontrolní úřad*) |
| Michael Michovský | Department of International Relations | Supreme Audit Office |
| Jan Kinšt | Member of College | Supreme Audit Office |
| Radek Urban | Director/Asset Management | Česká spořitelna Bank |
| Adriana Krnáčová | Executive Director | Transparency International Czech Republic |

**15 October 2003**

| | | |
|---|---|---|
| Oldřich Körner | Deputy Director | Confederation of Industry of the Czech Republic (*Svaz průmyslu a dopravy České republiky*) |
| Pavel Sobíšek | Chief Economist | HVB Bank Czech Republic |
| Tomáš Borovička | Acting Manager of Foreign Aid and Financing of Programs | Ministry for Regional Development |
| Aleš Michl | Economic journalist | *Hospodářské noviny* business daily |

**16 October 2003**

| | | |
|---|---|---|
| Ludmila Vebrová | Official, National Accounts | Czech Statistical Office (*Český statistický úřad*) |
| Filip Drapák | Advisor to Chairman | National Property Fund (*Fond národního majetku*) |

In addition, we corresponded with:

| | | |
|---|---|---|
| Tomáš Cahlík | Professor | Institute of Economic Studies, Charles University, Prague |
| Michal Hlaváček | Professor | Institute of Economic Studies, Charles University, Prague |

## NOTES

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# OXFORD ANALYTICA

## EGYPT

## FISCAL TRANSPARENCY

**Country Report 2003**

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# EGYPT

## COMPLIANCE RATINGS

| *Fiscal transparency* | *2003* | *2002* | *2001* |
|---|---|---|---|
| Clarity of roles | •• | •• | •• |
| Availability of information | •• | •• | •• |
| Budget preparation | •• | •• | •• |
| Accountability | •• | •• | •• |
| **Score** | 2.00 | 2.00 | 2.00 |

## OUTLOOK & COMMENTARY

Even though the institution-building process in which the country is engaged includes transparency and accountability as major pillars, little progress has been achieved in the area of fiscal transparency. In the fourth phase of Egypt's economic reform programme, fiscal reform will remain as a key issue to be addressed.

Reforms to the tax system are expected for the 2003-2004 period, but it is likely that the lack of transparency and simplicity will remain important problems to solve. The country also needs to solve the discrepancies between the budget figures that are discussed in parliament and those that are published in the Official Gazette. Further advances in the area of data dissemination are likely to occur soon.

# EXECUTIVE SUMMARY

## 2.00 Intent declared

Egypt has taken some measures to improve fiscal policy transparency in 2003, but it continues to show deficiencies in reporting fiscal data. Steps are being taken to clarify roles and responsibilities in the government sector and to improve the separation of fiscal and monetary activities. In addition, parliamentary scrutiny of economic and financial affairs has recently increased.

During 2003, summary information of national budget operations has started to be published by the Ministry of Foreign Trade (MoFT). However, this information remains factual rather than analytical, with no explanation of policy developments or economic targets. The introduction of a results-based budgeting system remains a government goal but little progress has been made during 2003.

Progress on the Data Access and Transmission Activity (DATA) project continued during 2003, and commentators have suggested that the country is on course to meet the IMF's Special Data Dissemination Standard (SDDS) requirements in the near future.

The basic legal framework for fiscal management is clear, though in need of updating. Public scrutiny of the budget remains inadequate. The government is aiming to introduce a programme-type budgeting system, but no specific time frame has been established. In addition, major improvements are still needed in reporting budget execution, contingent liabilities, and the fiscal risks undertaken by state-owned enterprises and financial institutions.

Egypt's overall score is unchanged from last year.

## 1. Clarity of Roles, Responsibilities and Objectives

●● Intent declared

**The government sector should be distinguished from the rest of the public sector and from the rest of the economy, and policy and management roles within the public sector should be clear and publicly disclosed.**

**Structure, functions and responsibilities of government**

The system of government in Egypt and the general responsibilities of its different levels are set out in the Egyptian Constitution[1] and amended by subsequent presidential decrees for restructuring ministries. The Constitution specifies the divisions between the legislative, executive and judicial authorities, as well as local government and civil community institutions. The president is the head of state, nominated by a two-thirds majority of the parliament and elected by referendum. The president has the power to veto legislation, and presidential decrees have the force of law. Among other things, the parliament approves the budget and development plans.

Since the launch of a broad stabilisation and reform programme in 1991, the government sector in Egypt has become better differentiated from the rest of the public sector. During this time, the role of the private sector in the development of the economy has grown and, as a result of the phased reform programme, clarity about economic and fiscal objectives has increased. However, economic and fiscal changes have outpaced improvements in clarity about roles and responsibilities, both of government economic and financial bodies and of individuals within those institutions. This reflects a number of factors, the most significant being weaknesses in Egyptian legislation and the susceptibility of office-holders to personal and political interests.

Egypt has now completed the third phase of the economic reform programme and goals of phase four include continuing fiscal reform, enhancing the instruments of monetary policy available to the Central Bank of Egypt (CBE), increasing the pace of structural reform and enhancing transparency in the regulatory and institutional framework.

The institution-building process in which the country is engaged is being supported by the improvement of governance, a process that involves the introduction of four key elements: transparency in economic management; predictability in macroeconomic policies and the regulatory system; accountability; and enhancing the capacity of public institutions. Many of the fiscal reform programmes undertaken in the past years have been short- or medium-term projects. The government has reported the advances of these programmes to the respective funding agencies, but they are not publicly available on a regular basis.

**Coordination and management of budgetary activities**

Egypt remains a highly centralized country in terms of fiscal policy operations. Fiscal information on sub-national levels of government is not publicly available, nor is the combined fiscal position.

Since November 2001 the economy portfolio of the Ministry of Economy and Foreign Trade has been changed. It now operates as the Ministry of Foreign Trade (MoFT) only, though still has responsibility for the Stock Exchange, the Capital Markets Authority and for dealing with credit rating agencies.

While the reorganisation of the economic ministries ostensibly removed some of the ambiguities and duplication in ministry responsibilities, it is not clear that it has yet yielded substantial benefit in economic and financial management. The MoFT is more dynamic and efficient than the Ministry of Finance (MoF), which is burdened by a large bureaucracy. The modalities of the MoF's responsibilities remain opaque, though its general mandate to manage fiscal planning, the budget and government finances is clear. Public availability of information at the MoF website, which does not have an English version, is limited.

The relationship between fiscal and monetary responsibilities has been clarified since the enactment of the Central Bank Law, where it is established that the CBE is the treasury's debt agent. The MoF has a high level of autonomy and coordinates with the CBE at the cabinet level. However there are no permanent mechanisms or mandatory procedures for direct coordination between the MoF and the CBE. With the recent changes in the exchange rate, and the CBE's move towards a more active monetary policy, this lack of coordination will need to be resolved.[2]

**Relations between government and public sector agencies**

The government sector in Egypt is, in general, adequately distinguished from the rest of the public sector. Nevertheless there is still a lack of clarity at the institutional level about responsibilities and authority for economic policy. In many ministries and government agencies, capacity below the top levels is weak and the management of economic policy is ultimately held together by the prime minister. This situation has not been helped by a lull in reforms following an economic slowdown after 1999, although prior to this significant structural improvements in the economy had been realised.

In order to integrate the national budget, the National Investment Bank (NIB) has been brought under the umbrella of the MoF by ministerial decree 418 of 2001. The ministry now has the authority to monitor and enforce fiscal discipline over investment expenditures. However, uncertainties remain concerning a number of NIB activities. The findings of an audit conducted of the NIB's lending and other operations are not publicly available. The role and functions of the NIB remain non-transparent.

**Government involvement in the private sector**

There are no publicly disclosed rules or guidelines for government involvement in the private sector, whether in terms just of regulation or of equity ownership. Egypt's economic reform programme is based on the establishment of a stronger private sector. Even while progress in this area remains slow, some advances in the legislative framework of the country have helped to disengage the state from some previous functions.

Amendments have been made to the banking and insurance laws, and the commercial law is being reviewed. However, the public sector still constitutes a large -- and inefficient -- share of Egypt's economy, and as such it is the focus of government involvement in the economy outside central government responsibilities. Egypt has moved towards a flexible exchange rate regime. Such flexibility is important for the continuing efforts of the authorities to introduce structural reforms to promote economic efficiency and to stimulate trade and investment.

The MoF, in cooperation with international agencies, has launched a programme to transform economic authorities into corporations. In 2002, the national air carrier, Egypt Air, has been transformed into a holding corporation entity, with four subsidiaries.

## There should be a clear legal and administrative framework for fiscal management

**Legal framework for budgetary activities**

The basic legal and administrative framework for fiscal management is clear, though in need of revision and updating. Law no. 53 of 1973, together with subsequent amendments and regulations covering the state budget, give the MoF responsibility for preparation of the budget. The ministry is required to review the budgets submitted to it by relevant public agencies and to "consult with the CBE in order to ensure coordination between fiscal, monetary, and credit policies within the framework of both the approved annual plan targets and the overall policies of the state".[3] The ministry is authorised to issue treasury bonds, through consultation with the CBE, and to issue relevant executive regulations as required.[4] On this basis, the administrative framework for fiscal management is largely determined by the MoF itself.

The budget is submitted by the government to parliament for review and ratification having first been approved in the cabinet and then by the president. However, budget figures published in the *Official Gazette* often differ from those ratified by parliament -- because members of parliament tend to add on significant extra expenditure -- and so, in practice, the final say is with the prime minister and the MoF before the budget is sent to the president for final approval.[5]

**Legal framework for taxation**

The MoF oversees the national Sales Tax Department.[6] This department discloses higher amounts of information than other government offices. Publicly available information includes the Sales Tax Law, executive regulations, and supporting information.

Egypt's tax system is perceived as opaque and highly complicated by the general public. The tax department is highly dependant on the MoF, and current legislation does not grant its member any kind of legal protection to perform their duties.

As part of the fourth phase of Egypt's economic reform programme, the MoF has launched a comprehensive tax reform programme that encompasses the income and sale tax systems. According to Egyptian authorities, the income tax reform programme incorporates the development of a tax system characterized by equity, transparency and simplicity. Objectives also include developing an effective supervision and coordination mechanism in the tax department, including better monitoring systems. If implemented, these reforms would increase the transparency and efficiency of the tax system.

A draft Unified Tax Law is due to be submitted to parliament during the 2003-2004 session. In addition, a Model Customs and Tax Centre has been in operation since September 2003.

**Ethical standards for public servants**

A code of practice does exist and is publicly available, but the extent to which it is actually followed is limited.

## 2. PUBLIC AVAILABILITY OF INFORMATION

●● Intent declared

**The public should be provided with full information on the past, current and projected fiscal activity of government.**

The MoF has no regular publications or up to date website, and information available at the MoFT remains the principal source on past fiscal activity. The principal publications disseminating fiscal information on a regular basis are the MoFT's *Monthly Economic Digest* and *Quarterly Economic Digest*. Fiscal data in both digests are derived from the MoF. Some projects currently under way should contribute to improvements at the MoF in the dissemination of information and data on past, current and projected fiscal activity.

Egypt has a special website that releases economic information, including the *Egyptian Economic Bulletin* (EEB) -- a monthly bulletin issued by the Cabinet's Information and Decision Support Center.[7] This publication provides business policy makers and the public, at various levels, with information concerning overall macroeconomic and sectoral performances of the Egyptian economy.

**Central government operations**

Information about the fiscal position of the government is not very comprehensive, but data on related indicators have been improving in recent years. During 2003, summary information on national budget operations, including revenues, expenditures, foreign and domestic liabilities has started to be published both quarterly and annually at the MoFT's website.[8] However, this information remains factual rather than analytical, with no explanation of policy developments or economic targets.

Publication of the authorised annual budget is done via the Official Gazette. However, this publication is very simple and the budget presented to parliament is more comprehensive. Moreover, information is submitted in a different format from the quarterly budget data -- crucially, this does not allow for a comparison between the budget targets and actual spending. The budget provides information on government expenditures for the fiscal year. However, information about future financial commitments of the government is not publicly available.

**Public sector operations**

The IMF has been helping the MoF to prepare a new fiscal reporting framework, intended to increase transparency in the government's fiscal activities. According to some commentators, publication of fiscal outturn data using a new three-tier reporting framework has already helped to improve the transparency of fiscal operations. Efforts are also being made to strengthen consistency in the components of the consolidated general government accounts.

Privatisation has been halted in favour of a 'holding companies approach' -- breaking up state monopolies into smaller, more transparent holding companies with more efficient management. At present there are sixty-two economic organizations, such as the General Authority for Petroleum; the General Authority for Supply Commodities; Electricity; Suez Canal; Ports Authorities; and General Authority for Industrialization. Even when these authorities are separated from the national budget[9], the government has to intervene to finance losses. The Suez Canal authority publishes annual reports. Other than that, information on social security institutions and public enterprises is not publicly available.

## A commitment should be made to the timely publication of fiscal information.

Under the auspices of a project supported by the US Agency for International Development (USAID), the Data Access and Transmission Activity (DATA) project -- a steering committee bringing together the MoF, the Ministry of Planning (MoP), the CBE, the Central Agency for Public Mobilization and Statistics (CAPMAS) and other ministries and government agencies -- has been overseeing the gradual introduction of the IMF's Special Data Dissemination Standard (SDDS). Egypt has already met 15 of the 17 core SDDS requirements. The DATA project has a comprehensive website, where developments are periodically updated.[10]

A great deal of action is currently being taken to further improve data dissemination standards and meet SDDS requirements. During 2003, further advances have been achieved in such areas as national accounts and real sector data; fiscal data; and external sector data. Moreover, the CAPMAS now publishes an annual Statistics Bulletin in hard copy and CD-ROM version, available from the National Information Centre.

In addition, an office was created in October 2003 within the MoP to act as a coordination unit vis-à-vis the SDDS. The minister of planning has been appointed to head the unit by prime ministerial decree, illustrating a degree of high level political commitment to addressing the SDDS. The office has already started its operations, has four permanent staff and is in the process of being fully automated. The MoP now provides a quarterly bulletin of real sector data, known as the Total Production Index, which includes a breakdown of quarterly GDP figures (non-seasonally adjusted) allowing for year-on-year comparisons.

Some commentators have suggested that Egypt is on course to meet the SDDS requirements by early 2004. However serious weaknesses still remain, in particular in fiscal data. This highlights the important point that 'participation' in -- or ostensibly 'meeting' -- the SDDS does not ensure a high level of fiscal transparency, comparable with that represented in the IMF's 'Code of Good Practices on Fiscal Transparency'.

**Debt reporting**

The reporting of debt data is considerably better than for most other fiscal data. The CBE is the principal debt reporting body, compiling domestic and external debt data from internal sources, the MoF and the NIB. The CBE publishes these data in its *Monthly Statistical Bulletin*. These data are reproduced in the publications of other ministries, in particular the *Quarterly Economic Digest* and *Monthly Economic Digest* of the MoFT. Data are given for external debt by type, cumulative arrears and the profile of external short-term debt and medium- and long-term public and publicly guaranteed debt. Similar data are given for domestic debt, including the level of government borrowing from the NIB.

**Advance release calendars**

In 2003, the Ministry of Finance had no advance release calendar for fiscal information. As part of the DATA project, efforts are under way to introduce one-quarter-ahead notice of the approximate release dates, and at least one month's notice of the precise release dates.

## 3. Open Budget Preparation, Execution and Reporting

●● Intent declared

### Fiscal policy objectives, macroeconomic framework and risks

**Fiscal policy objectives**

Egypt's fiscal policy objectives continue to be defined by the combination of its reform programme targets and domestic pressure against making unpopular reforms and cuts. Since the early 1990s, fiscal policy has mostly concentrated on limiting or reducing the budget deficit and improving spending effectiveness. After favourable progress between 1991 and 1997 towards meeting long-term fiscal objectives, in 1998-2000 the budget deficit increased sharply as a result of slowing economic growth and a switch from a tight to an expansionary fiscal policy.

Fiscal policy objectives are not included in the budget documentation. New fiscal policies are disseminated through the MoF and press statements, but this is not done in a consistent and regular way. The MoF prepares and releases five-year plans, but they are more of a "wish list" and bear little relation to reality.[11]

The government has sought to improve its deficit financing options by developing and broadening the local capital market. Despite these efforts, in the past years the MoF has had notable difficulty in meeting its fiscal targets. This has principally been because of the reduced growth of the economy. However the government has also been unwilling to force through unpopular measures which may have a heavy impact on employment.

The MoF comprehensive programme for second-generation fiscal reforms aim to cover: modernisation of the tax and customs system; corporatisation of economic authorities; efficient public debt management; a new system of procurement; pension reforms; and implementation of results-based budgeting. The MoF has implemented a communication system to disseminate programme results. Little progress has been made in schemes for formalising the informal sector. The draft Unified Tax Law would try to bring in more of the informal sector -- estimated at one-third to one-half the size of formal GDP -- but currently there is a fear of tampering with the informal sector because of its importance as a social safety net at a time of persistent economic downturn. [12]

**Macroeconomic framework**

The macroeconomic overview of the country is presented in the MoFT's *Quarterly Economic Digest*. Even when the figures are comprehensive and have improved from previous years, there is still no analysis of that information.

**Fiscal risks**

Budgetary documentation does not provide an assessment of the fiscal risks. No information is available about how extrabudgetary transactions are handled, though it is clear that there are many such transactions. Extrabudgetary transactions or 'leaks' have been admitted to, but these are not only for small amounts. Contingent liabilities are not included in the budget documentation. For some years, spending on the massive Toshka project, a major water and agricultural development in the south of Egypt, has been off budget, though the level of spending is now falling.[13]

**Fiscal sustainability**

In the few public communications on the budget, the government provides only a limited idea of what framework the MoF uses to determine fiscal sustainability. For the 2003-4 fiscal year, spending is budgeted to rise by 11%, driven by strong increases in wages and other current spending. In 2004-5, the deficit is expected to ease to 6.4% of GDP as tax revenue increase, together with faster economic growth. The recovery in private sector activity, and the easing of regional tensions, should also allow the government to ease growth in spending on subsidies and wages.

In the October-December 2002 *Quarterly Economic Digest*[14], the government recognizes that there is a need for the efficient and effective allocation of resources in terms of the magnitude of expenditures and the impact of these on the various sectors of the economy. The MoF is currently considering measures to assess the effectiveness of this expenditure.

Although not falling under the budget, there is some concern about the sustainability of the Social Security Fund (SSF) and the state pension system. The MoP is understood to be considering ways of strengthening the SSF and pension system. There are plans under study to potentially move the SSF from the Ministry of Social Affairs to the MoF, in order to achieve a more comprehensive and coherent fiscal policy. However, if or when this will be done is unknown. [15]

## Budget presentation

According to Article 86 and 115 of the Egyptian Constitution, the national budget must be submitted to the parliament two months prior to the close of the fiscal year. Each provision is approved separately. The plenary session must not close until the budget is approved. The parliament can only make modifications to the draft budget with the approval of the government. If the new budget is not ratified before the start of the new fiscal year, the old budget will be acted on until the new budget is ratified.[16] However, the final approved budget is not a clear and unambiguous document. The budget includes all government revenues and expenditures, but there are significant shortcomings in terms of how the budget is presented.

Budget transparency is limited in Egypt at all stages. Even upon the approval of the budget by the parliament, the amount of information publicly available to the general public is very limited. Within the public sector, sections of the document are only available on a "need-to-know" basis. During the implementation phase, basic financial statistics are not disclosed, making it difficult to assess whether expenditures are in accordance with the approved budget. The government has medium-term expenditure estimates, but these are not publicly available.

**Data reporting**

The budget does not convey information as to the objectives that are to be achieved. Information is restricted to how much is spent in broad public policy areas. In order to improve the basic analytical and decision-making process of budgeting, the government is planning to introduce a programme-type budgeting system. According to this project, in future the budget will be structured into programmes, sub-programmes, and groups of activities. However, no precise time frame has been presented for the effective implementation of this process.

In the first half of 2002, the MoF introduced a new three-tier reporting framework, prepared with the assistance of the IMF. On June 11, the parliament ratified the budget for the year ending 30 June 2004. However, as in previous years, details were not comprehensive. Part of the problem lies in the fact that the budget is not presented to the press in a completed tabular format, but rather is delivered orally by the finance minister.

A second complicating factor is that under existing legislation the budget has to be drawn up and presented to parliament in a specific format which differs from the three-tier method adopted by the government to present outturn data. Under the law governing the presentation of the budget to parliament, spending and revenue are both divided up into four sections. Spending is sub-divided into: wages; current expenditure and transfers; investment uses; and capital transfers. Revenue is separated into: sovereign revenue; current revenue and transfers; capital revenue; and loans and credit facilities. When he presents the budget, the finance minister also reveals expenditure totals in terms of subject matter. However, this spending may fit under more than one of the four spending sub-categories. This means that the sum of items normally listed as "current spending" would equal more than the total listed. It should also be noted that the budget is prone to amendment when it is published in the Official Gazette and becomes law, with spending plans often toned down.

## Budget execution and monitoring

The Office of Management and Budget at the MoF oversees and monitors budget execution. There continues to be a lack of transparency in budget targets and overall responsibility for budget control. Budget figures debated in the parliament continue to be more generous than the final figures published in the Official Gazette, and it is still not clear to what degree the MoF adheres to these published figures.

The aim of introducing 'performance' budgeting has been modified to 'results-based' budgeting. This system, sponsored by the World Bank, is still in an early stage of development, but the MoF has indicated that it would like to extend the system. Its main objective is to improve efficiency, but if successfully implemented it should also increase transparency and accountability.[17] The MoF is making progress in the establishment of a central Performance-Budgeting Division in some ministries. These efforts represent an important advance in Egypt's budgeting procedures.

A summary of the major budgets developments is released to the press. However, as the budget documentation does not contain a clear statement of objectives to be achieved by major budget programmes, the monitoring of these becomes increasingly difficult.

By law, the approval of the parliament is necessary for the transfer of funds from one item-line of the budget to another, as well as for any expenditure not included in the budget or in excess of its estimates.[18] In practice, the meaningfulness of this is limited by a lack of transparency in budget execution. This aside, there is no measure to avoid a quasi-fiscal deficit caused by losses at the CBE.[19]

### Accounting basis

The EU has provided technical assistance to the National Accounts Unit at the MoP to introduce new integrated accounting software, but no relevant changes have occurred in the past year. Accounting standards are specified by the MoF and the Egyptian Society of Accountants and Auditors, which is a member of the International Accounting Standards Committee (IASC) and the International Federation of Accountants. A draft Accounting and Auditing Law is on the legislative agenda for the 2003-2004 period, but it may be postponed to the following session.

Past budget data are reported on a gross basis. The overall balance of the general government budget is reported in the MoFT's *Monthly Economic Digest* as a 'Summary of National Budget Operations'. This showed quarterly revenues from: central government; tax; transferred profits; other non-tax sources; local government; public service authorities; investment self-financing; and sales of assets or other capital revenue.

**Procurement and employment**

In 1998, a law was passed introducing new regulations for government procurement which were intended to make the tendering process more transparent. [20] Under the new law, technical factors must be considered in addition to price, and preference for state companies may only be given where the bid of such a company is within 15% of other bids.

However, transparency in procurement remains poor. The procurement law allows government departments considerable discretion to confine procurement to preferred suppliers, in addition to which the prime minister is able to determine the terms and conditions of tenders for certain public entities. Information on the total annual value of procurements is not publicly disseminated. The government has asked the World Bank for assistance to further improve procurement practices, and an assessment has been carried out in order to identify key areas for reform. According to some commentators, a new government procurement system could be established during 2004.

According to statements by public officials, the government remains determined to award pay rises to public sector workers that are well above the rate of inflation, partly to compensate for the lack of earning opportunities in the private sector and informal economy (where public-sector employees and civil servants have often sought to bolster their government salaries.)

Effective service delivery is constrained by the civil service pay and personnel management system. Reform of the civil service is necessary if the government wants to achieve better results in budget execution and monitoring. Once the results-based budgeting become fully operational, the civil service will have to start operating under an incentive and personnel management system.

## Fiscal reporting

In accordance with the Constitution, the final accounts of the state budget must be presented to the parliament within a year of the end of the fiscal year.[21] Parliamentary scrutiny of economic and financial affairs -- and therefore of the budget -- has improved recently. This is partly owing to there now being more members of parliament with business and financial experience, but also to the government being more open to discussion.

The MoF does not publicly disseminate any final annual fiscal report, and final accounts are instead only publicly available through the fiscal reporting system of the MoFT and the IMF. However, information on the consolidated fiscal operations of the general government is available through the *Monthly Statistical Bulletin* released by the CBE.

Statements and announcements from the minister of finance are reported on an *ad hoc* basis by the Government Information Service, the local media and other independent publications such as the *Egypt Capital Markets Daily*. However the overall level of reporting is poor.

## 4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY

●● Intent declared

### Data quality standards

The adoption of the SDDS promises a considerable improvement in data quality. However it is likely to be several years before there can be real confidence that fiscal data produced within Egypt's SDDS framework accurately reflect revenue and expenditure trends and overall macroeconomic developments. As of 2003, published fiscal data were not accompanied by sufficient assurances of quality, the principal indicator of this being independent data users' lack of confidence in much fiscal data.[22] Local financial markets and independent analysts still express dissatisfaction with deficit data and overall budget, growth and inflation data. Moreover it is known that there is some variation in data compilation methodologies between different ministries and government agencies. It is not clear that enough is yet being done to resolve this, though adoption and sustained adherence to an SDDS data framework should eventually eliminate this problem.[23]

Although there has been an improvement in public discussion of economic matters, the government's attitude to independent analysis and forecasts remains unsatisfactory. Banks therefore continue to paraphrase their estimates and forecasts of key economic indicators so as to avoid conflict with key ministries and the government. Meanwhile, despite some expectations that a fiscal module of an IMF Report on the Observance of Standards and Codes (ROSC) conducted in 2001 would be published, the government has preferred to keep the findings undisclosed.

### Independent scrutiny of fiscal information

**Independent Audit**

The Central Auditing Agency (CAA) is responsible for the *ex post* review of the final budget accounts. The CAA is tasked with controlling government funds and those of other public bodies and its responsibilities are set out in Law No. 144 of 1988. The law specifies that the CAA is an independent body, with corporate public stature. The CAA, recently brought under the wing of the prime minister's office, has been actively engaged in the government's efforts to privatize the public sector and to work towards financial transparency.

The CAA audits the accounts that line ministries send to the MoF. The final report of the CAA, the findings of which focus primarily on accounting irregularities of economic authorities, is discussed in parliament. The CAA has taken important steps toward the harmonization of public sector accounting and auditing standards with the internationally accepted standards. However, the capacity of the CAA needs to be strengthened to improve compliance with internationally accepted public sector accounting and auditing standards.

The annual report of CAA on the accounts of the MoF and other government ministries and agencies is not distributed outside government circles. It therefore remains difficult to assess the quality of scrutiny of fiscal information.

**National Statistics Agency**

The CAPMAS is the national body for statistics. The head of CAPMAS reports to the MoP, though the agency is otherwise formally independent. As part of the DATA project, national accounts data compiled by CAPMAS and held by the National Accounts Unit in the MoP are being revised. A System of National Accounts has been adopted and a five-year time series is available for 1995-2000. As part of the DATA initiative, the country is currently preparing figures for 2000 onwards. Other major projects to be conducted before the DATA project ends in 2005 include the development of a National Statistics Policy, and the publication of labour force data on a quarterly basis rather than annually.

## INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to Egypt between 21 and 23 October 2003:

### Central Bank of Egypt

**22 October 2003**

| | | |
|---|---|---|
| Samia Turk | Director | Monetary Policy Department |
| Samir El Shahed | Executive Director | Money Laundering Combating Unit |

## ADDITIONAL INTERVIEWS

**21 October 2003**

| | | |
|---|---|---|
| Frank Szumilo | Chief of Party | USAID DATA project with Ministry of Planning |
| Moiz Zainuddin | Statistical Methodology Advisor | USAID DATA project with Ministry of Planning |
| Jamal Al-Kibbi | World Bank Cairo Office | World Bank |
| Mohamed Abdel Salam | Senior Commercial Officer | British Embassy in Cairo |
| Hanaa Ramzy | Economic Affairs Officer | British Embassy in Cairo |

**22 October 2003**

| | | |
|---|---|---|
| Nadeem Ul Haque | Senior Resident Representative | International Monetary Fund |

**23 October 2003**

| | | |
|---|---|---|
| Hani Geneina | Analyst | EFG-Hermes |

## IN ADDITION, WE CORRESPONDED WITH:

| | | |
|---|---|---|
| Doha Mounir | Senior Policy Advisor to the Minister | Ministry of Finance |

## NOTES

[1] Part 5, Articles 73-184, Egyptian Constitution.
[2] Interviews in Cairo, 21-23 October 2003.
[3] Law no. 53 of 1973, amended by Law no. 11 of 1979, executing regulations no. 323 of 1983 and Law no. 40 of 1996 in respect of the state budget.
[4] Articles 1-2 and 7-8, Law no. 4 of 1995 authorising the Minister of Finance to issue treasury bonds; see also Article 8, Annual State Budget Law.
[5] Interviews in Cairo, 21-23 October 2003.
[6] Egyptian Sales Tax Department, at www.salestax.gov.eg/
[7] Egyptian Economic Bulletin website, available at www.economic.idsc.gov.eg/
[8] Available at www.moft.gov.eg/English/Statistical_Annex/Monthly/Toc.stm
[9] As established by Law no. 11 of 1929.
[10] Data Access and Transmission Activity (DATA), at www.data-egypt.org
[11] Interviews in Cairo, 21-23 October 2003.
[12] Interviews in Cairo, 21-23 October 2003.
[13] The Toshka project is ongoing, but its budget remains highly opaque despite government efforts to scale back spending to the basics. President Mubarak inaugurated the main pumping station in October 2002, the main canal has been complete since 2000 and construction is underway on the four branch canals.
[14] Quarterly Economic Reports are publicly available at www.moft.gov.eg/English/Periodical_Reports/Periodical_Reports.stm
[15] Interviews in Cairo, 21-23 October 2003.
[16] Article 115, Egyptian Constitution.
[17] Interviews in Cairo, 21-23 October 2003.
[18] Article 116, Egyptian Constitution.
[19] 'The Coordination of Monetary and Fiscal Policies in Egypt' by Faika El-Refaie (Working Paper no. 54, April 2001, Egyptian Centre for Economic Studies), p. 31.
[20] See Tenders Law no. 89 of 1998 which replaced Law no. 9 of 1983.
[21] Article 118, Egyptian Constitution.
[22] Interviews in Cairo, 21-23 October 2003.
[23] Interviews in Cairo, 21-23 October 2003.

# OXFORD ANALYTICA

## INDIA

## FISCAL TRANSPARENCY

**Country Report 2003**

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# INDIA

## COMPLIANCE RATINGS

| *Fiscal transparency* | *2003* | *2002* | *2001* |
|---|---|---|---|
| Clarity of roles | ●●● | ●●● | ●●● |
| Availability of information | ●●●● | ●●● | ●●●● |
| Budget preparation | ●●● | ●● | ●● |
| Accountability | ●●● | ●●● | ●●●● |
| **Score** | 3.25 | 2.75 | 3.25 |

## OUTLOOK & COMMENTARY

Changes resulting from the implementation of the Fiscal Responsibility and Budget Management (FRBM) Act will be the biggest issue to monitor over the coming year. Reporting in particular should improve significantly if the statements the government is mandated to lay before parliament throughout the year are indeed produced. These include a medium-term fiscal policy statement and a fiscal policy strategy statement to be presented with the annual budget.

The sustainability of India's fiscal situation is a cause for concern and it has yet to be seen whether or not the government will be able to meet the fiscal targets set out in the FRBM Act.

# EXECUTIVE SUMMARY

## 3.25 Enacted

The government passed the Fiscal Responsibility and Budget Management (FRBM) Act -- the linchpin of India's fiscal reforms -- in July of this year. The Fiscal Responsibility and Budget Management Act is set to bring discipline and transparency to the central government budget process and should facilitate efforts to restore fiscal sustainability. The act, however, includes exceptional conditions for not meeting specified targets, such as emergencies, national calamities, and any other exceptional grounds as the central government may specify. Any changes resulting from the act that are referred to in the report are yet to be implemented, and their worth in practice is as yet not certain. Officials are hoping for the act to be fully implemented by end 2004.

Previous budget preparation deficiencies, the absence of a quantified macroeconomic framework, no publicly available assessments of fiscal sustainability and the absence of mid-year reports have all been addressed in principle by the Fiscal Responsibility and Budget Management Act. The FRBM Act improves the definition of fiscal objectives by mandating the government to present a medium-term fiscal policy statement and a fiscal policy strategy statement with its annual budget submission. Government reporting to parliament in general should improve as a result of the Act.

The transparency of India's fiscal transfer system continues to be a source of concern. The union and state budgets contain no information on the quasi-fiscal activities of public sector undertakings (PSUs) and tax expenditures. Following the example of the central government, however, a growing number of states have begun to list (explicit) loan guarantees in their budgets. Meanwhile information on implicit contingent liabilities remains limited.

Tax reform remains a key government priority. The central government attempted to introduce value added tax (VAT) at the state level earlier in the year but the reforms had to be withdrawn. The Ministry of Finance does not see these being re-introduced until April 2004. India has also introduced a system of permanent account numbers to simplify the filing of income tax returns, and this, along with increasing computerisation, is expected to reduce corruption within the tax administration.

Progress has been made in a number of areas including enhancing accountability. There are plans to strengthen regulation in the area of accounting standards and effectiveness of auditors. Plans to establish a permanent national commission on statistics have yet to be acted upon. The audit framework is satisfactory, but the recommendations of the auditor general are often ignored by state governments.

India's overall score has improved from 2.75 in 2002 to 3.25.

## 1. Clarity of Roles, Responsibilities, and Objectives

●●● Enacted

**The government sector should be distinguished from the rest of the public sector and from the rest of the economy, and policy and management roles within the public sector should be clear and publicly disclosed.**

**Structure, functions, and responsibilities of government**

The structure and functions of the Indian federal system of government are set out in the 1949 Constitution of India. The basic law divides the government into union, state and local levels and assigns specific functions to each level. It also establishes a list of responsibilities to be undertaken jointly by the union and states.[1] Matters of national significance, such as defence, trade, external borrowing, and federal public services and pensions are assigned to the centre. Functions with state-wide implications, such as law enforcement, agriculture, and state public services and pensions are assigned to the 28 states, while key development functions, such as economic planning, education, and social security are performed jointly by the union and states.[2]

The transparency of this system is weakened by the asymmetry between expenditure commitments (responsibilities) and revenue-raising powers, particularly at the local level. In 1999-2000, for example, the centre, states and local bodies respectively raised 62%, 35% and 3% of total revenues, while their respective shares of total expenditures were 32%, 35% and 33%.[3] As such, state and local governments depend for a large part of their revenues on the transfer of resources from the centre, through a number of government agencies. This makes it difficult to trace the flow and use of funds throughout government. According to the 11th Finance Commission, appointed in 1998 to review Indian finances until 2005, the "most serious flaw in the current system of federal transfers is the flow of the Centre's revenue to the States in segments through the Finance Commission, transfers through the Planning Commission, transfers to implement centrally sponsored schemes, and other discretionary transfers."[4] Despite the Finance Commission's comments, there are as yet no immediate plans to streamline the fiscal transfer system. Commentators however saw no real problem here, contending that the Finance Commission and the Planning Commission have distinct but complementary roles in the system of federal transfers based on the constitutional provisions and the process of economic planning. [5]

At the state level, improvements have been made, such as the introduction of fiscal responsibility legislation, and medium-term fiscal reform programmes. So far five states have enacted the Fiscal Responsibility and Budget Management (FRBM) Act, passed in July of this year, and other states have expressed their determination to do so but there is no information on when they will be able to enact the legislation. The Fiscal Responsibility and Budget Management Act is set to bring discipline and transparency to the central government budget process and should facilitate efforts to restore fiscal sustainability. It is hoped that it will facilitate prudential debt management consistent with fiscal responsibility by means of limiting central government borrowings, debt and deficit. Fiscal policy is to be conducted in a medium term framework. The act however, includes exceptional conditions for not meeting specified targets such as emergencies, national calamities, and any other exceptional grounds as the central government may specify. This clause casts doubt on how thoroughly the act will be implemented in practice. Additionally, although the FRMB Act includes provisions for the monitoring fiscal targets it does not make these enforceable and is essentially an act that makes fiscal reporting mandatory, not fiscal discipline.

A number of problems do remain. For example, there is the need to reform the tax system, divest public enterprises, and reduce subsidies and losses in the power sector.

**Coordination and management of budgetary activities**

The Ministry of Finance (Department of Economic Affairs) is responsible for formulating, executing and monitoring the union budget, as well as accounting, and fiscal relations with state governments. Budgetary items are divided into a central government 'consolidated fund' for authorised revenues and expenditures, a central government 'contingency fund' for emergency expenditures, and a 'public account' for government-related transactions that include small savings schemes and provident funds for government employees.[6] The Ministry of Finance (MoF) has been criticised for not enforcing budgetary discipline on central government ministries and agencies. The government tends to make relatively large corrections to the budget mid-year, and there is no indication that it will cease this practice in the near future.

**Relations between government and public sector agencies**

As manager of the government debt, the Reserve Bank of India (RBI) is allowed to participate in the primary market for government securities, although it ceased in 1997 to automatically monetise fiscal deficits through *ad hoc* treasury bills. Today, the RBI organises auctions for the primary placement of government securities. The Fiscal Responsibility and Budget Management legislation prohibits the Reserve Bank from subscribing to primary issues of central government securities, effective from 2006-2007. Commentators disagreed on the desirability of separating the RBI's debt management function from its monetary role. Some argued that such an institutional separation would improve fiscal and monetary transparency in India, while others claimed that the conflicting objectives of debt management and monetary policy would still remain despite the separation.[7]

The Advisory Group of the RBI, set up in 1999 to review India's compliance with international financial standards, identified quasi-fiscal activities by 'public sector undertakings' (PSUs) at the union and state levels as a serious limitation of fiscal transparency. The heavy subsidisation of public services, such as transport and electricity, through PSUs is not explicitly identified in the budget.[8]

Privatisation efforts stalled in September 2003, when the government temporarily stopped selling public shares in state-owned companies. [9]

**Government involvement in the private sector**

Relations between the government and the private sector are regulated by the constitution and sector-specific legislation. The government has recently made some progress in withdrawing from the private sector, through establishing independent regulatory commissions in key sectors like telecommunications, electricity and insurance. The Telecom Regulatory Authority of India (TRAI), State Electricity Regulatory Commissions (SERCs), Insurance Regulatory and Development Authority (IRDA), Securities and Exchange Board of India (SEBI), have now been up and running for some time. However it is expected to be some years before these institutions become effective regulators.[10] There is still a need for major overhaul in the agriculture regulatory regime in agriculture.

The appointment of former bureaucrats as chairs of regulatory bodies has constrained progress in improving transparency concerning regulation of the private sector. Once these individuals are phased out of the regulatory bodies, regulation will occur in a much more transparent manner.

## There should be a clear legal and administrative framework for fiscal management.

**Legal framework for budgetary activities**

India does not have a budget law, but the Fiscal Responsibility and Budget Management Act, passed in 2003, fills this gap. The FRBM Act aims to create a framework of fiscal discipline through statutory constraints on spending by the centre; to eliminate the revenue deficit; to reduce the fiscal deficit to 2% of GDP by 2006; and to reduce total debt to 50% of GDP by 2011. It also proscribes the RBI's subscription to government securities at the primary stage and increases the mid-year reporting obligations of the minister of finance in case budgetary outturns diverge from estimates.[11]

While the FRBM Act envisions mid-year budget reporting, this has not occurred this year.

**Legal framework for taxation**

The constitution assigns most progressive taxes, such as personal income tax (excluding agriculture), corporation tax, and customs and excise duties (apart from alcohol) to the centre. The lack of a tax on services inhibits transparency in the revenue-sharing arrangements between the centre and the states. Services make up more than half of India's GDP and were the fastest growing sector in the 1990s. The functional separation of the taxation of goods and services has also led to the wide-scale evasion of the sales tax.[12]

A government task force set up to review indirect taxation has recommended replacing central excise duties with a value added tax (VAT) and potentially merging the service tax in this. The task force has also urged the imminent reform of India's tax system to prevent a further decline in the ratio of indirect tax to GDP.[13] The central government tried to introduce VAT at the state level earlier in the year but the reforms had to be withdrawn because some states are experiencing problems with implementation and state governments have faced formidable opposition to their introduction from labour unions and other interest groups. As the reforms need to be implemented simultaneously across all states, the MoF does not see these being re-introduced until April 2004 to give states adequate time to tackle the problems mentioned above. [14] Although the MoF has given April 2004 as a target date for future implementation, commentators felt that April 2005 was a more likely date for this to occur.[15]

The Asian Development Bank (ADB) is providing technical assistance to the government's efforts to improve tax administration. The ADB has also helped at the state level in the training of officers to help enforce VAT compliance. The government has also received assistance from the Canadian government to improve the audit and revenue collection system.

VAT revenues should help to cut borrowing but further reforms are still necessary to reduce the bloated fiscal deficit. The budget for 2003/2004, announced in February 2003, introduces some measures to improve tax administration, though tax exemptions are not really addressed. There is still a need to widen the tax base, simplify the tax system and to reduce exemptions.

**Ethical standards for public servants**

Statutory laws for the behaviour of civil servants and fixed penalties for misconduct are available. However, corruption is rampant in India, particularly in those areas of the tax administration where officials have discretionary powers over tax collection, such as customs. Commentators argued that the computerisation programme of the central government will greatly improve the transparency and efficiency of the tax administration by reducing the interface between tax collector and payer.[16]

## 2. PUBLIC AVAILABILITY OF INFORMATION

●●●● Compliance in progress

**The public should be provided with full information on the past, current, and projected fiscal activity of government.**

**Central government operations**

The *Budget at a Glance* publication of the Ministry of Finance, which is available online, lists budget estimates for the ongoing fiscal year and revised estimates and outturns for most of the previous nine years. The original estimates are published in February every year, while the revised estimates, which contain revised revenue and expenditure targets and supplementary grants, are disseminated in November. As is a result of the FRBM Act, the MoF is now to publish a medium-term fiscal policy statement, which includes a three-year rolling budget, with its annual budget submissions.[17]

Some information on contingent liabilities is available in the union budget, which lists all the (explicit) loan guarantees of the central government. Some state governments have also begun to publish information about such guarantees in their budgets. However the restructuring of the Unit Trust of India, a public sector mutual fund, at the cost of some 3 billion US dollars (equivalent to around 1% of GDP) in September 2002 indicated the extent of the problem posed by some of India's largest public sector financial institutions to the union budget.

The budget documentation contains no information on the tax expenditures of the central government.[18] Quasi-fiscal activities undertaken by PSUs are only set out in the *Expenditure Budget* publication - though this contains no explicit statements just allocated numbers. These include subsidies allocated, though commentators claimed these were small and that government guarantees are more important since they are much larger, and can be found under a separate section in the expenditure documents.[19]

The government is trying to crackdown on PSU financing from state-owned banks through special financing vehicles - a strategy which hinders fiscal transparency. The government has made good progress in exposing such operations in recent times owing to greater government scrutiny of PSU operations. However, commentators expressed their concern over recent government moves to collect higher dividends produced by PSUs. [20]

Under the FRBM Act, the central government must lay before parliament a number of statements each year. These are: the *Medium-term Fiscal Policy Statement*; the *Fiscal Policy Strategy Statement*; and the *Macro-economic Framework Statement*. The *Medium-term Fiscal Policy Statement* sets out a three-year rolling target for proscribed fiscal indicators, including underlying assumptions. The *Fiscal Policy Strategy Statement* contains, *inter alia*, an evaluation on how the current policies of the central government conform to the fiscal management principles set out in the *Medium-term Fiscal Policy Statement*.[21]

**Public sector operations**

Data on general government or public sector operations are compiled by the RBI and published in the Bank's *Annual Report* and *Report on Currency and Finance*. Public sector data are disseminated on total expenditure, broken down into development and non-development spending; current revenues, broken down into tax and non-tax revenues; the balance (deficit/surplus); and financing, broken down into domestic and external sources. The data are recorded on a

cash basis and presented in a consolidated format. The consolidated fiscal position of the public sector is published in the RBI's *Handbook of Statistics* every December.

The central and state budgets are finalised sequentially because states must wait for the approval of budget transfers from the centre before they can complete their budget. The first set of consolidated data for the public sector generally becomes available nine months after the end of the reference year. General government data include the operations of the central and state governments, but exclude local governments. Moreover, the consolidated figures do not include the considerable quasi-fiscal activities undertaken by state-level public institutions and enterprises, such as state electricity boards and road transport corporations. Coupled with the absence of quantified information on union and state-level level contingent liabilities, these limitations reduce the reliability of general government data as an appropriate indicator of the fiscal position of the Indian public sector.[22]

## A commitment should be made to the timely publication of fiscal information.

**Debt reporting**

The RBI is responsible for the publication of data on central government debt. Data are disseminated for central government debt, broken down into domestic and external debt, and further classified by debt instrument and currency. Data are also available for domestic and foreign debt, classified by maturity, and for debt guaranteed by the central government (i.e. contingent liabilities). These statistics are published quarterly and within one quarter of the end of the reference quarter. The data are compiled by the Controller General of Accounts.[23] The annual *Receipts Budget*, *Annual Economic Survey*, and the RBI's *Report on Currency and Finance* are the main publications that report on central government liabilities in India. The MoF also publishes its annual *India's External Debt: A Status Report*, which includes debt service projections and central government guarantees of external debt raised by PSUs. Total outstanding loans to PSUs are listed in the *Public Enterprises Survey*, which is published by the Department of Public Enterprises with a two-year lag.[24]

The government has updated its SDDS requirements so that they now conform with IMF requirements. India provides a great deal of information on central government operations, central government debt, and general government operations. Data on central government operations are disseminated for: revenue and capital receipts; plan and non-plan expenditure; deficit items; and fiscal deficit financing (broken down into external and domestic sources). The data are based on the actual accounting records of central government units and are recorded on a cash basis. These data are released monthly and within one month of the reference month.[25] Despite all this, there are still some shortcomings in the timeliness and coverage of fiscal data.

**Advance release calendars**

The Controller General of Accounts disseminates an advance release calendar which gives at least three months' advance notice of the precise release dates for data on central government operations, debt, and public sector operations.[26]

## 3. Open Budget Preparation, Execution, and Reporting

●●● Enacted

### Fiscal policy objectives, macroeconomic framework, and risks

**Fiscal policy objectives**

The objectives of fiscal policy are set out in the budget speech of the minister of finance, delivered in February each year. Policy objectives are defined in terms of the fiscal deficit and critical areas of expenditure in the upcoming fiscal year. The FRBM Act, passed in 2003 improves the definition of fiscal objectives by mandating the government to present a medium-term fiscal policy statement and a fiscal policy strategy statement with its annual budget submission. The strategy statement will outline the government's policies on taxation, expenditures, market borrowings, lending, investment pricing of administered services, and other budgetary matters.[27] The medium-term policy statement sets forth a three-year rolling budget, specifying the underlying assumptions of the government's projections.

As of 2003, the only medium-term projections were those made by the Planning Commission in the framework of its five-year plans. These focus on real sector aggregates and do not provide a rolling perspective on fiscal policy. This will likely change as a result of the measures listed above under the FRBM Act. Projections, particularly of revenue targets, are highly inaccurate in India and suffer from a 'built-in optimism'.[28] The methodology for calculating revenues is not publicly available. However, the task force on indirect taxation recently recommended specific measures, such as the inclusion of customs refunds and credits in tax calculations, that are likely to improve revenue forecasting in the future.

The FRMB Act includes a revenue target for 2008. The target set involves a reduction of the revenue deficit by four percentage points within four years. The government hopes to reduce the revenue deficit by one percentage point for each year up to 2008, starting from the next fiscal year. However, the goal will be extremely difficult to meet, though the MoF has shown determination to do so. The government has ensured that the reduction will not affect public investment as this will be needed to ensure development of the economy. Overall, the MoF hopes to achieve the 2008 target by broadening the tax base while also reducing rates.

**Macroeconomic framework**

The FRBM Act requires that the government now attach a macroeconomic framework statement to its annual budget submission.

**Fiscal risks**

The budget documentation does not specify fiscal risks stemming from implicit contingent liabilities to public financial institutions like the Unit Trust of India or uncertainty about privatisation receipts. It is expected that as a result of the introduction of a macroeconomic framework, fiscal risks will start to quantified.[29]

**Fiscal sustainability**

The *Medium-term Fiscal Policy Statement* mandated under the FRBM Act includes an assessment of sustainability relating to the balance between revenue receipts and revenues expenses and the use of capital receipts.[30] However, the sustainability of India's fiscal situation is a cause for concern; indeed, this is what prompted the drafting of the FRBM Act in 2000. The FRBM Act has strict fiscal rules that seek to reduce the fiscal and revenue deficits and bring public debt down to a sustainable level. The central government is to take the necessary measures to reduce the fiscal deficit and revenue deficit in order to eliminate the revenue deficit by March 31, 2008. To this end the government must set annual targets for the reduction of fiscal and revenue deficit. There is a clause in the FRBM Act however, which dilutes the effectiveness of these rules. It includes exceptional conditions for not meeting specified targets such as emergencies, national calamities. It states that "…the revenue deficit and fiscal deficit may exceed such targets due to ground or grounds of national security or national calamity or such other exceptional grounds as the central government may specify."[31]

## Budget presentation

**Data reporting**

Budget data are recorded in gross terms and on a cash basis, in a manner consistent with the IMF's General Finance Statistics system. Government transactions are classified by administrative agency, economic category, and functions and programmes. In addition to this breakdown, the Indian budget also divides expenditures into plan and non-plan spending. The objectives of major budget programmes are set out in the annual budget speech.[32]

Given the substantial expenditure powers of state governments, the public sector balance is the most reliable indicator of general government activity in India. However, these data are only published after a nine-month lag.[33] Moreover, because of the sequential nature of budget compilation, it is unlikely that the government will be able to increase the timeliness of its reporting on public sector activity soon.

The expenditure budget only represents a small part of what the government spends, in this sense it is opaque. The plan/non-plan distinction is bogus as non-plan expenditure also includes expenditures left over from planned programmes, thus there is no meaningful distinction between the two forms of expenditures. Although the FRBM Act includes provisions for the monitoring fiscal targets it does not make these enforceable and is essentially an act that makes fiscal reporting mandatory, not fiscal discipline.

The budget specifies the programmes to which non-planned budgets are allocated, including those at the state level.

## Budget execution and monitoring

**Accounting basis**

The Controller General of Accounts (CGA) is responsible for government accounting in India. CGA is responsible for accounting of the central government's transactions. The CGA prepares monthly analyses of expenditures, revenues, borrowings, and the fiscal balance for the minister of finance and annual *Appropriation Accounts* and *Union Finance Accounts* for presentation to parliament. These documents are compiled in accordance with the 1990 Government Accounting Rules and presented to the legislature after their statutory audit by the Comptroller and Auditor General (CAG). The provisional final accounts are generally available within three to four months of the

end of the fiscal year. However, the CGA does not present information on payment arrears.[34] The accounts of most of the state governments are prepared by the CAG.

**Procurement and employment**

Procurement and employment regulations are clearly set out in relevant legislation. Tenders for contracts above a certain size are open to audits. While national legislation is firmly in place, India has not adopted WTO regulations on government procurement, which would require national treatment for firms from other WTO member states. Employment regulations require that vacancies be filled through competition, while senior appointments be vetted and approved by independent commissions.[35]

## Fiscal reporting

Previously, there was no system of regular mid-year reporting, although supplementary budgets are submitted to parliament each July based on mid-year expenditure reviews. The supplementary budgets are discussed, debated and voted upon by parliament, though they usually receive less scrutiny than the original budget. Expenditure against these grants is examined and commented upon by the Public Accounts Committee of parliament after audit by the CAG. The FRBM has made quarterly budgetary reporting by the minister of finance mandatory. The first report is due in January, before the next budget and it looks like this will happen. The FRBM envisions mid-year budget reporting though this has not occurred this year.

The MoF presented its first mid-year review of the economy and of central government finances on December 4. The mid-year review marks an important step in increasing fiscal policy transparency.[36]

## 4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY

●●● Enacted

### Data quality standards

The most serious issue in terms of data quality standards is the inaccuracy of revenue projections and budget targets at both the union and state levels. Year on year, the 'built-in optimism' of the forecasting process leads to highly imprecise revenue projections that are revised mid-year. The inaccuracy of revenue forecasts at the state level is equally problematic. States tend to over-estimate their revenue intake while under-estimating the losses of state electricity boards and other PSUs.[37] The continuing imprecision in projections and targets undermines public confidence in fiscal data.

### Independent scrutiny of fiscal information

**Independent Audit**

The Comptroller and Auditor General (CAG) is responsible for auditing the accounts of the central and state governments, PSUs, and major government organisations. The independence of the auditor general, whose status is identical to that of a supreme court judge, is guaranteed by the constitution.[38] The CAG undertakes both financial and performance audits. CAG reports are regularly reviewed by parliamentary bodies, such as the Public Accounts Committee and the Committee on Public Undertakings, and this intermediary mechanism between government departments and the auditor also allows for the consensual adoption of audit recommendations. Ministries are required to submit a report on the implementation of recommendations made by the auditor.[39]

Audits at the state level are somewhat more problematic. The CAG audits the accounts of state governments too and CAG Reports are placed before the state legislatures and discussed by the State Public Accounts Committee (PAC) and Committee on Public Undertakings (COPU). However, large states have been known to ignore its recommendations for decades. Such delays in implementation make the usefulness of state audit reports of questionable value.[40]

**National Statistics Agency**

At present, the functions of statistical compilation and reporting are discharged by the Central Statistical Organisation, which falls under the central government. Recently the government set up a National Statistical Commission to review the Indian statistical system, and this commission has recommended the establishment of a permanent and institutionally independent national commission on statistics. This organisation has yet to be set up.[41]

## INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following officials during a visit to India between 14 and 21 November 2003:

### Ministry of Finance, New Delhi

**17 November 2003**

| | | |
|---|---|---|
| M. Prasad | Joint Secretary | Department of Economic Affairs |
| Anurada Prasad | Director Budgetary Affairs | Department of Economic Affairs |

### Reserve Bank of India, Mumbai

**14 November 2003**

| | | |
|---|---|---|
| D. Anjaneyulu | Executive Director and Principal Monetary Policy Advisor | |
| Mridul Saggar | Director | Monetary Policy Department |
| O.P. Mall | Director | Monetary Policy Department |
| Himanshu Joshi | Director | Monetary Policy Department |

## ADDITIONAL INTERVIEWS, NEW DELHI

**17 November 2003**

| | | |
|---|---|---|
| Rita Bhagwati | Economist | International Finance Corporation |
| Neil Gregory | Country Manager | International Finance Corporation |

**19 November 2003**

| | | |
|---|---|---|
| Michael Wattleworth | Senior Resident Representative | International Monetary Fund |
| Sudip Mohapatra | Economist | International Monetary Fund |
| Dilip Mundle | Economist | Asian Development Bank |

**21 November 2003**

| | | |
|---|---|---|
| Govinder Rao | Director | National Institute of Public Finance Policy |

## NOTES

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[15] Interviews in India, 17-21 November 2003
[16] *Report on the Observance of Standards and Codes (ROSC), 'India: Fiscal Transparency'*, IMF, February 2001, Section A/15; Interviews in India, 8-14 October 2002
[17] 'Budget at a Glance', MoF website; *IMF ROSC, 'India: Fiscal Transparency'*, Section B/16
[18] *Report of the Advisory Group on Fiscal Transparency*, pp. 31-32
[19] Interviews in India, 17-21 November 2003
[20] Interviews in India, 17-21 November 2003
[21] The Fiscal Responsibility and Budget Management Act, No. 29 of 2003, Article 3
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[27] The Fiscal Responsibility and Budget Management Act, No. 29 of 2003
[28] Interviews in India, 8-14 October 2002
[29] *Report of the Advisory Group on Fiscal Transparency*, p. 44
[30] The Fiscal Responsibility and Budget Management Act, No. 29 of 2003, Article 3
[31] The Fiscal Responsibility and Budget Management Act, No. 29 of 2003, Article 4
[32] *Report of the Advisory Group on Fiscal Transparency*, p. 46
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[36] Oxford Analytica, 'Fiscal concerns shadow economy', 16 December 2002
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# OXFORD ANALYTICA

# INDONESIA

# FISCAL TRANSPARENCY

**Country Report 2003**

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# INDONESIA

## COMPLIANCE RATINGS

| *Fiscal transparency* | *2003* | *2002* | *2001* |
|---|---|---|---|
| Clarity of roles | •• | •• | •• |
| Availability of information | •• | •• | ••• |
| Budget preparation | ••• | ••• | •• |
| Accountability | ••• | ••• | ••• |
| **Score** | 2.50 | 2.50 | 2.50 |

## OUTLOOK & COMMENTARY

The Indonesian government has decided to conclude its assistance programme with the International Monetary Fund at the end of 2003. In 2004 and beyond, the government will no longer receive funds from the IMF nor have access to debt rescheduling through the Paris Club. In the past, the IMF has been an important catalyst in promoting fiscal transparency in Indonesia. While the IMF will no longer be there to play the role of taskmaster in transparency reform, it appears the current government is sufficiently committed to see key reforms through.

The passage and enforcement of the finance, treasury, and audit laws currently in progress will be a key indicator of the extent of the government's political will over the next year.

# EXECUTIVE SUMMARY

## 2.50 Intent declared

Indonesia is currently in the middle of a substantial revision of its fiscal policy framework. The passage this year of the State Finance Law is the first piece of legislation on the management of public finances to be enacted since Indonesia's independence. In addition, two other laws—one affecting the operations of the Treasury and another on the activities of the state audit agencies—are currently under debate and will likely be passed next year. When passed, this package of legislation and the implementing regulations will represent a significant step towards improving transparency in Indonesia's fiscal policy.

Particularly welcome is the requirement, contained in the State Finance Bill, that the president, governors, and heads of local governments must deliver an accountability report on the budget before the legislature every year. The law also makes government officials personally responsible for misused or embezzled public funds, and imposes strict penalties for such crimes regardless of the official's rank. If these provisions are backed by a strong enforcement mechanism, the legislation will mark a significant improvement in the country's fiscal transparency. Also encouraging are ongoing initiatives to reduce corruption in government procurement, improve the clarity of tax collection, and set up a unified national treasury system.

However, several concerns raised in last year's report are still pressing. The existence of significant off-budget accounts held by government entities and the lack of analysis on contingent liabilities remain serious obstacles to fiscal transparency. Two years into Indonesia's ambitious decentralisation process, much confusion remains about the fiscal obligations transferred to local governments. Also, the independence and effectiveness of the state's audit agencies, BKP and BKPK, are still far from adequate.

Indonesia's overall score is unchanged from last year.

## 1. Clarity of Roles, Responsibilities, and Objectives

●● Intent declared

**The government sector should be distinguished from the rest of the public sector and from the rest of the economy, and policy and management roles within the public sector should be clear and publicly disclosed.**

**Structure, functions and responsibilities of government**

Division of responsibilities between the executive branch, the legislative branch and the judiciary is specified in the National Constitution of 1945 and its subsequent amendments. Responsibilities of the Peoples' Consultative Assembly (the MPR), the Presidency, the House of Representatives (the DPR), the Supreme Advisory Council (the DPA), the Supreme Audit Board (the BPK) and the Supreme Court are explained in governmental websites.[1]

In August 2002, the MPR -- the country's highest legislative body -- made important constitutional amendments. Under the amendments, the MPR will be entirely elected and will consist of two chambers, the DPR (House of Representatives) and the DPD, a chamber of regional representatives. Formerly, Indonesia's president was elected by the MPR, but under the amended constitution, the president and vice-president, who will run together on one ticket, will be directly elected in general elections. In addition, a Constitutional Court is to be established, separate from the Supreme Court, with powers of constitutional interpretation, judicial review of legislation, resolving disputes between state institutions, actions for the dissolution of political parties, election-related disputes, and the duty to rule on motions to impeach the president.

Relations and the division of responsibilities between the central government and Indonesia's 33 provinces and over 400 local governments were fundamentally changed by legislation passed in 1999-2000, in force since 2001. Law 22/1999 assigns "authorities" rather than functions to levels of government, while Government Regulation 25/2000 further specifies the "authorities" of the central and provincial governments. Under these laws, the central government remains responsible for national defence, international relations, justice, security, religion, and monetary and fiscal policies.[2] Provinces play a relatively minor role as autonomous regions, as their basic task is to coordinate local governments. Provincial governments also may, at the request of local governments, perform functions that local governments cannot yet perform. Local governments are assigned all responsibilities not expressly reserved for the central or provincial governments. This includes management and oversight of mandatory "sectors", including health, education, public works, the environment, communications, agriculture, and industry and trade.

Another key decentralisation law, Law 25/1999, deals with fiscal decentralisation. Law 25/1999 fundamentally reformed Indonesia's intergovernmental fiscal relations. As part of this ambitious programme, the government implemented a new intergovernmental fiscal framework, relying largely on a general grant rather than the earmarked grants of the past, and gave natural resource-producing regions a larger share of the resource revenues.

From the beginning, a major concern in the decentralisation process has been the degree of clarity in the roles and responsibilities of the various levels of government. The government has provided some clarification and elucidation of the laws, but recent a World Bank report concluded that two years into decentralisation, it is still not clear what exactly has been decentralised and what obligations have been transferred to the local governments.[3]

In August 2003, Minister of Home Affairs Hari Sabarno announced government plans to revise Law 22/1999 on regional administration. The proposed revisions, expected to take effect in 2004, will address relations between the central government and local administrations and may bring more clarity to the division of responsibilities among levels of government.

**Coordination and management of budgetary activities**

The division of budgetary responsibilities is currently undergoing major revision. At present, there are two draft laws before the DPR—one dealing with the Treasury Department at the central bank and another dealing with the Supreme State Audit Board—that will affect the budget cycle. In April 2003, the House of Representatives approved a new State Finance Law. The law has not yet been given a number or an effective date, and it has yet to be published in the *State Gazette*, pending the president's signature.

Under the State Finance Law, the legislature will have expanded powers over fiscal affairs. In particular, Article 23 of the law makes any government loan or grant from foreign countries or institutions subject to DPR approval. The law will also enhance the power of the Ministry of Finance (MOF) at the expense of the National Development Planning Board (Bappenas) by transferring the responsibility for preparing short- and medium-term economic development plans from Bappenas to the MOF. The government has also announced an internal reorganisation of the MOF. In March 2004, the budget and treasury functions of the ministry will be separated if all goes as planned.[4]

**Relations between government and public sector agencies**

Government relations with the central bank (Bank Indonesia) are governed by the Central Bank Act of 1999, which gives the Bank legal independence. The act clearly establishes the responsibilities of Bank Indonesia and proscribes government interference in the conduct of monetary policy. The only overlap in the government's operations and those of the Bank occur in the issuance of bonds, and the holding of government deposits.

Legislative changes went into effect this year that affect the government's relations with state-owned enterprises (SOEs). Last May, the DPR passed a new law on SOEs which subjects state enterprises to higher levels of supervision. The law simplifies the corporate structure of SOEs, clarifies the economic requirements for privatisation and restructuring, and requires that each SOE have at least three different internal supervisory agencies. The latter provision, if adequately enforced, should make it harder for political parties and government officials to use SOEs as 'cash cows' for political or personal gain.[5]

In 2004, the government plans to privatise ten SOEs, including BRI (financial services), PGN (gas utility), Danareksa (financial services), and Angkasa Pura I (transportation).

**Government involvement in the private sector**

The Indonesian government retains a considerable presence in the private sector, mostly as a result of the massive bank rescue during the 1997-98 financial crisis, when the government recapitalised the banking sector and thereby acquired 43 billion dollars' worth of bank assets. The government holds these assets through the Indonesian Bank Restructuring Agency (IBRA) and has been trying to sell them to private investors for almost four years. Data on IBRA's asset holdings, the progress of loan restructuring and assets sales, and cash revenue is published on the agency's website.[6]

As of mid-2003, IBRA had completed an initial public offering of a 20% share in Bank Mandiri, the country's largest bank. The government also plans to divest a 30% stake in Bank Rakyat Indonesia (BRI), a 52% stake in Bank Lippo, and a 71% stake in Bank Internasional Indonesia (BII) this year, but a major scandal involving the alleged issue of fictitious letters of credit worth 200 million dollars by Bank Negara Indonesia (BNI) will likely

jeopardise the sale.[7] The scandal comes just as IBRA was hoping to accelerate the privatisation process before its operating mandate runs out at the end of December 2003. Once IBRA's mandate expires, it may be temporarily extended as in the past, or alternatively, its portfolio of assets may be transferred to a unit of the MOF.

The government also has private sector holdings through government-affiliated foundations, or *yayasan*. Segments of the public sector, particularly the Indonesian armed forces (TNI) and the police, reportedly control over 250 businesses valued at 3 billion US dollars through an opaque network of government-affiliated foundations *yayasan*. Until recently, the *yayasan* did not have the status of legal entities, but this has changed with the passage of a law regulating foundations. Attempts have also been made to audit the TNI's business interests, but these enterprises, which may generate as much as 70% of the military's expenditures, remain off the official budget.[8]

## There should be a clear legal and administrative framework for fiscal management

**Legal framework for budgetary activities**

The newly passed State Finance Law is the first piece of legislation on the management of public finances to be enacted since Indonesia's independence. As such, it is considered a milestone in the promotion of consistency, transparency and accountability in the management of public money resources.

Several elements of the legal framework were clarified. The law provides a comprehensive definition of "state finance" and outlines the general terms for the management of state finances. Also, the legislation clearly states that the president holds full authority for the management of state finances, a role which she can in turn delegate to the minister of finance, other ministers/chairmen of institutions, and governors, regents, and heads of local governments. In addition, the law stipulates a clear division of roles -- at both the national and regional level -- in the processes of budget drafting, deliberation, approval, implementation, and accountability.

**Legal framework for taxation**

The levy of taxes, duties, fees, and charges has been complicated by Indonesia's decentralisation process. Law No. 34/2000, authorises local governments to create new taxes, fees, and levies subject only to undefined principles and a 30-day review by the central government. If no action is taken by the central government within that period, the local regulation stands.

The 2001 decentralisation programme has increased the importance of shared revenues. The most important factor was the inclusion of oil and gas revenues and personal income tax in the taxes to be shared. For each of the shared taxes, the province gets a minor part, whereas the bulk of revenues go to local government.

While no systematic study of these taxes has been made, evidence suggests that both legal and illegal taxes are proliferating across the country, particularly along trade routes.[9] The central government has identified at least 100 'problematic' regulations of over 3,000 reviewed, but so far it has not abolished any of these, instead asking local governments to reconsider them.[10] In addition, the Ministry of Home Affairs does not have the resources necessary to review every local regulation and to ensure that the division of responsibility between central and local governments remains clear.

Tax collection remains inefficient, especially when compared to tax systems in neighbouring countries. However, encouraging steps have been taken to improve the transparency and efficiency of the tax collection system. Last year, the legislature replaced an institution known as the tax disputes settlement agency (BPSP) with an independent tax tribunal. Under the BPSP, tax disputes between the government and taxpayers were settled behind closed doors, often resulting in private bargains that caused financial losses to the state. The newly established Tax Tribunal, on

the other hand, opened its court hearings to the public and was placed under the supervision of the State Administrative Court (PTUN). Decisions issued by the new tribunal are final and binding.

In June 2002, the first Large Taxpayers' Office (LTO) opened in Jakarta under the purview of the Directorate-General for Taxation in the Ministry of Finance. The office focuses on processing the tax statements of the 200 largest corporate taxpayers and aims to provide open, transparent, and accountable tax services to large taxpayers, since they contribute around 23% of total tax revenue. The initial operations of the LTO have been promising. To reduce the likelihood of corruption, the LTO thoroughly screens officials and offers relatively high salaries. The government plans to open LTOs in other provinces. In 2003, the government registered 100 large taxpayers with the LTO and extended the LTO tax administration system in Kanwil VII and Jakarta.[11]

During 2003, the new electronic payments system has been extended across the country. In addition, the government has made efforts to expand the coverage of corporate tax audits, intensify the collection of arrears, enhance control of non-filing taxpayers, and increase the number of registered taxpayers. By the beginning of next year, the government hopes to publish a "Taxpayer's Bill of Rights", develop a code of ethics for tax collectors, set up a tax ombudsman, and create a special division within the Inspectorate General to deal with violations of the code of ethics. Plans have also been drafted to set up a "tax hotline" to provide citizens with information on taxes and to accept complaints from tax payers.[12]

**Ethical standards for public servants**

Ethical standards for public servants are explicitly stated in the laws of major governmental institutions, including Bank Indonesia and the Large Taxpayers' Office. A draft Code of Conduct, with its corresponding Code of Conduct Committee, has been established within the Office of the National Ombudsman. Lack of enforcement and monitoring, however, remain a serious concern.

The government intends to integrate the functions of the Independent Commission for the Audit of the Wealth of State Officials (KPKPN) into the Anti-Corruption Commission (ACC) in a manner that preserves the integrity of the wealth declaration process. To this end, the government will issue a decree before the end of 2003 to ensure that the capacity to obtain and analyse wealth declarations is maintained, and that the ACC has the powers to enforce the wealth declaration requirements. This process, however, has been delayed by slow progress in establishing the ACC.

The new State Finance Law also strengthens existing legislation on standards for public servants. In particular, Article 35 of the bill makes government officials personally responsible for state funds under their control. If the new law is enforced, officials will face jail terms for embezzlement and mismanagement, and they will be forced to personally reimburse the state for any misused or embezzled public money. The law makes all civil servants subject to equal punishment for the same fiscal crime, regardless of rank. Although the law does not provide for a clear enforcement mechanism, the implementing regulations and the State Treasury Law, which is still under debate at the DPR, will reportedly address the issue of enforcement.[13]

## 2. PUBLIC AVAILABILITY OF INFORMATION

●● Intent declared

**The public should be provided with full information on the past, current, and projected fiscal activity of government.**

**Central government operations**

Public commitment to the publication of fiscal information is a legal requirement. This is made clear in the opening paragraphs of each law that enacts the annual budget, in the laws that amend the budget, and those that state the actual revenue and expenditures recorded in the previous fiscal year. A brief review of the performance of the current year's budget is available on the central bank's Investor Information and Enquiries (IIE) website.[14] Also available there is summary information about the budget for the following year, including macroeconomic assumptions and future government policies affecting government revenues.

Transparency in public-sector financial management has benefited from the recent passage of the State Finance Law, which covers all state funds in all state institutions. The State Finance Law requires the government to submit reports of budget implementation for the first half of the current year no later than July. In addition, the president must deliver an accountability speech on the status of the state budget's implementation, audited by the Supreme Audit Board (BPK), six months after the sitting year ends. Similarly, governors, mayors, and regents must deliver accountability speeches at local legislatures six months after the sitting year ends. The accountability speech requirements will take effect starting in 2006.

A major obstacle to fiscal transparency in Indonesia is the opacity of off-budget accounts—mostly non-tax revenues collected by government and government-linked institutions and not publicly reported. Some efforts have been made over the past three years to make these funds more transparent. The Law on Foundations (No.16/2001) that took effect in August 2002 recognised *yayasan* as legal entities, and required them to produce annual financial statements and annual reports, although the law appears to limit the extent to which the BKP may audit military-controlled *yayasan*.[15]

More importantly, the government issued two presidential instructions (Nos. 9/1999 and 4/2000) and a MOF decree prohibiting state institutions from managing their own budget drawn from non-tax revenues. The government then set a deadline of July 2000 for all government institutions with off-budget funds to transfer them into a state revenue account subject to public audit. By the deadline, of a total of 58 ministries and state agencies, 24 reported their off-budget accounts, 21 declared they had none, and 13 institutions had not yet reported.[16]

Since then, reporting has slowed down, and evidence suggests that various ministries and state agencies still retain very significant off-budget funds. In September 2003, the BPK reported that it had encountered obstacles when trying to audit off-budget funds at various ministries.[17] According to the auditing body, several institutions refused to provide detailed reports of their accounts, such as the nominal value of the accounts and their purposes. In some cases, the institutions refused to report the existence of the accounts at all. Analysts estimate that the largest extra-budgetary funds hold at least 80 trillion rupiah (9.2 billion dollars). According to the MOF, funds from some of these accounts will be incorporated in the state budget within a year.[18]

With the implementation of fiscal decentralisation, the quality of sub-national government fiscal data has become a central concern for effective and transparent fiscal management. Currently, the central government requires the regions to submit financial reports. These are submitted to the MOF, including the budget, budget implementation reports, and final accounts. At present, this is largely a paper-based system, but the MOF is working to improve its Regional Financial Information System (SIKD) to allow for online submission. The MOF then publishes summary financial data on its website.[19]

Progress in establishing an effective reporting system for regional finances has been slow. There is still no publication programme for the consolidated position of sub-national authorities. The government has set a target date of September 2004 to consolidate all government accounts within a unified national treasury system. Under the recent Decree No. 29/2002 on Local Government Budgets 2003, the fiscal performance of local governments will be evaluated based on procurement standard examinations, work performance indicators, and cost standards.

Decentralisation laws 22/1999 and 25/1999 introduced important changes to sub-national budgeting practices. The concept of performance budgeting was introduced, and Law 25/1999 also allowed the regions to set their own financial management and procurement arrangement by regional regulation. The new performance-based budgets should, in theory, increase transparency and accountability in regional fiscal planning. However, it will require some time before regional governments are familiar with it.[20]

**Public sector operations**

The ongoing programme of performance audits of the 144 SOEs under the central government has continued this year, and has now entered phases III and IV. The audits of key state-owned enterprises (*Garuda, Pelindo II, Jasa Marga, Telkom, PT PN-IV*) were completed in 2002, and the results published and corrective actions formulated. The last round of audits, covering state enterprises in the banking, transportation, tourism, and basic industry sectors is currently under way and is expected to conclude in December 2004.[21] However, these audits, conducted by the Financial and Development Supervisory Board (BKPK)—the government's internal auditing agency—have been criticised by the Supreme Audit Board for inattention to possible financial irregularities in the SOEs' financial reports.[22]

The new State Finance Law contains several positive measures to improve the transparency of the SOE sector. Under the law, the BPK will audit all SOEs, including those under the central government and those under regional administrations. In addition, all SOEs operating under the central government will be required to attach their financial reports to the government's budget accountability report, which must be submitted to the House of Representatives by the president. SOEs operating under regional governments must attach their financial reports to the local government's budget accountability report, which will then be tabled at the local legislature.

The budget discloses information on tax exemptions and tax estimates in terms of net value, but statements on quasi-fiscal activities (QFAs) are not included. The government's contingent liabilities, which are quite significant, are not reported in the budget, either.

Aggregate budgetary information and out-turns for the preceding two fiscal years are presented to the legislature as an accompaniment to the financial note of the government. Budgetary information on state-owned companies and on regional governments is available, although the latter must be requested from individual regions.

## A commitment should be made to the timely publication of fiscal information.

Indonesia subscribes to the IMF's Special Data Dissemination Standard (SDDS) and complies with all standards for coverage, periodicity, and timeliness of reporting central government and public sector data.[23]

**Debt reporting**

Information on government debt and financial assets is published with the annual budget. Financial assets are also reported by the central bank, and information on government debt, including loans, interest, principal, maturity dates, and closing dates is covered in the government annual budget report. Projected repayments of short-term debt are published periodically. A consolidated government balance sheet is not published. Bank Indonesia publishes information on its debt management on behalf of the government, particularly on external debt. This information is available in *Bahasa Indonesia* and English on Bank Indonesia's website.[24]

In 2004, the government hopes to consolidate national debt management by moving the State Department Management Office (PMON) to the Treasury in the MOF.

**Advance release calendars**

The Indonesian government publishes an advance release calendar giving a one-quarter's notice of the expected release dates of public sector data. The same is true for central government operations data and for data relating to central government debt. In all three cases, notification of the exact release dates is given one week in advance and disseminated via the IMF's Dissemination Standards Bulletin Board.

## 3. Open Budget Preparation, Execution, and Reporting

●●● Enacted

### Fiscal policy objectives, macroeconomic framework, and risks

**Fiscal policy objectives**

Significant changes to the process of setting fiscal policy objectives and budgeting are currently under way. To oversee these changes, the government formed a Financial Management Reform Committee (FMRC) under the leadership of the Secretary General of the MOF. The FMRC prepared a white paper on the principles and strategy of budget reforms and submitted three draft laws to the DPR. One—the State Finance Bill—has been passed into law. The other two, the treasury and audit bills, are under discussion in the legislature.

Before the passage of the State Finance Law earlier this year, Indonesia's central government prepared two documents outlining medium- and short-term fiscal policy objectives. The National Development Plan (Propenas), which replaced the government's traditional five-year economic plan (Repelita), was a five-year forecast outlining government priorities and objectives in all sectors. Last published for the 2001-2005 period, the Propenas was considered to be an improvement over the Repelita because it focused more closely on fiscal policies and objectives, not just on the macroeconomic framework.[25] The other fiscal document was the Annual Development Plan (Repeta), a three-year rolling forecast prepared annually. The Repeta has been described as an important step towards transparency and accountability because stakeholders and the legislature can now hold the government accountable for deviations of budgetary and deficit targets.[26] Also, the Repeta also defines and ranks eleven priorities for the government's fiscal policy.

Under the new State Finance Law, the Propenas will be replaced by a document called the Medium-Term Expenditure Framework (MTEF), which will provide economic guidance over a three-year period. In addition, the new law requires that the government propose a bill on the state budget for the following year no later than August of the current year. Regions, in turn, must propose budgets to their local legislature in the first week of October of the current year.

Another transparency-related concern that surfaced in 2003 is the improper use funds for purposes other than those for which the funds were earmarked. In particular, a DPR committee authorised the government to use 1.6 trillion rupiah from a reserve fund created to provide emergency assistance during natural disasters to finance the government's military campaign in the restive province of Aceh.[27]

**Macroeconomic framework**

The macroeconomic assumptions underlying the budget are assessed in meetings between Bappenas, the MOF, and Bank Indonesia. The budget mentions some of these assumptions explicitly, including economic growth, foreign exchange, interest, and inflation rates, the oil price, and crude oil production.[28] Using these and other assumptions, a 'base case' scenario is created and published with the budget documentation.

Yet, according to the World Bank, macroeconomic models are not transparent to the public. In addition, analysts point out that since there is no binding agreement between the legislature and the government on fiscal policy prior

to the detailed budget, discussions on macroeconomic assumptions continue throughout the budget formulation process, with the legislature sometimes changing revenue estimates.[29]

**Fiscal risks**

The macroeconomic assumptions used in preparing the budget are stress-tested for changes in variables. These fiscal risks are presented to the legislature as working papers, but according to MOF's officials, they are not extensively discussed.[30] The most significant fiscal risk scenarios –those involving changes in interest rates and oil prices– are published in the final budget text.

An important source of fiscal risk is the significant off-budget and contingent liabilities the Indonesian government has accumulated since the 1997-98 crisis. These stem primarily from guarantees to protect depositors and creditors in the banking system, guarantee schemes to the private sector to restore the flow of credit, sovereign guarantees to private infrastructure providers, and pension payments obligations.

Contingent liabilities are not reported in the budget document, but some of these liabilities can be found separately in relevant documents such as the balance sheet of the national electricity utility (PLN) and the IBRA balance sheet. The central bank also publishes the amounts of bank recapitalisation bonds outstanding. However, no analysis has been made public showing the total amount of contingent liabilities, the likelihood that these will become real liabilities, or the budgetary impact of such an event.

**Fiscal sustainability**

Bank Indonesia has recently published a document on fiscal sustainability in which it discusses the government's fiscal sustainability targets, bond issuance, and measures to keep the debt burden under control. The document is available in the central bank's Investor Information and Enquiries (IIE) website.[31] However, it is not clear whether this publication will be published regularly. The World Bank has independently analysed issues of Indonesia's fiscal sustainability in detail in a recent report.[32]

## Budget presentation

**Data reporting**

The data classification for revenues, expenditures, financing and debt are compatible with Government Finance Statistics (GFS) standards.[33] Budgetary funds are presented by sector, sub-sector, programme, and project/activity. Expenditure is also classified by expenditure type.

Objectives of major government programmes are included in the budget and are presented by sector. Statements of objectives are described in more detail in a supplementary budget document called *Unit 3A*. The budget also details the central government's overall balance. In addition, the Financial and Development Supervisory Board (BPKP) regularly audits government agencies with a view to identifying any additional non-consolidated funds.

The government of Indonesia has declared in the March 2003 Letter of Intent to the IMF that developing an effective regional budget reporting system remains a priority. The government acknowledge that some progress in this area was made in 2002, with the finalisation of the regions' 2001 accounts, but further efforts will be necessary to establish a comprehensive quarterly reporting system. The strategic aim remains to produce regular quarterly budget reports within six months of the end of each quarter. To ensure timely data submission, sanctions such as postponement of transfers will be imposed on regions that fail to comply with the reporting requirements.[34]

## Budget execution and monitoring

The lack of a modern financial controllership function at the ministerial level is a serious internal controls weakness. Duplication of budget monitoring and record keeping among various government units results in highly fragmented financial information systems. Until recently, the consolidated financial statements presented to Parliament were not available until two years after the end of the fiscal year. The government has been trying to reduce this time to no more than twelve months, with the ultimate goal of reaching the OECD standard of six months, and to improve the quality of the report to include a balance sheet, a cash flow statement, and a budget realisation report.[35]

Following the Decentralisation Programme, some regions are in the process of increasing its budget transparency procedures. Budget evaluation still has to be developed among the regions. The annual accountability report of the head of the region to the Regional Council provides some useful information. However, this document is not very comprehensive for evaluating budget implementation on results achieved.

### Accounting basis

In 2002, the government established a Government Accounting Standards Committee to overhaul the government's accounting system and synchronise central and local government accounting. According to the Committee's exposure drafts 1-3, published in October 2002 and discussed in public hearings, Indonesia's central, provincial, and local governments will replace the single-entry, cash-basis accounting method currently in use with double-entry accounting on a modified accrual basis. All accounts, not just central government ones, will also be made consistent with GFS reporting standards.

In addition, the government will gradually adopt accounting standards based on Generally Accepted Governmental Accounting Standards (GAAS). Although the government set a target date of January 2004 for the full implementation of the first three exposure drafts, experts do not expect full implementation until 2005.[36] According to the Government Accounting Standards Committee, both central and local governments will be ready to prepare their basic financial statements in accordance with the government's accounting standards in 2005.[37]

Work on accounting reform is especially slow at the local government level. As stipulated in Law 25/1999, the heads of Indonesia's districts and municipalities (*kabupaten* and *kota*) are responsible for public sector accounting, and local governments have the freedom to develop their own systems and procedures for financial reporting. However, many local governments are unprepared for the task. With the help of international donors and the Indonesian Accountants Association, 20 municipalities have partially replaced the traditional cash-basis accounting method with a double-entry accrual-basis system.[38]

A fully electronic financial control system is currently being introduced, as well as a balance sheet with cash flow statements and a financial operation report. The new system will be able to simultaneously account for all the financial transactions of public agencies, the central state treasury and the central government.

### Procurement and employment

Procurement and contracting procedures are regulated by presidential decree, but these are not readily available in English. Regulations for employment practices exist and cover the recruitment process, pension plans and career plans. With support from the World Bank, the government is planning to establish an independent procurement body. The new body will be charged with policy-making in the area of procurement, disbursement settlement, and human resource reforms.[39] As of this writing, the measure was still in progress.

Two regulatory changes in the procurement process are worth mentioning. In November 2003, President Megawati Sukarnoputri signed a ruling which tightens procedures for procurement in the public sector. Also, the government will submit to the legislature a law, which will replace Presidential Decree No. 18/2000 on public sector procurement, prescribing penalties for corruption in the procurement process. In addition, the draft law will allow companies to bid for government contracts without having to be accredited by the Indonesian Chamber of Commerce and Industry (Kadin) or its affiliated associations. The draft law would also forbid medium- to large-scale enterprises from bidding for projects reserved for small businesses (projects worth less than rupiah 50 billion). The government has also set June 2004 as the target date for developing and implementing an electronic procurement system for government purchases of goods and services.[40]

## Fiscal reporting

Government authorities make regular reports on the implementation of the central government's fiscal programme, both to the legislature and the public. The Budget Law requires the government to make a mid-year report to the legislature. Central government reports on the budget consist of a *Semester Report* (every six months), a *Supplementary Report*, and an *Audited Report*. Monthly financial accounting reports are published internally. Reporting of sub-national fiscal activities is only presented to the regional parliaments.

According to the Indonesian Constitution, the legislature plays a key role in the budget process. This process includes preliminary pre-budget discussions within and between the various ministries and the legislature; the presentation of the budget to the parliament by the president; analysis of the budget by budgetary (or select) committees for one or two months; further analysis by smaller committees set up to address particular fiscal issues; the approval of the budget by the legislature; a revision 6 months later to assess the budget in light of any changes in the interest rate, exchange rate, inflation rate or the price of oil; the final presentation of the audited final accounts 14 months after the end of the fiscal year. In practical terms, however, the legislature's primary role is in budget formulation, with little formal provision for budgetary oversight by budgetary committees.

The role of the Parliament as the institution with public responsibility for financial oversight is not widely understood in the country. For most of the people, the Parliament is only responsible for policy debates, law-making and budget approval. Budget implementation and financial control have been historically viewed as tasks of the executive. A fully functioning Public Accounts Committee is yet to be established, although a Parliamentary Commission plays a similar role.[41]

In the area of provincial and local budget reporting, the Indonesian government have been strengthening efforts to minimise reporting delays, including through the imposition of sanctions on regions that fail to submit their end-2002 reports by the middle of the year. The Ministry of Finance has set up a web-based regional financial information database with extensive budgetary information for each region, but little analysis is done on these numbers.

## 4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY

●●● Enacted

### Data quality standards

Inadequate coordination of budget monitoring and recordkeeping has resulted in duplication and fragmented financial information systems. Central government's final accounting reports cover the central government budget and some extra-budgetary funds. The government presents current realisations of the budget to the cabinet every month. This data is not publicly available and is intended for government officers only.

Public activities are assessed through *ad hoc* sectoral and regular programme reviews. The *Semester Report* includes six-month reviews of all programmes by sector, while the *Supplementary Report* includes annual reviews.

### Independent scrutiny of fiscal information

**Independent Audit**

The Supreme Audit Board of the Republic of Indonesia (BPK) is Indonesia's national auditing body. It is legally independent from the government as enshrined in the national constitution. The BKP's mission is "to examine the accountability of state finances" and to disclose these findings to the House of Representatives.[42] However, the BPK is not financially independent, and does not enjoy a guaranteed budget protected from cutbacks.

In charge of auditing all state finances, BPK also audits state-owned enterprises and firms owned by regional governments. The board also monitors central and regional government budgetary implementation. Special audits are performed for activities suspected to be fraudulent or criminal. *The State Budget Financial Accounting Report* sets out the BPK's findings and is submitted to the legislature for parliamentary approval. The country's highest constitutional body (the MPR) has begun to assert a right to hold the BPK accountable by demanding annual reports and issuing recommendations.

Although BPK is the national auditing body, the Financial and Development Supervisory Board (BPKP), an internal audit agency created by Presidential decree in the Suharto period, also carries out external audits of ministries and reports to the president. The line between external and internal audit is blurred, and with it, the responsibilities of the BPK and BPKP. There is also confusion about the roles of BKPK and the Inspector General in internal audits.

Last year, the BPK launched a website with an English-language version.[43] The English website includes information on the history, legal foundations, and staff qualifications of the BKP. During 2003, additional statistical information grouped by subject, region, and provincial office was made available. However, much of the information on the Indonesian-language website, including *Peneriksa*, the BKP's regular publication, has not yet been translated.

A draft of the State Audit Law, submitted to Parliament in 2000, is expected to be passed in 2004. The law will affect the structure and activities of the BKPK and the BKP. Some activities of the BKPK may be assigned to the BKP, but the exact division of responsibilities is yet to be finalised by the legislators.[44]

**National Statistics Agency**

The Indonesian National Statistics Office (BPS) is required by Law to publish the National Accounts data as stated in the explanation of Article 5 of the Statistical Law. It is stated explicitly in the Decree of the Director General of the BPS No. 100, 1998. All statistics collected by the BPS are governed by the Statistical Law of Indonesia of 1997 (Law 16/1997) which established the statistical independence of the BPS. Under the law, the BPS has the freedom to determine methodologies, the forms of data collection, and the format and timing of publication of data. The BPS cannot publish, or otherwise make available to any individual or organisation, statistics that would enable the identification of data for any individual or entity.

The BPS has statutory independence on technical matters, but does not review fiscal data or assess its quality. This responsibility remains with the MOF.

## INTERVIEWS

In 2003, Oxford Analytica did not conduct in-country interviews in Indonesia for security reasons. Written questions were submitted to Bank Indonesia and the Ministry of Finance, but their responses had not been received by the time the report was finalised. Representatives of Oxford Analytica interviewed the following individuals during a visit to Dubai (2003 Meeting of the Boards of Governors of the World Bank Group and the International Monetary Fund) in September 2003:

### Bank Indonesia

**20 September 2003**

| | | |
|---|---|---|
| Hartadi Sarwono | Deputy Governor | |
| Halim Alamsyah | Director | Research Department |

**IN ADDITION, WE HAD A CONFERENCE CALL ON 4 DECEMBER 2003 WITH:**

| | | |
|---|---|---|
| Dr. William Wallace | Consultant | Ministry of Finance |

## NOTES

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# OXFORD ANALYTICA

## ISRAEL

## FISCAL TRANSPARENCY

**Country Report 2003**

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# ISRAEL

## COMPLIANCE RATINGS

| *Fiscal transparency* | *2003* | *2002* | *2001* |
|---|---|---|---|
| Clarity of roles | ●●● | ●●● | ●●● |
| Availability of information | ●●● | ●●● | ●●●● |
| Budget preparation | ●●● | ●●● | ●●● |
| Accountability | ●●●● | ●●●● | ●●●● |
| **Score** | 3.25 | 3.25 | 3.50 |

## OUTLOOK & COMMENTARY

he structural and fiscal reforms being pursued by the government look likely to continue, while rivatisation is set to accelerate. The immediate agenda includes privatisation of Bank Leumi and iscount Bank, likely to take place at the beginning of 2004.

ther developments underway include measures to allow for the introduction of accrual-based ccounting. In November, the Ministry of Finance began 'beta testing' an Economics Resources lanning (ERP) software platform, which will allow partial accrual accounting. This will be overnment-wide by 2007.

he OECD in May 2004 will conclude an internal discussion on enlargement. There is a strong possibility that Israel will be invited to join the organisation. If Israel decides to accept, this will have a bearing on transparency, since Israel will participate in OECD comparative studies, and will, on a gradual timetable of compliance, be subject to OECD norms on domestic legislation -- much of which touches on fiscal, monetary and external transparency.

The impetus for transparency is coming largely from the civil service, but continues to meet political opposition.

# EXECUTIVE SUMMARY

## 3.25 Enacted

In 2003, Israel on balance raised the quality of fiscal transparency, with specific improvements marred by other deteriorations. Most importantly, revenue projections have improved. Previously, revenue projections were overly optimistic, in order to make room for more spending without breaching deficit limits. Now, the only disagreements over revenue projections arise from GDP growth assumptions, and these differences, while potentially significant, are professional and legitimate.

Improvements have been made in the analysis of fiscal risks and other macro economic items with a bearing on the medium-term budget outlook.

Budget forecasting has also improved. Accounting software to enable accrual-based budgeting is in the 'beta testing' stage and is expected to be in use, government-wide, by 2007.

Israel is a member of the IMF's Special Data Dissemination Standard (SDDS), and meets its specifications for the coverage, periodicity, and timeliness of the data and for dissemination of advance release calendars.

'Creative accounting' in the budget remains a problem, particularly in the non-transparent financing of government-owned enterprises. Analyses of fiscal sustainability and contingent liabilities are still missing from budget documentation. Performance budgeting remains several years off.

Israel's overall score has remained at 3.25.

## 1. Clarity of roles, Responsibilities and Objectives

●●● Enacted

**The government sector should be distinguished from the rest of the public sector and from the rest of the economy, and policy and management roles within the public sector should be clear and publicly disclosed.**

**Structure, functions, and responsibilities of government**

Israel's Basic Laws, which have constitutional status, set out the structure, functions, and responsibilities of the government. Under these laws, the general government consists of the government ministries, local authorities, non-profit institutions (including universities, secondary schools, sick funds, community centres, museums, research institutes, and similar entities), and the National Insurance Institute.

The Ministry of Finance's (MoF) budgetary department is responsible for public expenditure, the coordination of the budget-planning system, and multi-annual planning. The Department of the Accountant-General (DAG) is responsible for budget implementation, control of state liabilities, establishing financial and economic procedures, and managing the government accounts.[1]

**Coordination and management of budgetary activities**

The coordination and management of budgetary activities are centralised within the MoF. Over the years, the Ministry has developed a strong technical capacity and expertise concerning budgetary activities. This has made it difficult for external analysts to review the budgetary figures that the MoF produces. For example, in 2002, although the MoF's revenue and spending projections came under heavy criticism, no other organisation had the broad range of expertise or technical capacity to challenge the MoF's assumptions. The result was that, within a few months following passage of the budget, two supplementary budgets had to be introduced.

From October 2003, the '*yellow notes*' publication, an explanatory guide to the budget presented to the legislature is being published on the MoF website. It includes several macroeconomic analyses.

An ongoing source of concern to analysts is the government's propensity, in all proposed budgets, to leave large funds under the section labelled 'reserves.' The purpose of this section is twofold: to deal with unanticipated crises and to fund the secret services. Secret services almost automatically take about two-thirds of the funds allotted. The rest is allegedly used for security alerts and other activities not foreseen. However, the 'free' reserve money has usually been used more prosaically to cover sudden increases in spending as a result of political deals in the Knesset (Israel's legislature), or to cover mistakes made by the MoF in overly optimistic projections. It is not unusual for the reserve fund to be carved up between sectoral interest groups at the beginning of the fiscal year, and for the fund to run out of cash well before the fiscal year is over. Contingency reserves remain hidden in other budget categories.

The reaction of the MoF has been to create a series of false projected expenditures in each budget that can then be used for real contingencies. All the data projections are open and available -- thus satisfying regulations on transparency. However, since the budget averages about ten thousand line-items, the figures are rarely checked by oversight committees. Commentators say that the monies are hidden in a variety of ways.[2]

However, not all the inaccurate forecasting of revenues is the fault of the MoF. The government as a whole plays a critical role. Over the past two years, funds from the privatisation of government companies have crawled almost to a halt -- largely as the result of lobbyists' pressures. The current government has yet to issue a timetable for privatisation. Another important source of revenue has been the Israel Lands Authority (ILA). Responsibility for it has passed through no fewer than four ministries. The ILA controls most of the re-zonable land in the country and its advisers set the price for available land. The land is then sold by auction at a set minimum price. However, as often happens, the minimum price, once fixed, is rarely reduced to react to real market conditions. During a recessionary period this seriously limits housing starts, and thus government revenues that accrue both from the land sales and the taxes on income and construction inputs. Although the regulations guiding the ILA's activities are publicly available, the criteria used by the ILA's land assessors have never been clearly laid out.

The MoF has cooperated with the Bank of Israel (BOI) in providing data to the Bank for its project to assess the medium-term implications of all fiscal-relevant legislation. Budget forecasting has improved. The Bank created a multi-year budget, based on budget trends and actual legislation, and published it for the first time in the 2002 *Annual Report*. It was updated in March 2003 to reflect the passage of more than 200 new measures. It is currently being updated to reflect the 2004 national budget. The Bank's multi-year budget study is a 70-page report listing each separate budgetary component and each assumption that goes into it. Beginning with the September 2003 MoF *Outlook* publication, available on the Internet, the MoF is publishing the medium-term budget forecasts and risks analyses, incorporating prices, labour markets and other real variables.

**Relations between government and public sector agencies**

The BOI Law places special emphasis on the independence of the central bank. Fiscal policy is exclusively the responsibility of the government. The BoI's services to the government include making and receiving payments, managing the government's domestic loans, and handling some of its financial activities abroad.[3] The amounts of credits, advances, or overdrafts to the government can be found in the monthly balance sheets of the Bank of Israel.[4]

As part of the structural and fiscal reforms currently underway, there is to be a major overhaul of the country's union-run pension funds. Israel's biggest pension funds are to be taken out of the management and care of the Histadrut (General Federation of Labour).[5]

The most recent IMF ROSC recommended the clarification of the relationship between insurance and pension supervision and other financial agencies.[6]

**Government involvement in the private sector**

The government still owns and is the majority shareholder of many large companies in Israel. These include El Al, Bank Leumi, Mekorot, Israel Oil Refineries, Bezeq, Israel Aircraft Industries, and Israel Military Industries. These companies do not publicly disclose their quarterly or monthly accounts.

Over the past couple of years, funds from the privatisation of government companies had crawled almost to a halt. The current government has yet to issue a short-term, or even a medium-term, timetable for privatisation. However, as part of the structural and fiscal reforms, the privatisation of public enterprises is to pick up pace. In 2003, the government sold the Israel Electric Corporation (IEC) and a minority stake in El Al. The government is laying the regulatory framework for part-privatisation of ports.[7] The immediate agenda includes privatisation of Bank Leumi and Discount Bank, likely in the beginning of 2004.

One of the tasks of the Government Companies Authority (GCA) is to publish an annual report on government companies. The report contains financial statements for government companies, the percentage of government equity holdings in these companies and the amounts of revenues generated by them for the state.[8]

## There should be a clear legal and administrative framework for fiscal management

**Legal framework for budgetary activities**

The Basic Law on the State Economy sets out general budgetary procedures and establishes the government's authority to pass an Interim Budget Bill when the budget has not been adopted by the legislature before the start of the fiscal year. This Interim Bill allows the government to spend one twelfth of the previous year's budget on a monthly basis for three months. If the budget fails to pass at a third reading, new elections must be held within 90 days.[9] The provision for an Interim Bill was employed in 2002 when the Knesset was unable to pass a budget bill by the beginning of the fiscal year. The provision was not used in 2003 because the budget was passed, on schedule, in December 2002.

The MoF's Budget Department administers public expenditure and coordinates and facilitates the entire government and public budget-planning system.[10] Procedures concerning the expenditure of public funds are set out as part of the Basic Law on the State Economy and the Basic Law on Government.[11]

Both law and precedent guide the preparation of the budget. In normal years, it is submitted to the cabinet in July. Usually four or five cabinet debates are devoted to this purpose. Even in the best of years, however, since ministers are invariably preoccupied with the implications of the budget for their own ministries, there is scant time for a full-scale macroeconomic debate because the massive document must be submitted to the Knesset by September.

**Legal framework for taxation**

All laws, tax ordinances and regulations are openly available and gazetted in *Reshumot* (the state gazette). Information on taxes is comprehensive and can be found on the government gateway website and is also provided by the State Revenue Administration.[12]

When governments are weak, there has been a strong tendency for small factions to introduce and negotiate the passage of new and expensive spending bills even after the budget has been passed. Knesset members are subject to intense pressure by small and often publicly invisible lobby groups. This has meant that serious distortions have crept into the taxation and regulatory system. This, in turn, leaves economic analysts with a lack of clarity for months on end as to how the tax and spending systems will work in the forthcoming year. Two attempts within the last few years to reform the system have failed precisely because the lobbying system was so strong.

As in 2002, any Knesset member's private bill that will require the expenditure of more than five million shekels must have the support of at least 50 members from the 120 member house. This law will be renewed as part of the Arrangements Law, which is the enabling legislation that accompanies every budget.

A 2002 abbreviated tax reform bill raised the value-added tax (VAT), increased social insurance payments, but also taxed certain types of capital gains for the first time and altered the tax framework under which the labour market operates. Implementation of these changes continued in 2003, with additional changes spread over the coming three years.

Tax reforms are bearing fruit, as the MoF has seen revenues coming from capital gains and other areas of recent tax reform. The speed-up in reducing tax rates for the middle class is included in the new Arrangements Law; it has been brought forward by two years.

**Ethical standards for public servants**

The Civil Service Code sets out ethical standards of behaviour for public servants. The code is only available in Hebrew.

## 2. PUBLIC AVAILABILITY OF INFORMATION

●●● Enacted

**The public should be provided with full information on the past, current, and projected fiscal activity of government.**

**Central government operations**

The budget documents are comprehensive and cover most fiscal activity by the government. Extrabudgetary data on pensions, the National Insurance Institute, and other government enterprises are included in the Budget Proposal document.

The Central Bureau of Statistics (CBS) publishes quarterly national accounts including data on general government current expenditure.[13] Some CBS data are being harmonised to comply with Eurostat protocols.[14] The CBS in 2003 began adapting Eurostat classification of goods, and provided re-classified data to Eurostat, dating from 1996.

Israel's Budget Proposal document contains budgetary data on the preceding two years, alongside forecasts for the prospective year. Each ministry's 'blue book' budget document compares the previous year's actual expenditure with the current and next years' budgeted expenditures. It does so on a 'net' and 'gross' basis, where 'net' separates out the expenditures not linked to (contingent upon) revenues.

While the budget includes a section on projections for budgeting and macroeconomic activity for the next three years, this projection does not include assessment of items passed by law that only go into effect in the years beyond that time frame. Such is the case with the tax reform law, which is spread over five years and could create large new deficits in forthcoming years.

Revenue projections are more reasonable in the 2004 budget.[15] Previously, revenu projections were overly optimistic, in order to make room for more spending without breaching deficit limits. This time, the only disagreements over the revenue projections arise from GDP growth assumptions, and these differences, while potentially significant, are professional and legitimate.

The defence budget remains the least transparent of all budget items.

Internal discussion within the MoF is underway with the intent of preparing semi-annual budget reports. However, it is unclear whether and when such reports will begin to be issued.[16]

Israel complies with the IMF System of National Accounts (SNA) of the IMF Government Finance Statistics Manual. From 2001, it began issuing bonds only in nominal terms. As it retires more pre-2001 debt, it will move closer to nominal calculations of outstanding debt and deficit costs, which will move it into line with deficit definitions under the Maastricht Treaty.[17] The Accountant General is responsible for reporting actual annual expenditures. The report is considered to be credible, but it is released with too great a lag.

The MoF in 2003 added Internet services for taxpayers, such as online payment of VAT and fines, and 'know your rights' information for new citizens. Translation of MoF information into English remains an area of weakness. There is a view that the private sector is already providing this service to the investment community.

**Public sector operations**

A number of powerful quasi-governmental organisations, such as the Jewish Agency, Keren Kayemet L'Ysrael (KKL) and Keren Hayesod, perform significant quasi-fiscal activities. The government and private donors fund these agencies. For a more complete understanding of their functions and sources of revenue it is necessary to consult the annual report each is required to publish.

## A commitment should be made to the timely publication of fiscal information.

Israel is a subscriber to the IMF's Special Data Dissemination Standard (SDDS) and meets its specifications for the coverage, periodicity, and timeliness of the data.

Chapter three of the State Comptroller Law requires the government to publish fiscal data. Further, Article 49c of the Budget Foundations Law states that a quarterly performance estimate of the deficit and its financing must be released at the end of each quarter and submitted to the Knesset Finance Committee.

**Debt Reporting**

The Budget Proposal document and the government's *Annual Financial Report* contain comprehensive information on government debt and financial assets. Data on central government debt are publicly disclosed quarterly, three months after the end of the reference quarter in the relevant issue of the CBS monthly 'Selected Economic Indicators.'[18]

**Advance release calendars**

In accordance with its commitment to the SDDS, Israel produces advance release calendars across the range of fiscal data that it releases under the provisions of the SDDS.

## 3. Open Budget Preparation, Execution, and Reporting

●●● Enacted

### Fiscal policy objectives, macroeconomic framework, and risks

**Fiscal policy objectives**

Fiscal policy objectives, the macroeconomic framework, and the policy basis for the budget are set out and analysed in both the final budget document (only available in Hebrew) and in the Budget Proposal document. The government sets a deficit target, which is prescribed by the Reduction of the Deficit Law. However, this Law has been breached in each of the subsequent years since its passage owing to the ongoing recession and the subsequent shortfalls in tax revenues; and the sectoral interests for additional transfer payments. In fact, according to officials, the law requires that the budget must be planned with the deficit target in mind, but that there is no legal requirement to meet the target.[19] As the Reduction of the Deficit Law is binding only at the planning stage, not in the expenditure stage, the MoF recognises that it is not working, and it is being adjusted. The amendment, currently under preparation, will strengthen it by means of an Expenditure Law limiting real growth in expenditure to 1% per year from 2005 onward. This will be particularly important when the economy eventually enters an expansionary phase, creating more robust revenues. It is hoped that the law will divert some part of stronger revenues toward reducing the national debt, rather than letting politicians spend the new revenues. [20]

The cabinet on March 25 approved a revised budget for fiscal year 2003. Confronted by the worst and longest economic recession in Israel's history, the government has adopted the largest-ever economic reform package. It contains a number of structural and fiscal reforms that the MoF has tried to persuade politicians to take up for years. The new coalition government is far more homogeneous on core economic issues than the previous one, thus facilitating reform. The massive overhaul of the structure of the economy and the elimination or amelioration of many of the distortions that has accrued over decades is underway. Structural and fiscal economic reform plans include abolishing special tax breaks for rural areas, merging some local councils, reducing payments to local authorities and hiking municipal taxes. In addition, there is to be a major overhaul of the country's union-run pension funds. There is also to be increased privatisation. Finance Minister Binyamin Netanyahu has managed to convince markets that, unlike his recent predecessors, he is serious about liberalising the economy. The impact of many of the structural changes will only be felt beginning in fiscal year 2004. [21]

**Macroeconomic framework**

The macroeconomic framework, including medium- and long-term budgetary goals, is set out in the *Major provisions of the Budget* section of the Budget Proposal. The same section sets out the targets for the coming fiscal year and outlines government policy for major economic and social sectors. The 'Composition of the Budget' section is intended to provide a comprehensive explanation of current expenditure and how it will be used in different economic sectors. However, this section cannot be relied upon as a definitive predictor of government activity. Each year, in mid-term, funds are invariably transferred from one sector to another to cope with stopgap needs.

'The Budget Framework' section of the Budget Proposal contains an explanation of the government's tax policy and its effects on the Israeli economy. The use of supplementary budgets is disclosed retrospectively in the budget for

the following year but this information is only available in Hebrew.[22] Since budget reporting is based almost entirely on cash flow, as the fiscal year draws to a close many payments to suppliers are held up and carried over to the accounts of the following year. In 2002 for example, the government chose not to issue VAT refunds as scheduled on December 20, but to hold them over until January 2003.

**Fiscal risks**

A subsidiary office to study liability management has been set up by the Accountant-General. The office has been formed under the debt management unit. The unit is building a model to analyse fiscal risks and other macroeconomic risks. The date of implementation is uncertain.[23] Until now, public debate on the issue tends to focus almost solely on the assessments made by the world's three largest analysts of sovereign debt (Moody's, S&P, and Fitch).

From September 2003, the MoF is publishing analysis of fiscal and macroeconomic risks in its *Outlook* publication.

**Fiscal sustainability**

There are no fiscal sustainability assessments, such as debt management sensitivity checks.

## Budget presentation

The complete budget is only published in Hebrew. Net expenditure and revenue-contingent expenditure constitute the gross budget. The National Budget specifies amounts as net expenditure, gross expenditure and revenue-contingent expenditure. Budget items of each expenditure type are also detailed. There is no performance budgeting.[24] Each ministry publishes a 'blue book' commenting on its performance. The MoF recognises that it will take years to implement performance-based budgeting. It is moving toward reporting quantified physical results of expenditure, such as number of kilometres of roads built, etc. A move to performance budgeting would improve transparency, and help parliamentary scrutiny of the budget process.

The auditing department of the Ministry of Interior, the State Comptroller, and the MoF's director in charge of salaries monitor the local authorities. A special accountant can restrict funding to the local authorities from the central budget. The financial reports of each authority set out the amount of budgetary transfers from the government. [25] The Ministry of Interior discloses the revenues and expenditures for the local authorities in its budget, which is published only in Hebrew. [26] The Budget Proposal document presents the consolidated fiscal position of the general government.

The *National Budget,* an annual joint publication of the BoI and MoF, includes forecasts for the next two years after the budget year. The *National Budget* for 2003 was not published because of disputes between the BOI and the MoF. This was also the case with the *National Budget* for 2004, that is, it was not a co-production of the central bank and the MoF. As in 2002, each will produce separate reports. This was not seen as a concern either by Bank or the MoF officials.[27]

## Budget execution and monitoring

The Internal Audit Unit audits all ministry units with the assistance of internal departmental audit units. It also monitors the correction of irregularities found in the internal audits and in audits by the State Comptroller. The unit presents its reports to the Director-General of the MoF and the directors of the audited units.

**Accounting basis**

Israel's central government transactions are recorded on a cash basis, except for foreign grants data, which are partly recorded on an accrual basis.

The government is taking steps that will allow for the introduction of accrual-based accounting. The MoF in November 2003 began 'beta testing' an Economics Resources Planning (ERP) software platform which will allow partial accrual accounting. This will be government-wide by 2007.

A significant change in accounting practices in 2002 was the decision to introduce the definition of 'government deficit'. However, the process is expected to take about ten years, until indexed-linked debt is finally retired.

It had been hoped that all private sector accounting would be done in nominal terms by the beginning of 2004. However, this does not look likely.[28]

'Creative accounting' is still a problem. For example, the government has spread the cost of scoring a US government-backed foreign-currency bond over its maturity, but the expense was regisered immediately. The government has also tried to disguise investment. For example, in the 2004 budget, approximately half of the funds allocated to the newly part-privatised railways authority are accounted for as 'share purchases' and categorised as 'negative privatisation'. This avoids labelling the funds as investment. The same thing will likely happen with roads under the planned newly part-privatised public works department. The amounts involved are not trivial; 2 billion shekels will be allocated to the railway authority under this arrangement. While it will show up in the National Income and Product Accounts as government expenditure, it is not recorded as 'financing' in the national budget -- yet it is clearly financing.[29]

**Procurement and employment**

The Government Advertising Agency operates government tenders which are advertised on the 'Israeli Government Tenders' website in Hebrew only.[30] The MoF website posts a list of tenders in English.

The Civil Service Commission is responsible for government employment. The commission operates open tenders for jobs in the civil service. However, 'Ministers' Personal Advisors' such as directors-general, spokespeople and political assistants are still not subject to objective criteria and are mostly appointed on political grounds.

Of particular concern in 2002 were the attempts by politicians to undermine regulations that limit the appointment of members of party central committees to the boards of directors of government corporations. Under these regulations, which are supervised by a special, independent committee, members of party central committees must prove that they are more qualified that any other candidate before being appointed as a government company director. Criteria for civil service positions in 2003 continued to be circumvented. For example, scandals erupted in which appointees were found to have essentially purchased college degrees.

## Fiscal reporting

The Basic Law on the State Economy and the Budget Foundations Law stipulate the criteria for fiscal reporting. These cover such processes as budget preparation and the budget proposal.

The DAG prepares regular and periodical financial statements of the government accounts and reports to the Knesset and State Comptroller on all budgetary operations. The Accountant-General reports on the mid-year budget execution to the Knesset.[31]

The Knesset Finance Committee is mandated to examine the budget prior to its passage into law. However, the committee has largely failed in its task as overseer of MoF activities. It lacks an independent body of experienced investigative experts. It has tended to accept MoF forecasts based on previous budgets, rather than conducting independent assessments of past performance. Moreover, the committee members have demonstrated consistently that their primary concern is continued or expanded funding for their sectoral interests, even at the cost of more important macroeconomic concerns. Nonetheless, in their search for monies to spend, they occasionally stumble upon areas of MoF opacity.

The backroom dealings of the Finance Committee also create another layer of opacity. When spending is examined by subject, rather than by institutional structure, the results can lead to considerable confusion. For example, spending on ultra-Orthodox religious institutions is funnelled through no less than four ministries and is distributed into dozens of budgetary subsections. There was a precedent-setting decision by the Supreme Court in 2002 that has alleviated some of the opacity. The Court decided that henceforth there could be no more "double-budgeting." In other words, the same institution can no longer receive financial assistance from two different ministries for the same purpose. This rule is being observed.

In theory, the CBS operates a computer programme and facilities to analyse spending by subject. However, these tools have rarely been used. It was used when a yearly audit of subsidies and payments to settlers was required under the terms of US loan guarantees in the 1990s, and has been used to analyse other subject areas, such as health care and education. It has not been used for other important but politically sensitive issues, and some members of the Knesset may not be aware that the CBS even has this capability.

The most recent IMF ROSC notes that 'the overall fiscal balance that is reported does not conform to the balance in most other countries because the interest costs exclude the inflation component of such payments (the authorities are gradually moving towards the methodology that is standard in other countries, so the discrepancy will decline over time). There is no within-year monthly report of expenditure broken down by composition.'[32]

## 4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY

●●●● Compliance in progress

### Data quality standards

The Central Bureau of Statistics (CBS) collates and publishes all statistical information in Israel. The bureau meets the IMF's SDDS for data quality.

### Independent scrutiny of fiscal information

**Independent Audit**

The State Comptroller's Office performs external audits on central and general government activities. The office has unfettered access to all information when carrying out its functions. It releases two reports per year, one that examines defence and security issues and the other on government operations. The State Comptroller's Office also acts as the state's ombudsman.

**National Statistics Agency**

The CBS follows UN and other codes for national statistics bodies and, in accordance with the Statistical Ordinance, "act[s] on the basis of scientific consideration." Thus, the CBS is viewed as an independent institution.[33] The CBS's library is open for public use.

## INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following officials during a visit to Israel between 27 and 29 October 2003:

### Ministry of Finance

**27 October 2003**

| | |
|---|---|
| Israel Kaplan | Senior Director, International Department |

### Bank of Israel

**28 October 2003**

| | |
|---|---|
| David Elkayam | Chief Economist, Monetary Department |
| Sigal Ribon | Research Department |
| Adi Brender | Senior Economist, Head of Public Sector Analysis, Research Department |
| Avner Halevi | Head of International Affairs Department |

**29 October 2003**

| | |
|---|---|
| Moshe Bar-Natan | Head of Internet Information Unit |

### Central Bureau of Statistics

**28 October 2003**

| | |
|---|---|
| Soli Peleg | Senior Director, Macro Economics Department |
| Aharon Blekh | Deputy Senior Director |

## NOTES

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[20] Interviews in Jerusalem, 27-29 October 2003.
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[22] Interviews with MoF officials, 29 October 2001.
[23] Interviews in Jerusalem, 27-29 October 2003.
[24] Interviews in Jerusalem, 11-13 November 2002.
[25]Interviews with MoF officials, 29 October 2001.
[26]Interviews with MoF officials, 29 October 2001.
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[28] Interviews in Jerusalem, 27-29 October 2003.
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[30] See http://michrazim.lapam.gov.il
[31] Interviews in Jerusalem, 11-13 November 2002.
[32] IMF Report on the Observance of Standards and Codes, (ROSC) March 2003.
[33] Interviews with MoF officials, 29 October 2001.

# OXFORD ANALYTICA

## JORDAN

## FISCAL TRANSPARENCY

**Country Report 2003**

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# JORDAN

## COMPLIANCE RATINGS

| *Monetary transparency* | *2003* | *2002* | *2001* |
|---|---|---|---|
| Clarity of roles | ●● | ●● | ●● |
| Open decision process | ●● | ●● | ●● |
| Availability of information | ●● | ●● | ●●● |
| Accountability | ●● | ●● | ●●● |
| **Score** | 2.00 | 2.00 | 2.50 |

## OUTLOOK & COMMENTARY

The Financial Management Reform (FMR) programme currently underway is likely to improve macroeconomic forecasting, revenue forecasting, and expenditure forecasting, and will lead to a medium-term fiscal framework. The task forces in charge of implementing the programme were involved in the preparation of the 2004 budget.

There are a number of upcoming improvements to watch for. Tax administration has been strengthened in 2003 and now the income tax and general sales tax departments are to be unified with assistance from the IMF. The process should take around two years in total, and the first results can be expected by the end of 2004. The general sales and income tax bases are to be broadened. The government is committed to meeting SDDS within two to three years. In the meantime, it is expected that Jordan will meet GDDS in terms of the quality and comprehensiveness of data in early 2004. The government, Social Security Corporation (SSC) and Municipalities budgets will be unified in early 2004. The Ministry of Finance's monthly *Government Finance Bulletin* is to be expanded and to provide more comprehensive information.

Jordan would benefit from advances in a number of areas, including: setting higher standards for fiscal data; quantifying major fiscal risks in the annual budget documentation; and providing a detailed assessment of fiscal sustainability.

# EXECUTIVE SUMMARY

## 2.00 Intent declared

Jordan continues to make progress towards the standards set out in the IMF Code of Good Practices in Fiscal Transparency. Steps are being taken to clarify roles and responsibilities in the government sector and to improve the separation of fiscal and monetary activities. However, public scrutiny of the budget remains inadequate. To some degree, previous improvements in the clarity of roles and responsibilities of the government and public sector were offset by the suspension of parliament in 2001. However, after several delays during 2002, new parliamentary elections took place in June 2003.

With support from the IMF, World Bank and GTZ (German Technical Cooperation) Jordan has taken steps to strengthen fiscal policy and management. The major effort is the Financial Management Reform in Jordan (FMR). Under this programme four task forces have been formed covering macroeconomic forecasting, revenue forecasting, expenditure forecasting and a medium-term fiscal framework. The task forces were activated in 2003 and have been involved in the preparation of the 2004 budget.

Jordan continues to produce and disseminate data and information in accordance with the IMF's General Data Dissemination System (GDDS) and is aiming to meet the requirements of the Special Data Dissemination Standard (SDDS) within the next two to three years. A new Statistics Law came into force on 16 February 2003 as a temporary law. It will need to be debated by the new parliament when it begins its first regular session in December 2003, but many changes are not expected.

The Ministry of Finance broadly communicates its fiscal policy objectives. However, its communication of macroeconomic frameworks on which budgets are based, and of how fiscal risks and sustainability are treated, is limited.

The Ministry of Finance is seeking to introduce results-based budgeting and monitoring. At the same time, improvements at the Jordan Audit Bureau and the Department of Statistics are providing increased assurances of the integrity of fiscal information. The Ministry of Trade and Industry has launched a bi-lingual monthly bulletin that contains data not published elsewhere on a regular basis.

As part of the structural reform process, a privatisation programme is underway, and procedures have been relatively transparent so far. Tax administration has been strengthened in 2003.

Jordan's overall score is unchanged from last year.

## 1. Clarity of Roles, Responsibilities and Objectives

●● Intent declared

**The government sector should be distinguished from the rest of the public sector and from the rest of the economy, and policy and management roles within the public sector should be clear and publicly disclosed.**

**Structure, functions, and responsibilities of government**

The structure of government in Jordan is clearly set out in the 1952 Constitution. The broad functions of ministries and related government agencies are determined by the King and the cabinet and are specified in law.[1] The government is trying to increase adherence to the laws that cover the institutions of the state, and it is now more committed to reform than in the past when it preferred to suggest change rather than implement it. There is now more stability in state financial institutions such as the Ministry of Finance (MoF), the Central Bank of Jordan (CBJ), the Jordanian Securities Commission (JSC) and the stock exchange. The government is also pushing ahead with a number of civil service reforms and has considerably reduced levels of red tape. Over the past year the focus has been mainly on civil and military pension reforms. Changes however are incremental.

Significant areas of weakness remain. The government has still done little to tackle corruption seriously, and the Constitution does not provide effective means for ensuring accountability and liability to prosecution. There is no ombudsman to whom citizens can report flawed administration, although an initiative by the Department of Administrative Development aims to establish public complaint offices within all ministries and government agencies.

To some degree, improvements in the clarity of roles and responsibilities of the government and public sector were offset by the suspension of parliament in 2001. After several delays during 2002, new parliamentary elections took place in June 2003. The absence of a sitting parliament before June allowed the preparation and passing of new laws to be sped up. This was beneficial to the extent that it enhanced a process that is otherwise slow. However, the lack of scrutiny of draft laws meant that some of these have been poorly adapted to Jordan's circumstances, without sufficient consideration for local economic and business conditions; for example, commentators stated that the competition law passed in 2002 goes too far in curbing private sector monopolies, and will in fact hamper mergers. In addition, the lack of public scrutiny of fiscal reports has been also detrimental for transparency.[2]

**Coordination and management of budgetary activities**

The MoF and the Central Bank of Jordan (CBJ) have been working to improve the separation of fiscal and monetary responsibilities and activities. In 2002, they began to receive technical assistance from the US Treasury for this purpose. The MoF is responsible for coordinating and managing budgetary and extrabudgetary activities, and the CBJ acts as banker and fiscal agent to the state. The Constitution specifies requirements for budget approval by the National Assembly but does not specify responsibilities for preparation of the budget.[3]

**Relations between government and public sector agencies**

Distinctions between the government sector and the rest of the public sector and economy are not always clear, because of a lack of detailed specification of management and policy roles. However, the Ministry of Administrative

Development is carrying out a project of 'work simplification' and job classification for ministries that may improve clarity in these areas.[4]

As part of the structural reform process underway in Jordan, a privatisation programme is underway. The long-awaited Jordan Telecom IPO was launched with moderate success in 2002. The government plans to sell stakes in the Arab Potash Company and the Jordan Phosphate Mines Company, and will continue to seek a strategic investor for Royal Jordanian Airlines. A new electricity law has been passed that paves the way for the privatisation of the sector through a new regulatory and tariff regime.[5] Commentators stated that the privatisation process here has been transparent and without any real problems.[6]

## There should be a clear legal and administrative framework for fiscal management

**Legal framework for budgetary activities**

The legal and administrative framework for fiscal management is set up by the annual Budget Law and a number of relevant regulations from the Ministry of Finance. The Budget Law covers all commitments or expenditures of public funds. Financial By-Law No. 3 of 1994 specifies a classification framework for all financial affairs, such as revenues, expenditures, documentation and records. This by-law also covers the procedures for implementing the framework and the associated financial and accounting basis.[7]

**Legal framework for taxation**

The Ministry of Finance is aiming to unify the tax system in order to improve tax collection and efficiency. As of 2002, three separate tax points were operating: customs, general sales tax (i.e. value-added tax) and income tax. The income tax and general sales tax departments are to be unified with assistance from the IMF. The process should take around two years in total, and the first results can be expected by the end of 2004.[8] The general sales and income tax bases are to be broadened. Tax administration has been strengthened in 2003, with the Income Tax Department developing enforcement and collection plans for tax arrears.

**Ethical standards for public servants**

The Jordanian Civil Service Bureau (CSB) states that it is committed to equal opportunity employment. Further, the Constitution asserts that appointments to government positions must be made on the basis of merit and qualifications.[9] In June 2002, a new civil service by-law was issued setting out a code of conduct and requirements for transparency in employment practices. Various ministries and departments are seeking a number of law revisions to gain greater independence from the CSB in pay and recruitment practices.[10]

## 2. PUBLIC AVAILABILITY OF INFORMATION

●● Intent declared

**The public should be provided with full information on the past, current and projected fiscal activity of government.**

Jordan is a participant in the IMF's General Data Dissemination System (GDDS), and is seeking to meet the requirements of the Special Data Dissemination Standard (SDDS).[11] It is expected that Jordan will meet GDDS in terms of the quality and comprehensiveness of date in early 2004. In general terms, the government is committed to meeting the SDDS within two to three years.

The MoF publishes a monthly *Government Finance Bulletin,* which has some data going back to 1992 and some to 1998. The earlier data not available in the *Bulletin* can be found in other publications such as the CBJ *Monthly Bulletin*. External debt data currently only goes back to 1998, but it is to be extended back to 1992. There is a project to make the bulletin more comprehensive and in accordance with IMF requirements.

Following the renewal of a stand-by arrangement with the IMF in July 2002, the government and the MoF remain keen to improve fiscal management and transparency. The country's long relationship with the IMF has also had the benefit of increasing transparency on reform programmes, with letters of intent from the MoF and the CBJ to the IMF now being published in the *Government Finance Bulletin* and on the Ministry's website.[12] The IMF programmes are coming to an end so the government is becoming a little more relaxed about publishing data.[13] Considerable information has been published about the current focuses of reform, tax and pensions.

There has been little improvement in terms of electronic sources of information. Government websites are still often a barrier to information.[14]

**Central government operations**

The MoF's annual final accounts include fiscal outturns for the two preceding years and forecasts of the main budget aggregates for the reference year. The annual Budget Speech (or 'Budget Letter') is published in the *Government Finance Bulletin* when it is first presented, and is subsequently available in Arabic on the Ministry of Finance website.[15] However, full budget data for years since 1997 is not available. Alternatively, the Department of Statistics publishes a series of national accounts estimates at base prices. [16]

The accuracy and availability of data on the economy and the fiscal activity of the government have improved during the past two years. The Department of Statistics now publishes quarterly national accounts data with a lag of not more than 70 days. The Ministry of Finance and all government agencies and departments use this data. The main regular publication of the MoF remains its *Government Finance Bulletin*. In addition, the MoF and the CBJ now regularly publish the summaries of Jordan's Article IV Consultations with the IMF, as well as letters of intent. In October 2002, the MoF allowed the publication of the IMF's first Report on the Observance of Standards and Codes (ROSC) in Jordan.[17]

**Public sector operations**

The Ministry publishes annual final accounts covering all the central government units that are included in the central budget. It also publishes disaggregated revenue and expenditure data for the 26 autonomous government agencies, such as the Social Security Corporation (SSC) and the national public transportation and water authorities.[18] Information on debt levels is set out in the *Government Finance Bulletin*. The full *Bulletin* is available from the Ministry's website after a lag of between one and two months.[19] Debt data from the *Bulletin* is used by the CBJ for its *Monthly Statistical Bulletin*. The government, SSC and Municipalities budgets will be unified in early 2004.

By law the Ministry of Finance cannot borrow from the CBJ beyond a fixed overdraft limit, nor can it borrow directly from the SSC or the banking system. Since 1999, it has used T-Bills and T-Bonds to finance the budget deficit. The Ministry's overall debt owed to the CBJ has therefore fallen. In 1998, the Ministry owed JD615 million Jordanian dinars (JD) in ordinary and extraordinary zero-interest advances from the CBJ. By late 2002, it had reduced this to JD 271 million, and it aims to reduce the debt to zero by the end of 2004. At the same time, the Ministry has been replacing high-interest loans from the SSC with lower-interest T-Bills and T-Bonds. It has also arranged debt swaps with European countries and interest reductions on debts to Japan.[20]

## A commitment should be made to the timely publication of fiscal information.

**Debt reporting**

Information on debt servicing is disclosed in the *Government Finance Bulletin*, which contains a separate table showing the debt level of public entities. It is expected that data on debt will be separated into government and government guaranteed by first quarter 2004.

There is some concern among commentators over the quality of information from the MoF on the budget deficit. For example, the monthly bulletin for August reports that the JD 225 million deficit for the first eight months of 2002 was turned around to just JD 23.4 million for the same period of 2003 without any explanation that it is the result of foreign grants. If the JD 46 million in interest payment is excluded, the budget is actually in surplus but again there is no explanation of how that has been achieved. Without the help of external aid the deficit would have been at 8-9%.[21]

**Advance release calendars**

No advance release calendar exists for fiscal information. However, in 2002/2003 the Department of Statistics was internally testing an advance release calendar, expected to be launched on the department's website in January 2004.[22] If released, the calendar will help clarify the regular release dates for specific fiscal data. Monthly fiscal data are published in the *Government Finance Bulletin* between five and six weeks after the end of the reference period; and annual data roughly three months after the end of the financial year. The annual final accounts are published around six to nine months after the end of the reference year.[23]

There is no pre-release of information to other government agencies and data are released simultaneously to all users.

## 3. Open Budget Preparation, Execution, and Reporting

●● Intent declared

### Fiscal policy objectives, macroeconomic framework, and risks

**Fiscal policy objectives**

The government remains broadly committed to economic liberalisation and is focusing economic policy on stimulating growth to prevent increases in unemployment and poverty. The government is trying to persuade Jordanians that its liberal economic policies are succeeding. The government is committed to keeping its reform and structural adjustments on track, such as streamlining the bureaucracy, and pension reform. Privatisation is progressing, but slowly.[24]

With support from the IMF, World Bank and GTZ (German Technical Cooperation) Jordan has taken many steps to strengthen fiscal policy and management. The major effort is the Financial Management Reform in Jordan (FMR). Under this programme four task forces have been formed covering macroeconomic forecasting, revenue forecasting, expenditure forecasting and a medium-term fiscal framework. The task forces were activated in 2003 and have been involved in the preparation of the 2004 budget. They work under a steering committee that includes the Secretary General of the Ministry of Finance, the Secretary General of the Ministry of Planning and the General Director of the Budget Department, who have in turn set up a technical committee. Among the recommendations they make, the task forces look at forecasting, and at how to manage the deficit -- i.e. reduce spending and/or increase revenues -- at least twice a year, mid-year and in October before the budget is finalised and presented. The task forces existed in 2002 but the Minister of Finance pushed for the task forces to activate the programme more efficiently this year.

**Macroeconomic framework**

The budget provides for a macroeconomic framework. The macroeconomic framework is based on a medium-term fiscal strategy which aims, *inter alia*, to further reduce public debt and unfunded future pension liabilities, broaden the general sales and income tax bases, and the privatisation of virtually all of the remaining state-owned commercial enterprises.

After reaching the end of its existing IMF-supported economic adjustment programme in May 2002, the Ministry of Finance embarked on a new two-year programme or stand-by arrangement. Adherence to this programme and the continued support of the IMF has been important for Jordan in securing debt rescheduling and relief. In late 2002, Jordan agreed a new debt rescheduling with the Paris Club of creditor countries.

**Fiscal risks**

Major fiscal risks are not quantified in the annual budget documentation, though since 2001 the annual Budget Law has prohibited off-budget expenditure or advances. Under current practices at the Ministry of Finance, the risk on off-budget expenditure or advances appears to be small. The Ministry of Finance has received German technical assistance to set up a tax-revenue econometric forecasting model able to treat variations in assumptions.

**Fiscal sustainability**

The Ministry of Finance does not publish a detailed assessment of fiscal sustainability. The government has prepared a comprehensive pension reform strategy, which should begin to work with support from the IMF and World Bank. Amendments to the pension law were enacted in March 2003. Continued implementation of the general sales tax, and at the same time negotiation of debt forgiveness arrangements and more efficient debt management, are also expected to help the MoF meet its tight fiscal targets.[25]

The task forces formed as part of the Financial Management Reform in Jordan (FMR) are important in preparing the budget and will be very important in managing the deficit. The task forces look at forecasting, and at how to manage the deficit -- i.e. reduce spending/increase revenues -- at least twice a year, mid-year and in October before the budget is finalised and presented.

## Budget presentation

The annual Budget Speech presents summaries of key economic indicators for the current and reference years, and statements of the budget's focus and indicators. The commentary in the speech sets the overall objectives of the budget. The budget for the reference year is set out in the appendix.[26] In the absence of parliament, public scrutiny has been limited to the senate. Parliamentary or senate approval is not required for all expenditure categories in the budget (e.g. the budget of the King's court and the armed forces).

## Budget execution and monitoring

The Ministry of Finance has a Fiscal Monitoring Unit and uses a reclassified system for government accounts that was implemented in 2000 at the Ministry and the CBJ. The Ministry of Finance and the Ministry of Planning have both experimented with performance budgeting. However, they have now dropped this in favour of results-based budgeting. This is being piloted in the ministries of health, education, industry and trade, and in the customs and tax departments.[27]

**Accounting basis**

Annual and monthly budget accounts are compiled on a cash basis, except for the interest on loans that is compiled on an accrual basis. Some items are now done on an accrual basis including interest payments and some other minor items.

There is no public disclosure of the system used for assessing payment arrears.

**Procurement and employment**

The General Supplies Department of the Ministry of Finance is responsible for almost all government purchases. The national Procurement Law does not allow non-competitive bidding but does permit government agencies to use a selective tendering process. Two criticisms made of procurement practices are that major public procurements are not widely advertised to the private sector, and that no provisions exist for blacklisting companies known to have bribed in a procurement process, or to prevent nepotism and conflicts of interest.

The MoF has indicated that it is seeking to make purchasing subject to performance criteria, reviews and the criterion of non-accumulation of external payment arrears (excluding arrears to official bilateral creditors, which are the subject of debt-forgiveness negotiations).[28]

## Fiscal reporting

Budget data is published in the *Government Finance Bulletin*, with revenues and expenditure stated by summary economic classification.[29] Results achieved relative to the objectives of major budget programmes, and as part of the structural adjustment programmes, are reported in the commentary of the *Bulletin*.

The head of the Jordan Audit Bureau (JAB) is required to present to parliament an annual report on the closing account of the fiscal year (the same as the calendar year).[30] There is no stipulation for mid-year reporting to the legislature on budget developments. Following an amendment in 2002 to the Audit Bureau Law, the Ministry of Finance must provide the JAB with its annual report within six months of the end of the fiscal year. The JAB must present its report to parliament within five months of that date, in time for the beginning of the new parliamentary session.

## 4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY

●● Intent declared

### Data quality standards

The Ministry of Finance and the Jordan Audit Bureau (JAB) determine the standards for fiscal data. Data on external and internal debts can be crosschecked with creditors' published details. However, there is no specific assurance of the quality of overall fiscal data beyond the general indications given by Jordan's participation in the GDDS. In 2001-2002, a data module mission from the IMF's Reports on the Observance of Standards and Codes gave a generally positive assessment, but identified shortcomings in statistical practices and databases (in particular for balance of payments data).[31]

### Independent scrutiny of fiscal information

Fiscal information is subject to inspection by the JAB, which maintains audit units in the Ministry of Finance and other ministries and government agencies.[32] The JAB submits to parliament (or the cabinet) annual and mid-term reports on the budget, disclosing any financial violations committed by public sector entities under its inspection and recommending subsequent actions. The JAB has no executive power over fiscal targets but can require ministries to make changes to comply with law. The constitution provides immunity to the JAB's head officer.[33]

Auditing is provided by the JAB, which cooperates with the International Organisation of Supreme Audit Institutions (INTOSAI) and the Asian Organisation of Supreme Audit Institutions (ASOSAI). In February 2002, the Audit Law was amended to reflect a move to performance-based *ex ante* auditing, rather than *ex post* auditing.[34] The Law was passed by decree during the suspension of parliament and will be debated by the new parliament during the normal session starting in December. It is expected that the legislation will be adopted without amendments. The Audit Bureau has a new president, who plans to introduce international private sector auditing and accounting standards to the office and to undertake a fundamental reorganisation.

Following recommendations from the World Bank, the Bureau of Administrative Control and Inspection has been absorbed into the Audit Bureau. Commentators explained this as necessary because financial decisions are influenced by administrative decisions and it makes sense to have the two elements together.[35] The Bureau of Administrative Control and Inspection acted in some ways as an ombudsman and the Audit Bureau is planning to incorporate this aspect of its work, but there could only be a separate office for the ombudsman as a result of a Royal Decree.

The JAB is preparing a major new programme in order to adopt a strategy of using private sector type controls in their work. It wants international standards of accounting and auditing adapted to its working environment as a government body. Local and international consultants will be needed for the re-organisation, which will cover both administration and operations. In 2004 there are plans to use existing international procedures to measure the effectiveness of spending, not just the administration of spending.

On the issue of independence, although the legislation makes the JAB responsible to parliament and ensures its independence from government, the Bureau characterises itself as being in a position between government and

parliament. Commentators suggested that the JAB could counterbalance political pressure by upgrading the quality of its work and establishing independence through good practice.[36]

The Ministry of Finance determines its own data compilation methodology and dissemination practices. These are largely based on the IMF's *Manual on Government Finance Statistics*. Monthly and annual data are compiled on a cash basis, except for the interest on loans, which is compiled on an accrual basis.[37] Some items are now done on an accrual basis including interest payments and some other minor items.

**National Statistics Agency**

National capacity in statistics appears to have improved. The Department of Statistics has been making internal changes and working with selected ministries to improve its data (e.g.the Ministry of Planning for foreign direct investment data). The department is only semi-independent, as its director-general answers to the Ministry of Planning.

A new Statistics Law came into force on 16 February 2003 as a temporary law. It will need to be debated by the new parliament when it begins its first regular session in December 2003, but there are not expected to be many changes. The Law is more flexible than previous law in allowing the Department of Statistics to provide its own data. However, it does not provide as much independence as the Department had hoped for in areas of salaries, incentives and recruitment.[38]

The Department of Statistics has been subject to external assessments by Eurostat (the European Commission's statistics office) and the US Census Bureau.

## INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to Amman, Jordan between 13 and 22 October 2003:

### Ministry of Finance

**15 October 2003**

| | |
|---|---|
| Ismael Zaghloul | Head of Research & Studies Directorate |
| Issa Saleh | Head of Statistics Division |

### Central Bank of Jordan

**13 October 2003**

| | |
|---|---|
| Hasan Abu Rashed | Head of Research |
| Walid Zinati | Head of Balance of Payments Division |
| Hassan Barakat | Head of Monetary Division |
| Shibli Abdelhakim | Senior Economist |
| Nedal Azzam | Economist, Monetary Division |

## ADDITIONAL INTERVIEWS

**14 October, 2003**

| | | |
|---|---|---|
| Salem Al-Khazaleh | President of Audit Bureau | Jordan Audit Bureau |
| Mamdoh M. Oran | Director of Economy & Finance Department | Jordan Audit Bureau |
| Mr Abbadi | Director of Studies Directorate | Jordan Audit Bureau |

**21 October 2003**

| | | |
|---|---|---|
| Dr Hussein Shakhatreh | Director General | Ministry of Statistics |

**22 October 2003**

| | | |
|---|---|---|
| Dr Mohammed Nabulsi | Chairman and CEO (Former CBJ Governor) | Jordaninvest |
| Basam Sakhija | Representative | Transparency International |

## NOTES

[1] http://www.kinghussein.gov.jo/constitution_jo.html
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[3] 'Financial Matters', Articles 112-16, Chapter 7, the Constitution.
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[6] Interviews in Amman, 13-22 October, 2003.
[7] Interviews in Amman, 2-6 October 2002.
[8] Interviews in Amman, 13-22 October, 2003.
[9] See www.nic.gov.jo/csb/cover.html , and Article 22 of the Constitution.
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[11] Interviews in Amman, 2-6 October 2002.
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[15] Budget speeches for the reference and preceding two years are available at www.mof.gov.jo/khitabm_ar.asp
[16] 'National accounts', Department of Statistics, www.dos.gov.jo/na/toc_na_e.htm
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[19] For the latest *Government Finance Bulletin,* see www.mof.gov.jo/english/current-bulletin.asp
[20] Interviews in Amman, 2-6 October 2002.
[21] Interviews in Amman, 13-22 October, 2003.
[22] Interviews in Amman, 13-22 October, 2003.
[23] 'Jordan: Data Categories and Indicators', http://dsbb.imf.org/gddsweb/country/jor/jorfisdcgagg0.htm
[24] Oxford Analytica Daily Brief, 'Jordan: war could undermine economic progress', 28 February 2003.
[25] 'Memorandum on Economic and Financial Policies, 2002', www.mof.gov.jo/english/pdfs/memor_2002.pdf
[26] See Appendix of Tables for 2002 Budget Speech, www.mof.gov.jo/khitabm_ar.asp (only available in Arabic at time of writing).
[27] Interviews in Amman, 2-6 October 2002.
[28] Paragraph 29, 'Memorandum on Economic and Financial Policies, 2002', www.mof.gov.jo/english/pdfs/memor_2002.pdf
[29] For the economic classification of government expenditures, see www.mof.gov.jo/chart1_may.htm and www.mof.gov.jo/chart1_may.htm
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[31] 'IMF concludes 2002 Article IV consultation with Jordan', Public Information Notice (PIN), www.imf.org/external/np/sec/pn/2002/pn0251.htm
[32] Audit Bureau Law No. 28 of 1952 (amended 2002), and Article 31 of the Constitution; Interviews in Amman, 2-6 October 2002.
[33] See Article 119, Chapter 7, the Constitution.
[34] Interviews in Amman, 2-6 October 2002.
[35] Interviews in Amman, 13-22 October, 2003.
[36] Interviews in Amman, 13-22 October, 2003.
[37] Fax from the Ministry of Finance, 2 September 2002; and see *A Manual on Government Financial Statistics* (IMF, 1986); 'Jordan: Data Categories and Indicators', http://dsbb.imf.org/gddsweb/country/jor/jorfisdcgagg0.htm
[38] Interviews in Amman, 13-22 October 2003.

# OXFORD ANALYTICA

## MALAYSIA

## FISCAL TRANSPARENCY

**Country Report 2003**

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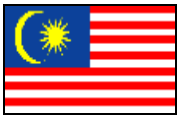
# MALAYSIA



## COMPLIANCE RATINGS

| *Fiscal transparency* | *2003* | *2002* | *2001* |
|---|---|---|---|
| Clarity of roles | •• | •• | •• |
| Availability of information | •••• | •• | ••• |
| Budget preparation | ••• | ••• | ••• |
| Accountability | •••• | •••• | ••• |
| **Score** | **3.25** | **2.75** | **2.75** |

## OUTLOOK & COMMENTARY

Malaysia has kept an adequate provision and timely publication of fiscal data, in compliance with its commitment to the IMF's Special Data Dissemination Standard (SDDS). In addition, important steps have been taken to provide additional information on central government operations.

Fiscal transparency should be substantially enhanced in the future if Prime Minister Abdullah Badawi stands by his commitment of strengthening Malaysia's governance by creating an institutional environment where laws are transparently enforced. These steps would simultaneously help to restore public confidence in the performance of the Anti-Corruption Agency and the Auditor General.

The main potential weakness remains the government's inability to delineate clearly its functions and responsibilities within the highly centralised environment under which fiscal policy has been hitherto implemented.

# EXECUTIVE SUMMARY

## 3.25 Enacted

Malaysia subscribes to the IMF's Special Data Dissemination Standard (SDDS) and observes all SDDS fiscal standards. Information on taxes, procurement, and ethical standards for civil servants is clear and publicly stated. Comprehensive publications provide basic fiscal data, including information on the finances of state governments, the consolidated general government financial position, and comparative data from the previous and present years, along with projections for the following year.

However, important concerns remain in the way reporting and disclosure are carried out in practice. There is insufficient clarity about the relations between key government institutions. In addition, steps to reinforce the independence of the Anti-Corruption Agency and the Auditor General are needed to allay public concern over these institutions' inadequacy.

Malaysia could significantly improve fiscal policy transparency through adding more explicit and detailed assessments of fiscal sustainability and fiscal risks to the budget, and the disclosure of macroeconomic models and assumptions used in government forecasts. The government is determined to tackle corruption in the administration of licences/permits and government procurement, but the necessary institutional framework is not yet fully operational.

Malaysia's overall score has improved from 2.75 in 2002 to 3.25.

## 1. Clarity of Roles, Responsibilities, and Objectives

●● Intent declared

**The government sector should be distinguished from the rest of the public sector and from the rest of the economy, and policy and management roles within the public sector should be clear and publicly disclosed.**

**Structure, functions, and responsibilities of government**

Malaysia is a federal state with a king acting as the constitutional head of state and a prime minister and cabinet exercising executive power. The Malaysian constitution sets out the distribution of legislative and executive powers between the federation and the states, as well as the organisation of the judiciary and the responsibilities of the Supreme Court.[1] Section V of the constitution outlines the division of power and relations between the federal government and the states.

In practice, Malaysia's federal political system has become highly centralised, to the extent that the theoretically clear definitions of responsibilities between the executive and judiciary branches and the legislature are now somewhat opaque. Malaysia has a parliamentary system that has not seen a change of government at the national level since independence in 1957. The United Malays National Organisation (UMNO) party (the dominant party in Barisan Nasional, the ruling coalition) controls the key economic positions in the cabinet. From 1981 to October 2003 (until his retirement), Dr Mahathir Mohamad dominated the government as prime minister, and UMNO as president. From June 2001 onwards, he also served as the country's minister of finance and treasurer of UMNO.

Dr Mahathir's strong leadership style and his multiple leadership positions contributed to a highly centralised system such that political considerations and development projects were often advanced at the expense of a clear division of powers among the three government branches.[2] In this context, commentators stated that Dr Mahathir's retirement might signal a move towards greater transparency in the distribution of government powers and responsibilities.[3] His successor, Abdullah Ahmad Badawi recently declared that the governance of Malaysia would be strengthened if laws were enforced transparently and without fear of favour.[4]

**Coordination and management of budgetary activities**

Clear mechanisms for the coordination and management of budgetary activities have been established, but management of extra-budgetary activities should be made more transparent.

The Ministry of Finance has overall responsibility for coordination and management of budgetary and extra-budgetary activities. The Treasury (under the Ministry of Finance) is responsible for the annual budget, which is divided into an operational budget and a development budget. In practice, the Treasury prepares an operational budget, dominated by salaries and operational expenses for government offices, while the Economic Planning Unit (in the Prime Minister's Department) devises a development budget, which is focused on capital-intensive projects for social and economic development.

The Treasury's overall fiscal objectives include the promotion of sustainable economic growth, the improvement of national economic resilience, and a more equitable sharing of national wealth. In addition, a Macroeconomic Inter-Agency Planning Group -- one of many inter-departmental committees -- meets regularly to coordinate fiscal policy

responses across agencies. The group consists of representatives from the Ministry of Finance, Bank Negara Malaysia (BNM, the central bank), the Economic Planning Unit, and the National Economic Action Council.[5]

**Relations between government and public sector agencies**

The Central Bank Act establishes the BNM as banker and financial adviser to the government, under the oversight of the minister of finance. In 1998, after a public dispute with the prime minister over monetary policy, the governor of the central bank and an assistant governor resigned. An official formerly in the Economic Planning Unit of the Prime Minister's Department then headed the bank temporarily and changed monetary policy to policies in line with those proposed by Dr Mahathir. Commentators have stressed that the independence of the BNM has been unclear since then, although bank officers assert that it has remained untouched.[6]

Relations between the government and other non-government public agencies, the public financial institutions and non-financial public enterprises, are not entirely clear. In its last Article IV consultation with Malaysia, the IMF encouraged the Malaysian government to better delineate the relationship between the central government and the rest of the public sector.[7]

Malaysia defines a 'general government sector' and a 'consolidated public sector'. The former comprises the federal government, state governments, local authorities, and statutory authorities. The latter is the 'general government sector' with the addition of non-financial public enterprises (NFPEs). Large NFPEs include the national oil monopoly *Petronas* (Petroliam Nasional Berhad: 100% state-owned and unlisted, although certain Petronas subsidiaries are listed), *Tenaga Nasional Berhad* (TNB: electricity, partially privatised and listed), *Telekom Malaysia Berhad* (TMB: telecommunications, partially privatised and listed), and *Putrajaya Holdings Sendirian Berhad* (developer of the new multi-billion ringgit federal administrative capital).

The Ministry of Finance's annual *Economic Report* includes revenues and expenditures from those NFPEs that are majority owned by government, without identifying the contribution from the individual enterprises or naming all the NFPEs. Only majority-owned NFPEs that have been sold in the previous year are named.[8] Annual financial reports of the NFPEs are similarly not forthcoming with the detail that would make the relations between government and the NFPEs transparent and allow the managers of the NFPEs to be held accountable for their performance.

Commentators said the Ministry of Finance has established fully owned corporations or special purpose vehicles listed under the Corporation Act, to avoid reporting their operations to parliament, thus evading legislative oversight.[9] Government officials argued that all fully state-owned corporations are subject to public scrutiny through parliament, but commentators said that the NFPEs and other enterprises in which the government has a significant interest report only to the Ministry of Finance.[10]

Some special purpose vehicles established by the government under the Companies Act are required by law to have audited financial reports lodged with the Registrar of Companies, but in practice such reports are extremely difficult to obtain.[11]

**Government involvement in the private sector**

Privatisation and corporate restructuring, as major elements of the development budget, are the primary responsibility of the Ministry of Finance's Privatisation and Public Enterprises Division -- also known as MoF (Inc). This is the government's holding company for share holdings in numerous publicly listed companies and special purpose vehicles. MoF (Inc) is the only state body allowed to own shares on behalf of the government, and it controls golden shares in certain privatised firms to ensure that these corporations serve national interests.

NFPEs and the style of privatisation have contributed to an unclear distinction between the public sector and the private sector. Identifying in budget documentation all equity holdings of government and its agencies could substantially increase transparency. The acquisition of new equities should be explained and the policy objectives served by such holdings made clear. New listing requirements set by the Kuala Lumpur Stock Exchange (KLSE) have made the disclosure of such government-controlled listed firms as TNB, TMB, and *Malayan Bank* more likely, but the government should act directly to ensure a high degree of transparency.

The government provides no timetable for state assets to be privatised, but does tie its privatisation policy to affirmative action goals. Privatisation occurs in two ways in Malaysia: state-originated through open tender, and private sector originated through private placement. Many of the largest asset divestments, including *Malaysia Airlines* and *Sports Toto*, have followed this second, less transparent method.

## There should be a clear legal and administrative framework for fiscal management

**Legal framework for budgetary activities**

The Treasury's budget preparation and examination process has now been converted into a (non-zero-based) two-year process, with annual budgets to be submitted to parliament every year as mandated by the constitution and the Financial Procedures Act (1957). The long gestation periods of development projects have been one of the main factors behind the shift to two-year budget planning.

**Legal framework for taxation**

Under Article 94 of the constitution, all taxes or rates must be levied under the authority of federal law. Tax laws and regulations are easily accessible and understandable. Direct tax laws include the Income Tax Act (1967), the Real Property Gains Tax Act (1976), the Stamp Act (1949), the Petroleum (Income Tax) Act (1967, as amended 1976), and the Labuan Offshore Business Activity Tax Act (1990). Indirect tax laws include the Customs Act (1967), the Sales Tax Act (1972), the Excise Act (1976), the Services Tax Act (1975) and the Entertainment Duty Act (1953). The Investors' Guide (part of the annual Economic Report produced by the Ministry of Finance) details tax incentives contained in those tax laws, for investments in selected sectors. Tax laws and tax incentives are also available on the website of the Treasury.[12]

The Inland Revenue Board (IRB) was formed in 1996 to administer the direct tax laws, replacing the former Department of Inland Revenue, with a view to greater autonomy and efficiency in tax administration. A Self Assessment System is in effect. Direct tax laws, regulations, rulings and guidelines are available on the IRB's website.[13] Tax decisions can be appealed to the courts and the Public Complaints Bureau of the Prime Minister's Department.

Petroleum is a major revenue source for the Malaysian government and its oil-producing states. Malaysian states have some limited tax powers over land and natural resources, but the majority of taxing power lies with the central government.

**Ethical standards for public servants**

Ethical standards of behaviour for public servants are provided in the *General Orders* of the civil service. Additional provisions are stipulated in the Prevention of Corruption Act (1961).

Commentators noted that government officers, when making administrative decisions to grant permits, licences, bank loans, building plots, and tax assessments, had significant discretion. Political patronage was also an important

consideration in such matters.[14] In response to the call made by Abdullah after he became prime minister (31 October) to slash bureaucratic red tape and tackle corruption in government, truck operators noted that 25% of commercial vehicle permits were owned by people not connected with the industry proper who rented out their permits.[15]

The public perceives the process for lodging complaints with the head of a government department, the Public Complaints Bureau, and the Anti Corruption Agency as ineffective, and the Anti Corruption Agency is not seen as independent. Commentators argued that it has been used to discipline politicians and other figures that had disagreed with the executive government.[16]

## 2. PUBLIC AVAILABILITY OF INFORMATION

●●●● Compliance in progress

**The public should be provided with full information on the past, current, and projected fiscal activity of government.**

**Central government operations**

The Treasury provides summary information on the fiscal activity of the government in its *Economic Report*, which is released together with the minister of finance's *Budget Speech.* The *Economic Report* and *Budget Speech* for the past five years are available (in English and Bahasa Melayu) on the Treasury's website.[17] The accountant general prepares an annual statement of accounts that is audited by the auditor general, tabled in the parliament, and published as the *Federal Public Accounts*.[18]

The *Economic Report* details the macroeconomic goals of the government in the short, medium, and long term; expected macroeconomic trends; fiscal objectives of the upcoming budget; the expected revenue and expenditures of the federal government; and the financing options of the government. Expenditure is broken down into operating expenditure and developmental expenditure. Revenue is also broken down into direct taxes, indirect taxes, and non-tax revenues with further details for each sub-section. The finance section of the *Economic Report* discloses the different types and amounts of government financing for the previous year, and those of external and domestic public debt. Summary information on the financial operations of state governments, the consolidated general government financial position, and the summarised financial position of NFPEs is also available. In all cases, comparative data from the previous and present years (along with projections for the following year) are provided.

The *Economic Report* notes the expected shrinkage in public investment as a share of total investment, but fails to provide any analysis of how this would affect future development and fiscal objectives. The ten-year *Outline Perspective Plan* (also known as the *National Vision Policy*) provides a longer-term context for annual budgets and longer time frames for historical data and future projections. However, neither of these documents explains how these forecasts were produced.

The *Budget Speech* provides good context for the fiscal objectives of the upcoming budget and some indication of planned future fiscal trends. The appendices list the proposals for change in the upcoming budget and the timetable for their implementation. Owing to the dominance of the ruling party coalition, Malaysia has no history of failed budgets or substantial budget changes. However, supplementary fiscal stimulus packages can take place when the macroeconomic assumptions of the budget fail to be met.[19]

The Treasury, in accordance with the constitution, publishes memoranda on the past year's actual government revenues and planned revenues for the following year, both in aggregate terms and broken down into numerous taxation-based and non-tax revenue streams. It also produces an annual *Federal Budget Book*, which is presented to parliament, and a supporting *Programme and Performance Budget Estimates Book* covering the programmes of all the line ministries and statutory bodies of the government, including a ten-year flow chart of operating expenditures.

The *Federal Public Accounts* report details the balance sheet of government, containing statements of assets, consolidated accounts, and memorandum accounts, with accompanying notes.

**Public sector operations**

The Treasury's *Economic Report* gives summary information on the government's consolidated public sector fiscal position (although the central bank provides more detailed information). The Treasury also reports on the current year's expected revenue figures for the public sector and revenue figures for the previous year. Data on the fiscal position of Malaysian state governments is only available in the public accounts.

The annual budget does not cover quasi-fiscal activities (QFAs) of state investment funds (including *Khazanah*), the *Employees Provident Fund*, and other public enterprises. QFAs are not open to substantial public scrutiny. The annual *Economic Report* from the Treasury reports the 'consolidated public sector' balance, but identifying and quantifying QFAs therefore depends critically on high-quality reporting from the public financial institutions and NFPEs.[20] Such reporting from the public financial institutions and the NFPEs is not readily available.[21]

## A commitment should be made to the timely publication of fiscal information.

**Debt reporting**

In accordance with its commitments to the IMF's Special Data Dissemination Standard (SDDS), the Malaysian government releases monthly data on central government debt broken down into domestic currency debt and foreign debt, debt guaranteed by the government, and maturities. Foreign debt is disaggregated by the issuing currency. Government officials said that the present data collection procedures are part of the budget preparations tabled in parliament in October. A flexibility option is therefore being taken on the timeliness of the non-financial public sector data. However, the Treasury is reviewing the procedures with the aim of ensuring that the statistics can be collected and released earlier, preferably within the timeliness of six months after the end of the fiscal year specified by the SDDS.[22]

Since the 1997-98 Asian financial crisis, the central bank has adopted the practice of releasing the coverage ratio between total external short-term debt and its gross international reserves. The BNM's *Annual Report* discloses the composition of central government debt and financial assets, while the Treasury's *Economic Report* provides summary information of public and total external debt. State governments are not permitted to hold debt, but there is a paucity of data on the financial status of their economic development corporations. Valuable information on government debt is provided by the Treasury on its website.[23]

**Advance release calendars**

The Ministry of Statistics disseminates advance release calendars on the fiscal sector at least one quarter in advance of their approximate release dates.[24] The IMF's SDDS website announces exact release dates at least one week in advance of the release.

## 3. Open Budget Preparation, Execution, and Reporting

●●● Enacted

### Fiscal policy objectives, macroeconomic framework, and risks

**Fiscal policy objectives**

Three major publications shape fiscal policy objectives. *Vision 2020* (published by the Prime Minister's Department) provides ambitious long-term goals for fiscal policy. As such, it sets 2020 as a deadline for Malaysia to become a developed country, based on an average GDP growth rate of more than 7%. Another major objective is the continued drive to reduce the wealth gap among Malaysia's racially defined communities.[25] The ten-year plans, for example the *Outline Perspective Plan: 2001-2010* and the five-year plans, for example the *Eighth Malaysia Plan 2001-2005*, produced by the Economic Planning Unit, provide more detailed guidance for annual budgets and projections for the future. The five-year Malaysia Plans are subject to mid-term review: the *Eighth Malaysia Plan* had its mid-term review on 30 October.[26]

The 2003 *Budget Speech* assesses the budgeted expenditure and sets out any new policies and macroeconomic changes, such as an increase in private investment to achieve future fiscal and development policy objectives. In addition, the Treasury holds public consultations with local actors who are invited to participate in the annual budget preparation, though this is not a legal requirement.

There is a regular system of consultations (Annual Budget Dialogue) in place. During May and June each year, the ministry holds three to four discussion sessions with industrial associations, economists, business leaders, and civil society groups.[27] Those invited may submit memoranda to the government expressing their views before the public consultation takes place. However, some commentators have repeatedly cautioned that these public consultations by invitation are not substantive and lack a clear measure of their impact, while other asserted that the consultations are extensive and meaningful.[28]

**Macroeconomic framework**

*Vision 2020* provides a broad macroeconomic framework for fiscal policy in Malaysia. The Ministry of Finance does not disclose the assumptions behind the macroeconomic framework.

**Fiscal risks**

The budget documents generally do not identify or quantify major fiscal risks or the potential for more supplementary stimulus packages.[29] In addition, there is no explicit identification or quantification of risks when projected revenue is not realised as expected, and of the risks of how can exchange rate or interest rate fluctuations affect the debt service payments. There is inadequate disclosure about the nature and magnitude of contingent liabilities related to revenue guarantees for large projects.

**Fiscal sustainability**

The government remains committed to an expansionary fiscal position, aiming to compensate for "the lacklustre performance of private sector", but to achieve a balanced budget in the near term.[30] The budget documents continue

a pattern from recent years that is predicated on a continuing trend for declining deficits without compromising efforts to develop new 'sunrise' industries.[31]

Commentators argued that development expenditure -- because it is capital expenditure and not recurrent operating expenditure -- can be reined in and so bring the budget (and the consolidated public sector account) to balance or surplus.[32] However, details on how cuts in development spending will be achieved, given the failure to adhere to the constraints of the *Eighth Malaysia Plan*, is missing from budget documents. A detailed analysis of fiscal sustainability in the budget documents would be welcome to increase fiscal policy transparency.

## Budget presentation

### Data reporting

Malaysia meets the IMF's SDDS for coverage, periodicity, and timeliness of central government data and public sector data, although it has opted for a flexibility option for data reporting on public sector debt expanding the reporting period from six to ten months. For consolidated central and state-level fiscal data, annual reports are provided within six months of the end of the financial year. Data on central government activities are produced monthly within one month, but lack any ministerial comment or comparisons with budget projections. The Treasury's *Economic Report* gives summary information of operating expenditures, development expenditures, revenues, and the financial position of state governments and non-financial public enterprises. Data on the financial public enterprises are not available.

Contingent liabilities taking the form of external and domestic loan guarantees made by the government to five statutory bodies and fifteen companies were disclosed in the *Federal Public Accounts 2002*.[33] No provision is made for disclosing contingent liabilities arising from performance contracts (guarantees of revenue) on Build-Operate-Transfer (BOT) schemes. These are only addressed when guaranteed performance indicators are not achieved, as in the cases of the Putra and Star light rail systems and Ekran's contract for the delayed Bakun Dam project.[34] In November, another project with guaranteed revenue failed and the government agreed to buy the project.[35]

Since 1997, guarantees for bank deposits, the government's re-nationalisation programme, and the declining returns of many government-run investment funds have all contributed to the growth in contingent liabilities. As part of its monthly reporting of gross international reserves, the central bank includes the amount of contingent liabilities denominated in foreign currency and their maturities.[36] Since contingent liabilities are difficult to recognise under the cash accounting currently used by the government, including a statement of the policy purpose of each provision that gives rise to a contingent liability, the duration of the guarantee, and the intended beneficiaries, would enhance transparency in budget documentation.[37]

## Budget execution and monitoring

As part of the Modified Budget System, all agencies and statutory bodies involved in development projects submit periodic progress reports to the government. All ministries and statutory bodies also provide the Ministry of Finance with programme and performance budget estimates. The formation of a task force to monitor these projects has improved substantially the effectiveness of budgetary implementation.

The *Programme and Performance Budget Estimate Book* is the most important document tabled in parliament by the Treasury as part of the budget process. It provides details on the performance budget documents of each state agency and statutory body.

**Accounting basis**

Central government and the majority of state government data are based on the accounting records of actual outturns. Monthly central government reports are compiled using a modified cash accounting method, thus allowing one month for outstanding bills to be settled. The Treasury is in the early stages of shifting to a modified accrual accounting basis (there is no time frame for this change).

Government accounts presented to parliament go through two stages of audit. The National Audit Department ensures that the accounts follow proper accounting principles. The parliamentary Public Accounts Committee then scrutinises the auditor general reports, having expanded its brief from examining compliance with standards to also looking at actual performance, increasing parliamentary oversight. Each ministry and statutory body is subject to internal auditing, but procedures and outcomes are not open to review.

**Procurement and employment**

The Treasury is responsible for government procurement. Recently, tender responsibilities have been further delegated to the procurement boards of line agencies as part of the "let managers manage" concept under the Modified Budget System. The Treasury is developing an e-procurement system to reduce bidding costs and make the process more efficient and transparent. So far, this system is in the second phase of implementation, covering ten major procuring agencies and standard procurement items like office furniture. The Treasury hopes to launch its quotation and tendering modules by the end of this year.[38]

Overall, the procurement process has a legally defined two-step process for federal and state procurement. The minister of finance is responsible for federal expenditure and respective chief ministers for state expenditures. Procurement guidelines are accessible to all interested parties. Treasury Circular Letters (TCL) are available on the Treasury's website.[39] Similarly, a Treasury Instruction Letter of 17 April 2002, outlining exceptions to standard procurement procedures, is available on the website.[40]

The government's long-standing affirmative action programmes, with some government contracts only open to *bumiputra* (indigenous Malay) contractors, heavily shape procurement in Malaysia. In the 2003 budget, the value ceilings for these contractors were raised significantly. This legal limitation of the procurement process is in line with the government's long-standing development objective of raising the socio-economic level of the majority *bumiputra* community and of developing a *bumiputra* commercial and industrial community. However, commentators noted that the preference for *bumiputra* firms for government procurement was in practice a preference for 'political favourites'. Certain non-*bumiputra* firms had become accepted as preferred suppliers/contractors. In addition, suppliers were known to have written to the ministry to argue that a particular project should be allotted by negotiation, not open tender.[41]

Government employment and promotion patterns have also been heavily influenced by the communal equity objective of the government, with 80% of new positions in the elite Malay Civil Service set aside for *bumiputra* applicants.

## Fiscal reporting

The Treasury publishes the annual *Programme and Performance Budget Estimates Book* at the end of the budget-making process. This internally distributed book provides the detailed figures, projections, and identification of performance outputs that support the actual budget tabled in parliament. Results of major budget objectives are routinely presented to parliament as a matter of tradition or because of questions raised by sitting members.

There is no legal requirement for the Treasury to provide mid-year budget updates to parliament, and normally no routine updates are given. Central government public accounts are prepared by the Treasury's Accountant General Office division and then audited by the National Audit Department.[42] These are published in two volumes. Volume one provides a summary of federal public accounts, and the accountant general's report (published in English and Bahasa Melayu).[43] Volume two covers a more detailed federal public account and memorandum account in the national language.[44]

## 4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY

●●●● Compliance in progress

### Data quality standards

Fiscal data meet the IMF's SDDS and are reported on a cash basis in ringgit. The Treasury's Accountant General Department, the central bank, and the Statistics Department verify the internal consistency of fiscal information.

### Independent scrutiny of fiscal information

**Independent audit**

A national audit body, independent of executive government, has existed since 1957 to report to the legislature and the public on the financial integrity of government accounts. Commentators have cast doubt on whether problems identified by the independent auditor have been rectified since to meet the basic requirements of transparency, mechanisms should be in place to help ensure that remedial action is taken in response to adverse findings in audit reports.[45] Independent experts have not hitherto been invited to assess fiscal forecasts, including the macroeconomic forecasts on which they are based and the underlying assumptions.

The National Audit Department -- headed by the auditor general -- is the main auditing body for the central government, state governments, statutory bodies, local authorities, and the Islamic Religious Council. Articles 105-107 of the Malaysian Constitution and the Audit Act of 1957 stipulate the responsibilities of the auditor general.[46]

The king appoints the auditor general on the advice of the prime minister after consultations with the Conference of Rulers.[47] The auditor general submits relevant reports to the king or head of the relevant state, who then submits it to the appropriate legislature. The auditor general has legal protection from political interference similar to that of the federal judges.

Apart from the annual audit reports to both central government and each state government, the auditor general has the right to submit supplementary reports pursuant to his responsibilities at any other time of the year. The Public Accounts Committee of the parliament uses reports from the auditor general as a basis for examining the performance and activities of government departments and agencies. Prior to their presentation in the parliament, the reports are classified documents.

Commentators noted that no prosecutions have hitherto been pursued based on reports from the auditor general, and also that, although the expenditure of all government departments and agencies was required to be audited annually, in practice not all departments were audited each year because of the size and complexity of the task.[48]

**National Statistics Agency**

The Department of Statistics (DOSM)[49] works under the Prime Minister's Department and the BNM. Its main duties involve the gathering and evaluating government data sets in cooperation with the Treasury. All statistics collected and published by the DOSM are governed by the 1965 Statistics Act (as amended in 1989), which grants the DOSM independence to determine data coverage, contents, methodology and periodicity.

## INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to Malaysia between 20 and 24 October 2003:

### Ministry of Finance

**23 October 2003**

| | | |
|---|---|---|
| Ghazali Mohd. Yusoff | Deputy Secretary | Economics and International Division |
| Chua Tong Ka | Principal Assistant Secretary | Economics and International Division |
| Khodijal Abdullah | | Tax Analysis Division |
| Tajol Azhar | | MoF (Inc) and Privatization Division |
| Chua Choon Hua | Assistant Secretary | Loan Management and Financial Policy Div. |
| Mohd. Zahrain Mohd. Nor | | Budget Division |
| Nik Ab. Kadir Nik Mat | | Budget Division |
| Azah Hanim Ahmad | | Procurement Management |
| Shari bin Mohd. Tahir | | Financial Advisory Division |

### Economic Planning Unit, Prime Minister's Department

**22 October 2003**

| | | |
|---|---|---|
| Datuk Dr Victor Wee | Senior Director | Macroeconomic and Planning Division |

### Bank Negara Malaysia

**21 October 2003**

| | | |
|---|---|---|
| Datuk Latifah Merican Cheong | Assistant Governor | |
| V. Vijayaledchumy | Director | Monetary and Financial Policy Department |
| Lee Yan Li | Senior Manager | Monetary and Financial Policy Department |
| Farizah Ahmad | | Monetary and Financial Policy Department |
| Abdul Rasheed Ghafur | | Bank Regulation Department |
| Lee Whai See | | Legal Department |

## ADDITIONAL INTERVIEWS

**21 October 2003**

| | | |
|---|---|---|
| Mohamed Ariff | Executive Director | Malaysian Institute of Economic Research |
| Azmi Setapa | Analyst | Malaysian Institute of Economic Research |
| Tunku Abdul Aziz | President | Transparency International (Malaysia) |

**23 October 2003**

| | | |
|---|---|---|
| Dr R. Thillainathan | Executive Director and COO | Genting Corporation |

## NOTES

[1] See the Malaysian Constitution at: www.eur.nl
[2] For example, a United Nations special rapporteur has noted that the judiciary has not recovered its independence since six Supreme Court judges were suspended, and three subsequently removed, in 1988. The suspension and removal of the judges followed a court case that arose after Dr Mahathir's then deputy, Tengku Razaleigh Hamzah, failed in a leadership challenge in 1987. Several court cases followed, including one in which a judge ruled that UMNO was unlawful; UMNO then split into UNMO Baru, led by Dr Mahathir, and Semangat 46, led by Tengku Razaleigh. 'In the aftermath of the court cases related to UMNO, three judges were sacked, including the chief justice.' See 'The Mahathir Era' (insert), *The Edge*, 3 November 2003 and Param Coomaraswamy, 'Injustice for all', *Far Eastern Economic Review*, 8 October 2003, p. 26.
[3] Interviews in Malaysia, 21-23 October 2003.
[4] 'Prime Minister Datuk Seri Abdullah Ahmad Badawi tabling a motion of thanks to the Member of Parliament for Kubang Pasu, Tun Dr Mahathir Mohamad', *The Star*, 4 November 2003, p. 23.
[5] Dr Mahathir announced, in November 1997, the establishment of the National Economic Action Council to overcome the effects of the weakened ringgit and depressed prices on the stock exchange: 'Thank you, Dr M' (insert), *The Star*, 31 October 2003.
[6] Interviews in Malaysia, 21-23 October 2003.
[7] Interviews in Malaysia, 21-23 October 2003. For example, the Ministry of Finance is responsible for the huge state-run pension plan, the *Employees Provident Fund* (EPF), and the state investment body, *Khazanah Nasional Berhad* (Khazanah). The EPF Investment Panel forms investment polices and strategies that should be, in theory, in the interest of the members of the EPF. However, commentators said that EPF investment strategies have been more in the interest of the government and particular entrepreneurs than that of EPF members and the return on investment of their savings, and they also noted that the coupon rate of government securities bought by the EPF was not disclosed. See IMF Public Information Notice (PIN) No. 02/135, "IMF Concludes 2002 Article IV Consultation with Malaysia," December 10, 2002.
[8] *Economic Report 2003/2004* (Ministry of Finance, 2003), pp. 105-7 and Table 4.13, p. xxxix.
[9] Interviews in Malaysia, 1-5 November 2002.
[10] Interviews in Malaysia, 21-23 October 2003; and Joseph Paul, Mary Magdaline Pereira, and V. K. Raj, *National Integrity Systems Country Study: Malaysia* (Kuala Lumpur Society for Transparency and Integrity, 2003), p. 45.
[11] Interviews in Malaysia, 21-23 October 2003.
[12] Tax laws, tax incentives and an introduction to the tax system is available in the national language, Bahasa Melayu, and English, at www.treasury.gov.my
[13] See www.hasilnet.org.my/ in Bahasa Melayu and English
[14] Interviews in Malaysia, 21-23 October 2003. Paul, Pereira, and Raj, *National Integrity Systems Country Study: Malaysia*, p. 50.
[15] *The Star*, 9 November 2003, p. 14.
[16] Interviews in Malaysia, 21-23 October 2003. Paul, Pereira, and Raj, *National Integrity Systems Country Study: Malaysia*, p. 51; and Wong Chun Wai, 'Support Pak Lah in fighting corruption', *The Star*, 9 November 2003, p. 33.
[17] See www.treasury.gov.my/
[18] Accountant General, *Federal Public Accounts 2002* (Percetakan Nasional Berhad, 2003).
[19] Interviews in Malaysia, 21-23 October 2003.
[20] The consolidated public sector balance is reported in *Economic Report 2003/2004*, pp. 106-107.
[21] In its latest Article IV consultation with Malaysia, the IMF also recommended that the government contain quasi-fiscal expenditures and ensure that remaining quasi-fiscal operations are reflected transparently in the central government budget. See IMF Public Information Notice (PIN) No. 02/135, "IMF Concludes 2002 Article IV Consultation with Malaysia," December 10, 2002.
[22] See http://dsbb.imf.org/
[23] See www.stn.fazenda.gov.br/divida_publica/index.asp
[24] See www.statistics.gov.my/English/framesetAdvanced.htm
[25] For more on Vision 2020, see www.smpke.jpm.my/vision.htm
[26] 'Mid-term Review' (insert), *The Star*, 31 October 2003.
[27] Interviews in Malaysia, 21-23 October, 2003.
[28] Interviews in Malaysia, 21-23 October 2001; Interviews in Malaysia 21-23 October 2003.

[29] For example, in May 2003 Dr Mahathir launched a Package of New Strategies, largely financed off budget, to deal with short term impacts from the Iraq War and Severe Acute Respiratory Syndrome (SARS), and also with longer term objectives of invigorating domestic consumption and investment and reducing dependence on the external sector. The government published a booklet (in *Bahasa Melayu* and English) describing the RM7.3 billion package and the sources of funding to be used, but there is no assessment of if and how it will impact the budget, the debt-to-GDP ratio, and the balance sheets of the financial institutions providing the funds. See "New Strategies Towards Stimulating the Nation's Economic Growth", Putrajaya, 21 May 2003.
[30] *Economic Report 2003/2004*, p. 2.
[31] *Economic Report 2003/2004*, p. 107.
[32] Interviews in Malaysia, 21-23 October 2003.
[33] G2 Statement of Memoranda of Guarantees, *Federal Public Accounts 2002*, p. 590.
[34] Interviews in Malaysia, 1-5 November 2002.
[35] The project in question was the RM250 million Seremban-Port Dickson toll highway. After the builder and operator found that toll collections did not meet its expectations, the revenue guarantee was invoked shifting the liability to the government. See R. S. N. Murali, 'Seremban-PD highway to be run by govt', *The Star*, 13 November 2003, p. 10.
[36] See www.bnm.gov.my/en/Statistics/reserves.asp
[37] Interviews in Malaysia, 21-23 October 2003.
[38] Interviews in Malaysia, 21-23 October 2003.
[39] See spp 11 thn 01.pdf at: www.treasury.gov.my/domhost/mof/circular/circular.nsf
[40] See www.treasury.gov.my/surat/panduanep1.pdf
[41] Interviews in Malaysia, 21-23 October 2003.
[42] See www.treasury.gov.my
[43] Accountant General, *Federal Public Accounts 2002* (Percetakan Nasional Berhad, 2003).
[44] World Bank, *Malaysia: Public Expenditure,* 2000.
[45] Interviews in Malaysia, 21-23 October 2003.
[46] See the Enabling Legislation, including Articles 105-107 of the Constitution and the Audit Act (1957) on the website of the National Audit Department at www.audit.gov.my/audit/index.htm
[47] Constitution of Malaysia, Article 105
[48] Interviews in Malaysia, 21-23 October 2003. Paul, Pereira and Raj, *National Integrity Systems Country Study Report: Malaysia*, p. 47.
[49] www.statistics.gov.my

# OXFORD ANALYTICA

## MEXICO

## FISCAL TRANSPARENCY

**Country Report 2003**

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# MEXICO

## COMPLIANCE RATINGS

| *Fiscal transparency* | *2003* | *2002* | *2001* |
|---|---|---|---|
| Clarity of roles | ●●●● | ●●●● | ●●●● |
| Availability of information | ●●●● | ●●● | ●●●● |
| Budget preparation | ●●● | ●●● | ●● |
| Accountability | ●●●● | ●●●● | ●●● |
| **Score** | **3.75** | **3.50** | **3.25** |

## OUTLOOK & COMMENTARY

The Federal Law on Transparency and Access to Public Information has substantially increased the availability of fiscal information in all government levels. However, major efforts are needed in order to increase fiscal monitoring and government officials' accountability over budget spending and reporting.

Fiscal transparency could be increased in the future if fiscal responsibilities were clearly established in the constitution. Success will depend on whether states and municipalities perceive reforms as permanent, in order to allay concerns over the unfeasibility of the fiscal federalism programme if based only on short-lived, discretionary changes approved in Congress.

# EXECUTIVE SUMMARY

## 3.75 Compliance in progress

Mexico sustained its efforts to attain further improvements on fiscal transparency in 2003. The Federal Law on Transparency and Access to Public Information and the Federal Institute for Public Information Access have substantially improved the timely and complete access to fiscal information for all government levels and entities. The implementation of additional measures to overhaul budgetary and auditing procedures, together with the consolidation of government procurement and data compilation systems, have all increased fiscal transparency.

Mexico complies with the IMF's Special Data Dissemination Standard (SDDS) and publishes a comprehensive range of fiscal information, but efforts should still be made to improve the integration and clarity of all statistics and data records.

Fiscal transparency could be substantially enhanced through the implementation of performance-based budgeting, and by making available more detailed reporting on the financial requirements for pension liabilities in all government levels.

Mexico's overall score has improved from 3.50 in 2002 to 3.75.

## 1. Clarity of Roles, Responsibilities and Objectives

●●●● Compliance in progress

**The government sector should be distinguished from the rest of the public sector and from the rest of the economy, and policy and management roles within the public sector should be clear and publicly disclosed.**

**Structure, functions and responsibilities of government**

Mexico's government structure is clearly defined in the 1917 Mexican Constitution (as amended) and complementary laws.[1] The constitution allocates authority to implement policy to different government levels, defines federal responsibilities, and entitles Congress to legislate on federal issues.[2] Responsibilities that are not defined in the constitution should be assigned to the state governments. Municipal tax and spending powers are detailed in the constitution.[3]

The distribution of concurrent obligations and unclear areas of responsibilities concerning all three government levels -- such as the regulation and provision of education, health and social assistance, and the management of roads and water supply -- are being revamped under a comprehensive fiscal federalism programme.[4] The government has allocated budgetary funds targeted at strengthening the local governments' faculties and management procedures, and their social responsibilities -- for example, the Fund for Basic and Normal Education (FAEB) and Health Service Fund (FASSA), among others. Nevertheless, commentators have said that additional efforts should be made in decentralising the *de facto* decision-making processes for public spending and tax revenue allocation, which are still highly centralised.[5]

For fiscal accounting and reporting purposes, the non-financial public sector includes the general government -- as defined in the IMF's GFS manual -- and parastatal institutions. In turn, the general government includes the federal government and all sub-national levels, including their administration and autonomous entities. The financial public sector includes the Central Bank of Mexico (Banxico), development banks, insurance companies, financial trust funds and the IPAB (an autonomous deposit insurance agency).[6]

**Coordination and management of budgetary activities**

The Ministry of Finance and Public Credit (SHCP) coordinates the federal budget.[7] The Federal Law of Budget, Accounting and Public Expenditure (LPCGF) gives broad powers to the SHCP to issue standards, set expenditure ceilings, programme cash disbursements, and authorise amendments to the budget within the limits established by law.[8]

The budget bill contains the Federal Expenditure Budget (PEF) and the Federal Revenue Law (LIF). The former contains resource allocations for constitutionally autonomous entities, centralised public institutions, entities under direct budgetary control, and transfers to remaining entities (such as non-financial parastatal entities under indirect control).

The corresponding coordinating bodies and the SHCP approve the draft budgets for all entities under indirect budgetary control. The Chamber of Deputies receives a forecast of their cash flows, for informational purposes only.

State and municipal governments follow an independent budget process, subject to their own legislation (in general, directives are contained in the state constitution).[9]

**Relations between government and public sector agencies**

Mexico has a series of independent and autonomous institutions, the most prominent being Banxico, which has full autonomy to conduct monetary policy.[10] The central bank may lend to the government in extraordinary circumstances. Loans are limited to a percentage of the PEF's authorised expenditures and must be paid in full within three months.

The Federal Audit Office (ASF) is financially independent and has full autonomy over the external supervision of the federal executive branch.[11]

The Banks and Securities Commission (CNBV) is technically autonomous and supervises the stock market, banking sectors, financial institutions, and the central deposit of securities. Past concerns about the CNBV's operational autonomy (in relation to its financial dependence on the SHCP and the appointment procedures of top CNBV officials) have been gradually allayed.[12] Since September 2002, the CNBV embarked on a comprehensive overhaul of its regulatory and surveillance schemes for the financial sector, enforcing international standards based on increased transparency and information availability in order to foster market efficiency. The CNBV has issued a number of rules to minimise conflicts of interests in company boards and increase pre-emptive monitoring over capital adequacy, asset quality, profitability, and risk diversification.[13]

**Government involvement in the private sector**

Article 28 of the constitution identifies those strategic sectors where operations should remain exclusively in the public sector. These include telegraph and postal services, petroleum and oil derivatives, basic petrochemicals, radioactive minerals and nuclear power, and electricity (although private sector self-supply and small-scale electricity generation are allowed). There are about 200 state-owned enterprises in Mexico; their budgets constitute part of the PEF and are thus approved by the Chamber of Deputies. The government has made important efforts to distinguish state-owned enterprises' non-commercial activities from strictly commercial activities. Substantial progress has been made in ensuring that state-owned enterprises' commodities reflect their true economic value.

Public financial institutions carry out considerable quasi-fiscal operations. These agencies incur persistent losses from such activities as lending at below market rates or granting credit without guarantees to developing sectors and -- in the past -- have required major recapitalisations. In May, the state-owned development bank *Banrural* started a comprehensive process of debt and non-performing loans restructuring in order to be transformed into *Financiera Rural*, which started operations in mid-August. The Fox administration has asserted that *Financiera Rural* aims at establishing transparent and efficient credit lines to finance agriculture and farming activities by introducing a new environment of co-responsibility that reduces corruption and malpractice.[14]

Public financial institutions follow an independent budget process, with a series of reforms adopted in 2002 requiring them to adhere to spending guidelines and ceilings established by the SHCP. Adherence to these rules is also subject to supervision by the Ministry of Public Function (SFP, formerly the Ministry of Administrative Control and Development)[15] and the CNBV; the reforms have thus widened information disclosure by public financial institutions. Nevertheless, commentators have said that the CNBV should be granted full financial autonomy in order to bolster the effectiveness of audit procedures and regulation.[16]

Banking restructuring programmes and portfolio purchases, administered by the Bank Savings Protection Institute (IPAB) are well documented in its reports and financial statements.

## There should be a clear legal and administrative framework for fiscal management

The constitution and the LPCGF provide the legal framework for the budgetary process in Mexico. The executive submits the LIF to Congress for approval. The president also introduces the PEF, which requires approval by the lower chamber only. Any increase in spending must be adequately funded with revenues authorised in the LIF. Since the Constitution and the LPCGF in broad terms do not specify whether this can be done with additional borrowing, legislators have included quantitative ceilings on net external-debt annual balances.[17]

Since discretionary expenditure changes have to be matched by tax increases or new tax proposals in the LIF, Congress frequently modifies tax legislation during the budget process. However, given time restrictions, commentators said that these changes are approved without detailed quantitative estimates or technical analysis of their impact on economic activity. The law draft (introduced by the executive in 2001) that aims to give a more detailed framework to the budgetary process has yet to be approved.[18]

**Legal framework for budgetary activities**

Mexico has a clear legal and administrative framework for fiscal management. The Organic Law of the Federal Public Administration (LOAPF) centralises the fiscal process under the SHCP, which issues regulations and oversees budget and off-budget activities.[19] The SHCP is also required to estimate revenues and manage public credit. The Manual of Budgetary Rules sets standards and reinforces the authority of the SHCP to establish spending ceilings.[20] The SHCP approves disbursement timetables for budget execution and authorises amendments to the budget within the PEF's established limits. The SHCP is required by law to disclose fiscal information to Congress, while government agencies must report to the SHCP. The PEF establishes criteria to increase expenditures or make debt payments when revenue surpluses are above the LIF's estimates. It also sets out criteria for revenue-sharing transfers and expenditure cuts to meet budgetary targets and policy objectives.

**Legal framework for taxation**

Under the constitution, the federal government has the authority to tax international trade, goods and services, and natural resources while the state governments possess the majority of tax powers. However, the Fiscal Coordination Law of 1979 (as amended in 2000) transfers the authority to tax from states to the federal government. The subsequent revenues are distributed through a General-Revenue Sharing Fund, which allocates up to 20% of revenues according to state population sizes and their ability to generate revenues.[21]

Although the transfer of resources from the federal to state governments has been transparent and non-discretionary, the federal government has begun to return some fiscal powers to the states under the fiscal federalism programme.[22] Tax legislation at the federal and state level is publicly available through the Tax Administration Service (SAT) and the SHCP websites. States control income tax for individuals and 5% of income tax for corporate activities. They can also establish sales tax on real estate. The 2004 budget bill draft contains provisions that would allow states to manage tax collections and impose a 2% tax on final sales. However, commentators said that the federal government has provided little incentives to state and municipal governments to exercise taxing powers.[23]

**Ethical standards for public servants**

Articles 108-114 of the constitution and the Federal Law on the Administrative Responsibilities of Public Servants establish responsibilities and ethical standards for all public officials.[24] The SFP is in charge of enforcing and supervising adherence to the standards and the law. In addition, most agencies and ministries (including the SAT, CNBV, Banxico and the Federal Audit Office) publish their own codes of conduct and standards for public employees.

## 2. PUBLIC AVAILABILITY OF INFORMATION

●●●● Compliance in progress

**The public should be provided with full information on the past, current and projected fiscal activity of government.**

Mexico is a member of the IMF's Special Data Dissemination Standard (SDDS), and publishes a broad range of fiscal information. In June 2002, Congress approved the Federal Law on Transparency and Access to Public Information (LFTAI), which mandates timely and complete access to fiscal information on all government expenditures, subsidies, transfers, privatisation processes, fiscal concessions, and public procurement. Further, chapter two of the LFTAI created the Federal Institute for Public Information Access (IFAI), through which fiscal information for any government level or entity must be available to the public.[25] The IFAI is now fully operational, and most government websites now include a 'transparency portal' where all information -- as required by the LFTAI -- can be accessed.[26]

**Central government operations**

Fiscal information (also in English) is available on the SHCP's website.[27] Available data include monthly and quarterly reports to Congress covering the country's macroeconomic evolution and fiscal performance. In addition, the SHCP releases the *Timely Public Finance and Public Debt Statistics*. These contain monthly and quarterly data on the budgetary public sector, financial requirements, revenues and expenditures, cash flows, and public sector debt.

As established on Article 24 of the LIF 2003, the SHCP submits monthly reports on the evolution of tax revenues, outstanding net public debt, and domestic and foreign debt operations. It also mandates a quarterly report on public finances and debt, which must include detailed information on each institution's revenues and budget execution, cash programmes, and debt stocks and flows.[28]

**Public sector operations**

The National Programme to Finance Development (PRONAFIDE) contains the government's overall medium-term economic strategy, as well as the optimal policies to meet its targets.[29] The SHCP discloses information on central government budgets, public health institutions, and the decentralised agencies under direct budgetary control. Information on state-owned enterprises includes transfers from the federal government (included in the PEF) and their projected cash flows. The LIF contains profit margins of state-owned enterprises to be included in the budget.

The SHCP publishes an annual activities report explaining the fiscal policy implemented, the legislative agenda, and any regulatory measures adopted.[30] Important progress has been attained on the compilation and reporting of the annual *Public Account* report for the fiscal year 2002, which now includes chapters of general results and a data book available online.[31]

Most non-financial state-owned enterprises disseminate their financial statements and balance sheets on their own websites. In addition, the CNBV releases these data for public sector financial institutions. However, only a few financial statements of numerous public trust funds (established with development banks) are publicly available. The SHCP does not disclose periodic assessments of contingent liabilities and quasi-fiscal activities of non-financial parastatal entities.

The *Gazettes of States and Municipalities* disclose fiscal information on sub-national government levels, although data are not frequently updated and do not follow a standardised presentation. However, the SHCP's Fiscal Coordination Unit has issued a series of regulations to improve overall fiscal transparency practices in states and municipalities, and the agreements on fiscal cooperation between the SHCP and the states began to be signed in March.[32]

The National Institute of Statistics (INEGI) collates fiscal information for the states and municipalities through the *Integral Information System* (SII) and the *Municipal Database System* (SIMBAD). Consolidated data are published in the *Revenue and Public Spending in Mexico* reports on an annual basis. This contains information on general government, state and municipal revenues, spending, and registered debt.[33]

## A commitment should be made to the timely publication of fiscal information.

The LFTAI requires the publication of monthly reports on budget execution by institution, public finances, and debt within the guidelines established in the PEF. This information is available on the SHCP website.

**Debt reporting**

As part of its commitment to the IMF's SDDS, Mexico publishes comprehensive information on outstanding domestic and foreign debt. Information on maturities, scheduled payments, and recent borrowing operations are disclosed. The *Timely Public Finances and Public Debt Statistics* contain data on outstanding (net and gross) domestic and foreign debt. The monthly Public Finances and Public Debt Reports provide consolidated debt data.[34]

Information on the stock of contingent liabilities stemming from the reforms to federal pension and health insurance systems, and on other possible sources of contingent liabilities (such as the pension systems for state/municipal government employees and the military) are still not publicly available. However, commentators said that the SHCP only reports the financing flows required for each fiscal year, since calculations for the present value (or stock) of contingent liabilities arising from pension systems are extremely sensitive to the underlying assumptions (e.g. the discount rate, GDP and population growth rates), and thus these figures could prove misleading.[35]

**Advance release calendars**

As part of its commitment to the SDDS, Mexico disseminates advance release calendars for fiscal information available on the IMF's SDDS, SHCP, and INEGI websites.[36]

## 3. Open Budget Preparation, Execution and Reporting

●●● Enacted

### Fiscal policy objectives, macroeconomic framework, and risks

**Fiscal policy objectives**

The SHCP submits the macroeconomic analysis report Economic Policy Guidelines (CGPE) together with the LIF and PEF bill proposals to Congress in early November.[37] The CGPE includes information on fiscal policy objectives and sectoral priorities, but this is limited to aggregates. Procedures and econometric forecasting models used to estimate macroeconomic projections are not disclosed.

**Macroeconomic framework**

The CGPE sets out the macroeconomic framework and procedures for budget preparation for the relevant fiscal year. However, according to the law, the PEF's sectoral objectives must meet the ones set out in the *National Development Plan* (PND) and the PRONAFIDE. The PRONAFIDE sets targets for the federal (non-financial) government's debt and budget during the presidential term.

Since the relationship between the PRONAFIDE's medium-term financial plan and each year's budget process was not entirely clear (given that its objectives were seldom met) the authorities have decided to update the PRONAFIDE forecasts to reflect changing foreign and domestic economic conditions affecting fiscal performance, while harmonising short, medium, and long-term objectives. Multi-year forecasts (2004-2007) for national accounts, public sector balances, and investment projects are included in the CGPE 2004.

**Fiscal risks**

The CGPE discusses the established macroeconomic assumptions, previous years' outturns, and the next year's forecast, but there is no explicit analysis of fiscal risks. Unlike the 2003 budget bill, the 2004 budget draft does not include a macroeconomic scenario where a number of fiscal reforms (particularly in the tax system) are approved. Only the baseline scenario -- excluding the reforms -- is available.[38]

**Fiscal sustainability**

There are no comprehensive SHCP studies or reports on fiscal sustainability that include pension liabilities for the military, public universities, and state/municipal government employees. The CGPE 2004 includes a medium-term analysis on deficit sustainability for the federal government.

Mexico has kept its annual automatic mechanisms to adjust expenditure when actual revenues differ from budget forecasts, although these are not supported by explicit fiscal rules. This omission put significant political pressure on federal authorities in 2003, when actual oil revenues exceeded the LIF forecasts and state governments demanded additional disbursements.[39]

Legislation prevents states and municipalities from borrowing in foreign markets and sets ceilings on states' domestic borrowing.

## Budget presentation

**Data reporting**

Data are available with a comprehensive budget classification by institution, function, programme, and economic category. However, information on programme classification in the PEF 2004 is much more aggregated than in the previous year, which has diminished fiscal transparency.[40] Institutional classification divides expenditure into budgetary branches, which comprise autonomous branches, administrative branches, general branches, and entities under direct budgetary control.

Each agency's data include expenditures by programme that, in turn, include information on functions, expenditure classified by activity, responsible unit, project, and economic category. The functional and economic classification used is generally compatible with international classifications, and improvements have been made to present the data according to international practice.

## Budget execution and monitoring

Budget execution schedules and performance evaluations have been enhanced with the introduction of the *System for Budgetary Execution Control* (SICGP) and the *Integrated System for Federal Financial Management* (SIAFF), which allows institutions to report disbursements electronically. The SICGP has been gradually introduced across the federal government -- thus improving the ability of the SHCP to monitor fiscal management in both government agencies and parastatal institutions -- which has helped to reduce budgetary lags.

The Treasury Department's SIAFF allows the recording of expenditures at all levels and stages of the fiscal process, and discloses fiscal data in real time. It started operations in January, and full implementation is expected by mid 2004.[41] More importantly, the SHCP now publishes the monthly progress on budget expenditures for the central government and parastatal institutions, which also includes payment obligations and guarantees by the federal government.[42]

Commentators expressed their concern about the fact that most budgetary programmes have no annual/periodic performance analysis or review. As such, budget allocations for these programmes do not follow any clear socio-economic assessment.[43]

**Accounting basis**

Mexico uses a modified cash-based accounting system. Some government commitments and guarantees are now been recorded (as required by law); accrued obligations are recorded at the same time as the payment orders. The Treasury does not make all third-party payments directly, but transfers a portion of the funds to executing units, thereby converting them into 'independent' treasuries.

The government has started a comprehensive review of accounting practices in local governments through the Modernisation Programme for States' Accountancy Systems and Registers, as part of the decentralisation process. The government has reported substantial progress in providing technical assistance in thirteen states. The SHCP releases the monthly *Technical Bulletin on Government Accountancy* to make available the guidelines and any technical progress that fosters transparency in the government's accounting practices.[44]

**Procurement and employment**

The Law on Procurement, Leasing and Services in the Public Sector and the Law on Public Works and Related Services, with their respective regulations, have substantially enhanced procurement systems. Regulations apply to the federal government with the exception of the judicial and legislative branches and other autonomous entities.

The SFP operates an electronic procurement system (COMPRANET)[45] that discloses all calls for tender, bidding documents, and award decisions.[46] In addition, the LFTAI provides detailed guidelines for disseminating procurement information by every government unit in Mexico -- this information is generally found on each unit's 'transparency portal'.

## Fiscal reporting

The SHCP and the Executive Office are required by law to report fiscal information to Congress. For example, the PEF requires the SHCP to submit quarterly reports on economic balance, government finances, and public debt. These reports must be made available within 35 calendar days after the end of each quarter. All audited public sector accounts must be submitted to Congress before 5 June of the following year.

The Federal Audit Office (ASF) produces the *Review and Audit of the Federal Government Public Account* for each fiscal year, which is published by the end of March of the following year.[47] The report contains detailed execution information on the revenue and expenditure budgets and provides an explicit comparison of budget execution against initial and amended allocations. The Federal Audit Law (2000) also requires the ASF to supply a mid-year status report on the federal government accounts, which is submitted to Congress in August.

## 4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY

●●●● Compliance in progress

### Data quality standards

Mexico observes the SDDS data dimension requirements in all categories, using flexibility options for the timeliness of data on the operations of general government and central government. Timeliness requirements are exceeded with respect to data on national accounts and central government debt.[48]

The methodology used to compile government finance statistics follows national concepts and definitions that are generally similar to the IMF guidelines of the Manual on Government Finance Statistics (GFSM 1986), such as the publications *International Financial Statistics* and the *Government Finance Statistics Yearbook*. The government is currently assessing the advisability of introducing the Government Finance Statistics Manual 2001 (GFSM 2001).[49] Government finance statistics are compiled and disseminated for the federal government (budgetary central government), consolidated central government, general government, budgetary public sector, non-financial public sector, and public sector borrowing requirement.

Budget execution is considered to be in line with approved budgetary figures, although cuts and supplements do take place. Nevertheless, these changes are always documented on the SHCP website. Public sector fiscal reports and the federal government's *Public Account* are reconciled with broad fiscal and monetary data. The government has attained substantial progress in reducing the time lag for the presentation of the *Public Account* report and increasing the availability of data for all government levels (federal, state and municipal).[50] Since January, INEGI has started publishing the *Monthly Statistics of States' Public Finances*, which has allowed the SHCP to compile revenue, expenditure, and financing information for state governments more accurately.

### Independent scrutiny of fiscal information

**Independent Audit**

The SFP carries out internal audits, but commentators stated that its audits -- and the overall internal supervision process -- are extremely unreliable.[51] The ASF possesses full institutional, operative, and financial autonomy and exercises external supervision over the whole federal executive branch. As such, the ASF has authority to conduct audits for all federal public entities, states, municipalities, and individuals. Since these would produce duplication of functions, audits at sub-national level are implemented through coordination agreements with state legislatures and auditors, following guidelines established in the Federal Audit Law. The ASF reports to the Chamber of Deputies by 31 March of the following year. Once the deputies have reviewed the reports, the documents are published and made available upon request.

**National Statistics Agency**

The SHCP is responsible for the production and dissemination of financial statistics on the federal government. INEGI is a devolved body of the SHCP, and by law it has the authority and responsibility for planning, promoting, and implementing the organisation and development of an integrated national and economic accounting system. INEGI does not possess auditing functions to verify the federal government's financial statistics.[52]

## INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to Mexico between 17 and 19 November 2003:

### Ministry of Finance and Public Credit (SHCP)

**17 November 2003**

| | |
|---|---|
| Alejandro Werner | Head of Unit for Public Finances' Economic Planning |
| Jesus Serrano | Director of Economic Policy |
| David Madero | Director of Financial Planning and Head of Investor Relations Office |

### Central Bank of Mexico (Banxico)

**17 November 2003**

| | |
|---|---|
| Alejandro Diaz de Leon | Director of Macroeconomic Analysis |

## ADDITIONAL INTERVIEWS

**18 November 2003**

| | | |
|---|---|---|
| Mario Rodarte | Director General | Centro de Estudios Economicos del Sector Privado (CEESP-CCE) |
| Joost Draaisma | Economist | World Bank, Mexico Office |

**19 November 2003**

| | | |
|---|---|---|
| Isaac Katz | Professor of Economics | Instituto Tecnologico Autonomo de Mexico–ITAM |
| Helena Hofbauer | Executive Director | FUNDAR |

## NOTES

[1] Constitution of the United States of Mexico of 1917 (as amended in September 2003, in Spanish only.) www.diputados.gob.mx/organi/constitu.htm
[2] Constitution of 1917, articles 73 and 117-121.
[3] Constitution of 1917, article 115.
[4] See *Special Programme for an Authentic Federalism* (in Spanish only), Ministry of Interior (SEGOB): www.e-local.gob.mx/peaf/disco02/
For a list of the funds included in the fiscal federalism programme see: www.e-local.gob.mx/ramo33/fondos.htm
[5] Interviews in Mexico, 17-19 November 2003.
[6] For a concise description of the Mexican Public Sector see IMF Country Report 02/200. "Mexico: Report on the Observance of Standards and Codes—Fiscal Transparency Module." page 7, figure 1. www.imf.org/external/pubs/ft/scr/2002/cr02200.pdf
[7] Ministry of Finance and Public Credit (*Secretaría de Hacienda y Credito Publico*-SHCP) www.hacienda.gob.mx
[8] Law of the Federal Budget, Accounting and Public Expenditure (*LPCGF- Ley de Presupuesto, Contabilidad y Gasto Federal*, in Spanish only): www.cddhcu.gob.mx/leyinfo/pdf/61.pdf
[9] State constitutions: www.e-local.gob.mx/leyesloc.htm#01
[10] Law of the Bank of Mexico (as amended in 1999): www.banxico.org.mx/siteBanxicoINGLES/aAcercaBanxico/RegimenJuridico/LeyBancoMexico/LeyBancoMexico.html
[11] The Federal Audit Law of 2000 replaced the Senior Comptroller of Finance with the Federal Audit Office.
[12] Interviews in Mexico, 17-19 November 2003.
[13] *Circulares – Regulacion emitida por la CNBV* (CNBV rules, in Spanish only) www.cnbv.gob.mx/noticia.asp?noticia_liga=no&com_id=0&sec_id=10&it_id=64
[14] Interviews in Mexico, 17-19 November 2003.
[15] Ministry of Public Function (SFP) www.funcionpublica.gob.mx/index1.html
[16] Interviews in Mexico, 28 November – 3 December 2002. Decisions to intervene and sanction financial institutions are adopted by the CNBV Board of Directors. The SHCP directly appoints six of the 13-member board, including its president (although members are chosen based on rigorous criteria). The CNBV's president, who chairs the board, appoints two additional members. Therefore, the SHCP could potentially influence the decisions of eight of the 13-member board. See the Law of the Banks and Securities Commission of 2001 (*Ley de la Comisión Nacional Bancaria y de Valores*) at: www.cnbv.gob.mx.
[17] In particular, for the fiscal year 2004 the executive requested that the net balance of the external debt should be reduced by 500 million dollars.
[18] Interviews in Mexico, 17-19 November 2003.
[19] Organic Law of the Federal Public Administration (*Ley Orgánica de la Administración Pública Federal*) www.shcp.sse.gob.mx/asesorjurdc/doctos_190402/ley_organica_administracion.pdf
[20] *Reglamento de la Ley de Presupuesto, Contabilidad y Gasto Público Federal* (in Spanish only): www.shcp.sse.gob.mx/contenidos/asesoria_juridica/temas/leyes_y_disposiciones/documentos/ley_presupuesto.pdf
[21] Fiscal Coordination Law of 1979 (*Ley de Coordinación Fiscal,* in Spanish only): www.shcp.sse.gob.mx/contenidos/asesoria_juridica/temas/leyes_y_disposiciones/documentos/otras_leyes_disposiciones/documentos/leyes/ley_coordinacion_fiscal.pdf
[22] *Special Programme for an Authentic Federalism* and *Local Fiscal Coordination Laws* (in Spanish only): www.e-local.gob.mx/leyesloc.htm#03
[23] Interviews in Mexico, 17-19 November 2003. In particular, local governments would be under strong political pressure if the forecast (local) tax revenues were not met. In this context, they still prefer to operate under a centralised system where they are not accountable for not attaining the required tax revenue flows.
[24] *Ley Federal de Responsabilidades Administrativas de los Servidores Publicos* (in Spanish only): www.shcp.sse.gob.mx/contenidos/asesoria_juridica/temas/leyes_y_disposiciones/documentos/otras_leyes_disposiciones/documentos/leyes/ley_respon_2002.pdf
[25] Federal Institute for Public Information Access: www.ifai.org.mx/index.html
[26] For example, see the SHCP's transparency webpage at: www.hacienda.gob.mx/difus/transparencia/
[27] Basic Economic and Financial Data: www.hacienda.gob.mx/english/eofp/index.html

[28] See Public Finances and Public Debt Reports: www.hacienda.gob.mx/english/iro/documents_1.html
[29] SHCP 'PRONAFIDE 2002-2006': www.hacienda.gob.mx/english/docs/pronafide0602e.pdf
[30] *Informe de Labores* (in Spanish only): www.hacienda.gob.mx/docs/index.html#infolabshcp
[31] *Cuenta de la Hacienda Publica Federal 2002* (in Spanish only): www.hacienda.gob.mx/docs/index_a5.html
[32] *Convenios de Colaboracion Administrativa en Materia Fiscal Federal* (in Spanish only): www.hacienda.gob.mx/servs/normativ/convenios/index.html
[33] *Ingreso y Gasto Público en México 2001* (in Spanish only): www.inegi.gob.mx/prod_serv/contenidos/espanol/bvinegi/igpm/igpm.pdf?texto=&tipo=1&s=est
[34] Public Finances and Public Debt Reports: www.hacienda.gob.mx/english/iro/documents_1.html
[35] Interviews in Mexico, 17-19 November 2003.
[36] Mexico Advance Release Calendar from the IMF website http://dsbb.imf.org/Applications/web/sddsctycatarclist?strcode=MEX
[37] Economic Policy Guidelines 2004: www.hacienda.gob.mx/english/difus/n_bol38.html
[38] PEF fiscal year 2004 (in Spanish only): www.shcp.sse.gob.mx/contenidos/presupuesto_egresos/temas/ppef/2004/index.html
[39] Interviews in Mexico, 17-19 November 2003.
[40] Interviews in Mexico, 17-19 November 2003. In particular, there were concerns because the lack of detail for some programmes means that the budget allocation and execution will not be comparable with the 2003 outturns and any information included in future -- such as the 2005 budget bill.
[41] *Integrated System for Federal Financial Management* (SIAFF, in Spanish only): www.tesofe.gob.mx/siaff
[42] Allocation and Disbursement of the PEF (*Asignacion y Ejecucion del Presupuesto de Egresos del Poder Ejecutivo*, in Spanish only): www.hacienda.gob.mx/eofp/indice.html
[43] Interviews in Mexico, 17-19 November 2003.
[44] *Technical Bulletin on Government Accountancy* (Boletin "Contabilidad Gubernamental", in Spanish only): www.hacienda.gob.mx/docs/index.html#boletin
[45] www.compranet.gob.mx
[46] Procurement Regulations (in Spanish only): www.funcionpublica.gob.mx/unaopspf/norma.htm
[47] Auditoria Superior de la Federacion: www.asf.gob.mx/asf.htm
[48] 'Mexico: Report on the Observance of Standards and Codes—Data Module', IMF Country Report No. 03/150, June 2003, www.imf.org/external/pubs/cat/longres.cfm?sk=16581.0
[49] Interviews in Mexico, 17-19 November 2003.
[50] During last year's interviews (28 November – 3 December 2002), some interlocutors commented that further improvement could be achieved by reducing the time lag for the presentation of the *Public Account* report by enhancing the accounting system, and efficiently collating background information and data.
[51] Interviews in Mexico, 17-19 November 2003.
[52] However, on 17 December 2003, the Senate approved a number of constitutional amendments to give the INEGI statutory autonomy and supervisory powers. These measures should be discussed in plenary sessions in early 2004.

# OXFORD ANALYTICA

## MOROCCO

## FISCAL TRANSPARENCY

**Country Report 2003**

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# MOROCCO

## COMPLIANCE RATINGS

| *Fiscal transparency* | *2003* | *2002* | *2001* |
|---|---|---|---|
| Clarity of roles | ●●● | ●●● | ●●●● |
| Availability of information | ●●● | ●●● | ●● |
| Budget preparation | ●●● | ●●● | ●●● |
| Accountability | ●●● | ●●● | ●●● |
| **Score** | 3.00 | 3.00 | 3.00 |

## OUTLOOK & COMMENTARY

Morocco has a number of projects in the pipeline which, given sufficient commitment, could lead to significant improvements in fiscal transparency over the coming year. The compilation of aggregate statistics for local administrations may soon make it possible to generate consolidated statistics for general government, thereby fulfilling a key requirement for complying with SDDS.

Improvements are also expected in the transparency of government procurement practices. In this regard, the government is planning to pass amendments to the law on public procurement in 2004. Over the coming year, the Ministry of Finance is aiming to eliminate the backlog in final expenditures accounts dating back to 1996. Progress in this area will lead to improvements in accountability.

The government is in the process of implementing public administration reforms including a decentralisation of expenditures and a move towards a form of performance budgeting. These reforms could, in the longer-term, result in greater transparency and increased efficiency of its budget expenditure.

# EXECUTIVE SUMMARY

## 3.00 Enacted

Morocco's public finances and budgetary activities take place within a clear and comprehensive legal framework. The budget preparation process is open and well understood by the public. Private sector participants feel they are adequately consulted during preparation of the Finance Law.

The Ministry of Finance is making progress towards developing consolidated statistics for the general government, which is one of the main requirements for participating in the SDDS. In an ambitious initiative, aggregate statistics on local government finances are currently being compiled in a cooperative effort between the Ministry of Finance and the Ministry of the Interior.

Progress is also being made towards improving oversight and accountability at the level of local administrations. A new law on financial jurisdictions has facilitated the creation of regional chambers of accounts that will be responsible for providing independent oversight of the finances of local administrations. Procurement practices are improving as certain ministries adopt more transparent processes. A case in point is the Ministry of Finance, which has set up a website for providing information on public tenders. An amendment to the law on public procurement is expected to be passed by parliament in early 2004, and should reinforce progress in this area.

On the downside, a number of weaknesses have yet to be adequately addressed. At the level of public availability of information, a key weakness in fiscal transparency is the general lack of information on items such as tax expenditures, quasi-fiscal activities and fiscal risks within the budget documentation. Whilst the budget is prepared within a framework consisting of medium-term policy goals defined by the King in a five-year plan, forecasts for key macro-economic indicators and fiscal targets are only set one year ahead thus limiting the effectiveness of the budget as a tool for longer-term planning.

With regard to financial control, Morocco's system is characterised by heavy a priori controls that can lead to excessive formalism and bureaucracy to the detriment of effective oversight and enforcement. At the level of external audit, the Accounts Chamber -- *Cour des comptes* -- is legally tasked with the role of auditing the execution of the finance laws. However, as a result of the excessively long delays within the Ministry of Finance in preparing the final expenditure accounts, it has not been able to fully perform this role, nor can it undertake audits on its own initiative.

Morocco's rating is unchanged from last year.

## 1. Clarity of Roles, Responsibilities, and Objectives

●●● Enacted

**The government sector should be distinguished from the rest of the public sector and from the rest of the economy, and policy and management roles within the public sector should be clear and publicly disclosed.**

**Structure, functions, and responsibilities of government**

Morocco's administration comprises the central government, 17 regional governments (*wilaya*), 49 provinces, 12 prefectures and eight urban prefectures, and over 1,500 communes.[1] Regional governors (*wali*) constitute an intermediate level of administration with control over several provinces. The Constitution clearly sets the government apart from the private sector.

**Co-ordination and management of budgetary activities**

The Ministry of Finance (MoF) is responsible for drafting the finance bill -- *Loi des finances* -- and for its implementation through its various departments. The roles and responsibilities of the MoF are detailed in the 1978 Decree on the Organisation of the Ministry of Finance and are detailed on the MoF's own website.[2]

The respective roles of the Ministry of the Interior and the Ministry of Finance with regard to local government finances are not clearly defined. For example, the Ministry of the Interior is in charge of local budgets at the commune level, but the MoF plays a role in the approval of local budgets. Local government borrowing can only be included in the local budget once it has received approval from both the MoF and Ministry of the Interior.[3]

**Relations between government and public sector agencies**

Although the division of roles and responsibilities across government is formally clear, the broad formal remit of the Ministry of Finance under law leaves some room for ambiguity, particularly with regard to monetary, exchange rate, financial and credit policy where the Bank Al-Maghrib plays a role in policy formulation and/or implementation.

The government sector in Morocco is clearly distinguished from non-government sectors, in spite of the fact that government activities extend into many areas of the public sector and the rest of the economy. Total central government expenditure last year accounted for 29.1% of GDP.[4] The MoF publishes a list of public entities in its annual budget annex, and a table showing autonomously managed public services under particular ministries, which are also known as Services de l'Etat Gérés de Manière Autonome (SEGMA). They are presented separately from the general budget because they are partly financed from revenues generated by the services they provide to the public. The MoF also publishes, with the Finance Bill, a report that describes the mission and activities of the various SEGMAs as well as their budgetary impact for the current and previous year.

The Finance Law also covers numerous funds called Special Treasury Accounts -- *Comptes spéciaux du trésor* -- that earmark funds from a variety sources for specific uses (examples include the Fund for the Development of Agriculture, the National Fund for the Development of Sport, and the National Fund for Cultural Action). A number of independent observers comment on the opacity of these funds. Whilst these funds are consolidated with the

general budget, from the perspective of accountability, their sheer number (over 40) and size (they represent approximately 17% of the general budget) warrant greater visibility.

**Government involvement in the private sector**

Morocco is in the midst of implementing an ambitious privatisation programme of public sector enterprises which has so far transferred 37 joint-stock companies and 27 hotels into private hands, most recently the tobacco company Régie des Tabacs. The total receipts since 1993 amount to some four billion dollars. In many instances, the government has retained a stake in primarily private companies.[5] In its role of overseeing the privatisation of public enterprises, the MoF is tasked with elaborating and proposing general policy for reforming and restructuring the public sector, and opening it to private investment. The MoF is also responsible for advising on the sale of public enterprises.

The activities, performance and fiscal impact of public enterprises are described in the *Rapport sur le secteur des établissements et enterprises publics*, published at the time of the Finance Law. However, there is no attempt to identify or quantify the scale of quasi-fiscal activities either in the *Rapport* or in other elements of the budget documentation.

## There should be a clear legal and administrative framework for fiscal management.

The Ministry of Finance and Privatisation consists of some 14 departments or directorates, ranging from Treasury and Budget, to Privatisation, Customs and Duties, and Public Institutions and Participation. The responsibilities and organisational structure of each department are clearly set out and publicly available.[6]

Whilst in formal terms the legal and administrative framework for fiscal management is clear, independent observers, the World Bank and even Ministry of Finance officials describe the Moroccan system of public administration and financial management as characterised by excessive formalism.

The MoF has been pursuing a *Strategic Action Plan, 2001-2004* which aims to bring about improvements in many of the MoF's departments and in its overall fiscal management.[7] As part of this, the Budget Department has been reforming and modernising its working methods. This has involved reviewing public sector commitments, administrative structures, civil service pay and public expenditure. The decentralization of various MoF operations, including the General Fiscal Inspectorate, has increased the efficiency of monitoring local government expenditures.[8]

Since 2002, the government has also been moving towards a form of performance budgeting called *Globalisation des crédits* that involves restructuring budget categories according to programmes; developing objectives and indicators for each programme; and allowing greater flexibility in the way ministries spend their budget allocations.[9] However, this initiative is in its early stages with only a few ministries having implemented this new form of budgeting.[10]

**Legal framework for budgetary activities**

The guidelines and procedures for the annual budget and finance law are defined in the 1998 Organic Law, its subsequent amendments, and other laws.[11] These stipulate that the Finance Law be approved annually by parliament, and that only supplementary budgetary laws be used to amend it during the course of the year. Contingency procedures are specified in case the Finance Law is not passed before the end of the calendar year, in which case the government passes a decree which releases credit for the necessary functioning of public services, and allows the government to submit new budget proposals to parliament.

During a fiscal year, if deficits arise due to unforeseen expenditures or a shortfall in revenues, the government must pass an amendment to the budget through parliament – a *Loi de finances rectificative*. Independent observers indicate that in practice, however, many important expenditures are implemented by decree without the approval of parliament.[12]

As of December 2003, the Organic Finance Law was not available on the Ministry of Finance website. Indeed, while there are numerous laws and decrees published on the Ministry of Finance website, it is not comprehensive and many important documents are unavailable.

**Legal framework for taxation**

The Ministry of Finance's Tax Department administers taxes and duties. The Department disseminates extensive information on the tax system, including explanations of different taxes, information on tax concessions for various sectors of the economy, guidance notes for taxpayers, and tax laws.[13] Taxes have a clear basis in law. A number of relevant legislative documents and procedures are either reproduced or described on the MoF's website.

At the local level, the tax system would benefit from simplification and streamlining. There is a proliferation of local taxes that are a burden to administer yet yield relatively small amounts in revenue (over 35 such taxes were counted)[14]. Moreover, certain taxes at the local level share a similar taxation base as the taxes administered by the central government but information is not shared between the two levels of government.[15]

**Ethical standards for public servants**

The General Statute on Public Office regulates the conduct of civil servants and the public administration. The regulations of this statute are formulated by the Ministry for the Modernisation of the Public Sector (MMSP).[16] A new law governing the responsibilities of fiscal directors, inspectors, and public accountants was adopted in May 2002 and is designed to improve the quality of governance. Effective control of the fiscal process has been further enhanced by the January 2003 law on fiscal jurisdictions.[17]

## 2. PUBLIC AVAILABILITY OF INFORMATION

●●● Enacted

**The public should be provided with full information on the past, current, and projected fiscal activity of government.**

**Central government operations**

Morocco is not yet a subscriber to the IMF's General Data Dissemination System (GDDS) nor to the Special Data Dissemination Standard (SDDS). However, considerable progress has been made in improving the quality of government data and Morocco remains committed to taking the necessary steps to comply with the standard. According to a data ROSC prepared by the IMF in 2003, Morocco is not far off from meeting SDDS requirements. Areas that require improvement include the timeliness of data release in most areas, and the coverage of the data, particularly for general government operations.[18]

The principal vehicles of disseminating information on the government's fiscal activity are the annual budget documentation (the Budget Presentation Note and the Finance Law) and periodic reports from the Ministry of Finance. The annual Finance Laws for the previous and current years are available from the Budget Department and the Ministry's website.

The MoF's regular publication is its *Note de Conjoncture*, which it publishes monthly on its website. Public finance and debt data are provided with the *Note*.[19] The Table of Treasury Expenditure and Revenue -- *Charges et ressources du Trésor* -- published with the Note and compiled by the Directorate of Treasury and External Financing (DTFE) is the MoF's principal source of statistics of public finances.

The Budget Presentation Note for 2003 sets out the economic, political and social objectives of the government; budgeted expenditure and revenues; and action programmes for specific ministries. In addition, the Finance Law contains an *Economic and Financial Report* that examines the national and international macroeconomic environment, the competitiveness of the national economy, and the Finance Law in this context.

The budget documentation provides a one-year forecast for the principal macroeconomic indicators and main budget aggregates. The Ministry of Finance might consider extending the forecasts to facilitate longer-term budgetary planning and assessments of fiscal sustainability.

With regard to information on tax receipts, a number of independent observers mentioned the need for the publication of a more detailed breakdown of tax revenues by segments. Currently, information on tax revenues are only provided for broad categories of tax (i.e. income tax, VAT and corporate tax).[20]

**Public sector operations**

The MoF's reports and budget documentation provide basic aggregate fiscal data on central government operations, as well as certain information on extrabudgetary activities. The central government accounts contain annual data collected by the DTFE on the activities of the social security and pension agencies. However, the totals exclude the activities of the Directorate of Public Establishments and Participations which oversees Public Administrative Establishments, Public Industrial and Commercial Establishments, and non-financial public enterprises.[21] The

Hassan II Fund was removed from the central budget in 2002 and transformed into a Public Industrial and Commercial Establishment.

The budget documentation does not provide consolidated budget data for the general government. Although the General Treasury now compiles aggregates on local government activities, this data is not published in the Ministry of Finance's regular publication, the *Note de conjonture*. Plans are in place for comprehensive general government statistics in the near future.[22] A recent Ministry of Finance report traces the evolution of overall public sector finances since 1980.[23]

Nowhere in the budget documentation is there a statement identifying and quantifying contingent liabilities, tax expenditures and quasi-fiscal activities. With regard to contingent liabilities, in the past, the government has provided guarantees on bonds issued by certain specialised banks with financial problems, though the authorities claimed that there were no such arrangements currently in place.[24]

## A commitment should be made to the timely publication of fiscal information.

**Debt reporting**

The Ministry of Finance publishes summary monthly data for domestic and external public debt on its website, which accompanies the *Note de Conjoncture*. The MoF publishes annual data in the budget and the Finance Law. The Bank Al-Maghrib regularly publishes debt data in the monthly *Monetary Statistics* and in its *Quarterly Bulletin*, though the data in *Monetary Statistics* is only that of the Bank Al-Maghrib and licensed credit institutions.[25]

**Advance release calendars**

There is no advance release calendar available for fiscal data, although the key data is released at regular intervals in the *Note de Conjoncture*. The IMF has commended efforts by Morocco to improve the quality, timeliness and public disclosure of economic and financial data.[26] The MoF usually releases monthly data within approximately two months of the reference month.

## 3. Open Budget Preparation, Execution, and Reporting

●●● Enacted

### Fiscal policy objectives, macroeconomic framework, and risks

**Fiscal policy objectives**

The objectives of fiscal policy are clearly laid out in connection with the presentation of the finance bill. The government sets out both its goals for key macroeconomic variables and more general policy targets. The broader policy framework within which fiscal policy is developed is derived from the priorities set by the King in various speeches and the five-year plan covering 2000-2004.

For 2003 the government set a target of GDP growth of 4.5% and a budget deficit (including privatisation revenues) of 3% of GDP. However, the experience of last year pointed to significant discrepancies between the targets and the actual figures. For instance, the real deficit at approximately 5% compared to a target of 3%.

**Fiscal risks**

While the budget documentation lays out the principal underlying assumptions, there is no elaboration of fiscal risks that may hinder the achievement of fiscal objectives.

In the past, risks have been created by retroactive wage payments, as in 2001 when they contributed to a sharp increase in the budget deficit. Another potential source of concern is the insolvency of two state-owned banks and the fragility of the pension funds. According to IMF estimates, as of end-June 2002, the cost of recapitalising two specialised banks to the eight percent minimum capital adequacy ratio amounted to 3.5% of the annual government budget.[27]

Reliance on revenues from privatisation has also been a persistent risk factor in the MoF's fiscal projections. Unfavourable market conditions have in some instances led to privatisations being delayed or cancelled.[28] Transparency in this area is compromised by the government's decision to continue to treat privatisation revenues as above the line revenue.

**Fiscal sustainability**

Morocco has seen a marked decrease in the central government debt to GDP ratio from 86% in 1992 to 70.65% in 2002. Moreover, recent concerns over fiscal sustainability, due to growing budget deficits, have abated a great deal since last year's improvement in the fiscal balance. Although this is partly because of cyclical factors, a strong commitment to structural reform on the part of the new government of Prime Minister Driss Jettou has substantially increased the probability of a marked decrease in the government's budget deficit and public sector indebtedness alike. The current projections are a deficit of 2.9% of GDP and debt-GDP ratio of 60% by 2008.[29]

The Ministry of Finance has set as a medium-term objective a budget deficit of 3.0% of GDP excluding privatisation receipts.[30] To reach this goal, it acknowledges that it will need to implement substantial reforms in order to limit expenditure, particularly on public sector wages, and increase revenues from taxation.

A major step towards meeting policy goals can be expected following the adoption this year of the new labour law which allows more effective control of the large public sector wage bill which in 2002 amounted to 12% of GDP and 36% of budgeted expenditures, though this is only likely to begin having an impact in the medium-term. The government is, moreover, committed to gradually eliminating price subsidies on particular goods.

## Budget presentation

The Finance Law for the new budget must be presented to parliament at least 70 days before the end of the current fiscal year. The fiscal year is the same as the calendar year. The accompanying *Economic and Financial Report* should also be presented by 1 November. The budget is presented in a pre-arranged format, split by administrative, economic and functional levels of government, and budgetary management. Budget data are reported on a gross basis.

### Data reporting

Changes in the government's fiscal position are regularly reported in the monthly *Note de Conjoncture*. With the *Note* is provided a Table of Treasury Expenditure and Revenue -- *Charges et ressources du Trésor* -- which details actual monthly revenues and expenditures as well as financing needs. However, it does not contrast actual amounts with budgeted amounts.

## Budget execution and monitoring

### Internal control

Procedures for budget execution and monitoring are set out in a number of laws, in particular the Law for the Control of Expenditure Commitments and its subsequent amendments.[31] Various departments and other institutions provide pre- and post-budget execution monitoring. The MoF's Expenditure Commitment Inspection Office is the principal body charged with a priori monitoring of the regularity of expenditure commitments. The General Treasury is responsible for the execution of the Finance Law and the supervision of the finances of the local governments. The Treasury is also responsible for monitoring tax collection, savings, other flows of funds, and the budgets of local and regional authorities.[32]

Many observers, including the Ministry of Finance officials themselves, complain that internal control tends to be heavily geared towards an a priori and formal approach which can result in excessive bureaucracy, petty controls, and delays, thereby providing fertile grounds for corruption.

A posteriori control is exercised by the General Inspectorate of Finances (*Inspection Generale des Finances*), the Accounts Chamber (the *Cour de Comptes*), and parliament. However, in practice this remains a major area of weakness. The effectiveness of the extant control mechanisms is constrained, partly because of limited human resources but primarily due to a lack of cooperation between different bodies charged with monitoring and control functions.

The General Inspectorate of Finances (GIF) audits the activities of central and local administrations, and public enterprises. The GIF draws up an annual audit programme, approved by the minister of finance, which lists the institutions that will be subject to an audit during the course of the forthcoming year. While the number of institutions covered is large, the GIF has shifted its focus to large public enterprises that perform a strategic role in the economic and social development of the country. In 2002, the GIF undertook 40 audits of which 15 were public

enterprises. When an audit uncovers significant irregularities the GIF can pass on the file to the Accounts Chamber or to the courts. In 2002, the Accounts Chambers was called to intervene on 10 occasions.[33]

Government ministries have general inspectors who are responsible for internal audit, but their effectiveness is often minimal. Moreover, they are institutionally directly dependent on the ministers in question.[34]

**Accounting basis**

Revenues are recorded on a cash basis and expenditures after the payment order has been issued. Flows are valued on the basis of the payments made.[35] Regulations for public accounts procedures can be found in the Royal Decree for the Regulation of Public Accounts 1967.[36]

The MoF aims to comply with the accounting standards and frameworks of the International Organisation of Supreme Audit Institutions (INTOSAI), of which Morocco is a member. Accounting accuracy is limited by inconsistencies in the accounting and auditing standards used by public and private enterprises.[37]

**Procurement and employment**

Morocco has greatly improved the transparency and efficiency of its procurement process. A new law (consisting of some modifications to the 1998 decree) intended to modernise public procurement rules is expected to be adopted sometime in 2004.[38] Private sector observers claim that public procurement practices are becoming more transparent, especially within central government.[39] However, it varies considerably according to the entity concerned, be they central government ministries, public enterprises or local administration. Procurement at the level of the local administrations is particularly problematic because of diffuse responsibilities which inhibit transparency. The MoF, for example, provides greater visibility of the procurement process through its website where it publishes a list of tenders and provides detailed information for the various stages of the tendering process.

The central government's Expenditure Commitments Inspection Department, the *Côntrole des Engagements de Dépenses* (CED), which is part of the Ministry of Finance, discloses regulations governing procurement on its website. These include full regulations of current contracts and agreements that have been made, along with payment details and fixed penalties for late delivery or non-fulfilment of contracts.[40]

As in many middle-income countries, corruption remains a concern in Morocco. Transparency Maroc has criticised the government for an increasing lack of commitment to eliminating corruption, and in 2003 Morocco was downgraded to 70th position on the TI Corruption Perceptions Index.[41]

## Fiscal reporting

There is no regular reporting by the MoF besides the official statement by the minister on the execution of the Finance Law. This takes place at a press conference after adoption of the Finance Law for the next year. In this speech the minister provides an overview of the final account of the previous year's budget. Mid-year reports on budget developments are only presented to the legislature when there are major changes to the budget. In such cases, the finance minister must announce the changes to parliament. Parliament may request additional information from the minister and he may be called upon to come to the parliament to answer questions.

## 4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY

●●● Enacted

### Data quality standards

In early 2002 an IMF mission evaluated Morocco's data compilation and dissemination practices. This followed a separate ROSC on accounting and auditing in Morocco. Some of the areas that have been identified as in need of improvement include: harmonisation of local government financial data; consolidation of public finances data; and data on the international investment position.

The budget documentation does not include a statement of the accounting basis and standards used in the compilation and presentation of the budget data. The Table of Treasury Expenditure and Revenue is prepared in accordance with the IMF Government Finance Statistics Manual (GFSM) 1986 (the most current version is GSFM 2001).[42]

The MoF uses accounting standards which it developed in collaboration with relevant departments and professional organisations, and which were consolidated by the National Accounting Council in the early 1990s.[43] These appear to include both cash and accrual accounting, and other methods. There are only limited indications of internal data consistency and reconciliation with data from other sources.

The MoF in conjunction with the Ministry of Interior is carrying out a programme for the harmonisation of local government statistics.

### Independent scrutiny of fiscal information

**Independent Audit**

The Accounts Chamber is responsible for providing independent oversight of public finances. Its two principal functions are inspecting on an annual basis the accounts of the public accountants -- *comptables publiques* -- and undertaking management audits of public entities. The precise modalities of when and how the Accounts Chamber can be called upon to undertake a management audit are not clearly specified. The role of the Accounts Chamber as a source of independent oversight for public finances could be significantly strengthened, however, by providing it with the powers and resources to set its own priorities. At present, the Accounts Chamber acts when called upon to do so by external organisations such as a ministry. This limits its ability to perform as an effective source of independent scrutiny.

A new law of financial jurisdictions extends the jurisdiction of the Accounts Chamber to cover local governments accounts through the creation of Regional Chambers -- *Cours régionales des comptes* -- which report to the Chamber.

The Accounts Chamber presents an annual report to the King, confirming that this activity has been carried out in accordance with the law. The new law on financial jurisdictions requires the publication of the report in the *Bulletin Officiel*, although this is yet to happen.

The Accounts Chamber is also responsible for auditing the government's final expenditure accounts -- the *Loi de règlement*. However, final expenditure accounts for the years 1997-2002 have not been prepared by the MoF. This

year, the Chamber was examining the 1996 accounts. Such a long delay renders the results of the audit largely irrelevant, and significantly damages government accountability towards parliament and the public. The MoF is planning to rectify the backlog over the coming year.

A number of independent observers mentioned that accountability could be also be improved by strengthening the oversight role of parliament, in particular the Public Finances Committee, by providing it with additional support, information, and possibly training.[44]

**National Statistics Agency**

The Directorate of Statistics, part of the Planning High Commission, with its 16 regional delegations has the primary responsibility for assembling and disseminating statistical information. Since 1998, the Directorate has operated under the auspices of the Ministry of Economic Provision and Planning. The government's long-standing plan to turn it into an autonomous agency is yet to be realised.[45]

No law formally establishes the responsibility for the collection, processing, and dissemination of government finance statistics.[46] The DTFE has de facto responsibility for aggregating and publishing government finance statistics.

The principal problem with the statistical system has been its high degree of decentralisation. Most organisations still assemble and publish their own statistics.

## INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to Morocco between 19 and 21 November 2003:

### Ministry of Finance and Privatisation, Rabat

**20 November 2003**

| | |
|---|---|
| Mr Abdelali Benbrik | Inspector General of Finances |
| Mr Omar Faraj | Director of Administrative Affairs |
| Mr Ahmed Hajoub | Directorate of the Treasury and External Financing |

### Accounts Chamber, Rabat

**21 November 2003**

| | |
|---|---|
| Mr Bennasar El Baz | Secretary General |

## ADDITIONAL INTERVIEWS

### Casablanca

**19 November 2003**

| | | |
|---|---|---|
| Bachir Rachdi | Secretary General | Transparency Maroc |
| Mostafa Meftah | Director | National Federation for Buildings and Public Works |
| Khalid Abaroudi | Secretary General | Moroccan National Business Confederation (CGEM) |

### Rabat

**21 November 2003**

| | | |
|---|---|---|
| Najib Akesbi | Professor of Economics and Management | Institut Agronomique et Vétérinaire Hassan II |

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[21] "Morocco: Report on the Observance of Standards and Codes – Data Module; International Monetary Fund, April 2003, available at www.imf.org/external/np/rosc/rosc.asp#M
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# OXFORD ANALYTICA

## PAKISTAN

## FISCAL TRANSPARENCY

**Country Report 2003**

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# PAKISTAN

## COMPLIANCE RATINGS

| *Fiscal transparency* | *2003* |
|---|---|
| Clarity of roles | ••• |
| Availability of information | •• |
| Budget preparation | ••• |
| Accountability | •• |
| **Score** | 2.50 |

## OUTLOOK & COMMENTARY

The government is committed to continuing with its drive for improved governance and greater transparency. The "Fiscal Responsibility Ordinance" sets binding rules designed to ensure fiscal sustainability and openness. Ambitious commitments about data dissemination have been made in connection with Pakistan's GDDS membership. The government is tackling deeply entrenched corruption and auditing practices are being reformed with external assistance.

In spite of considerable progress, the improvement in the government's fiscal fortunes has had more to do with a generally favourable macroeconomic situation and low interest rates than structural reform. An exogenous shock can thus potentially upset the process. Moreover, populist tensions will likely continue to introduce inconsistencies to reform and complicate their implementation, especially with the transition to civilian rule.

# EXECUTIVE SUMMARY

## 2.50 Intent declared

Following decades of fiscal irresponsibility, the Pakistani authorities in 2000 embarked on an ambitious reform plan designed to improve governance and fiscal transparency. The tax administration has been overhauled to a significant degree, in spite of some measures being watered down by evidence of declining revenues. A comprehensive programme of restructuring and privatisation has been undertaken for public sector enterprises.

The government has introduced a formal fiscal rule in the "Fiscal Responsibility and Debt Limitation Ordinance" which was presented to the parliament in 2003. The new law makes a binding commitment to reduce government debt to sustainable levels over the coming decade and sets formal expenditure ceilings for the intermediate period.

Pakistan in late 2003 joined the General Data Dissemination Standards (GDDS) of the International Monetary Fund, which marks a formal commitment to modernise the system of fiscal data collection and dissemination in accordance with international best practices.

Even though the authorities' commitment to reform appears genuine, some questions pertain to the sustainability of the plan. Much of the recent improvement has been made possible by the favourable macroeconomic climate and successes in debt restructuring at a time of historically low interest rates. Populist pressures remain legion and the government risk-averse at a time when debt servicing costs, even with the recent reductions, are high. There has recently been some evidence of the reforms slowing down. For instance, the General Sales Tax has not been extended to services. A protracted parliamentary stalemate was only resolved recently when President Musharraf cut a deal with the Islamist parties. This should permit a resumption of substantive reform, even though the parliamentary situation may continue to create delays. Additional help may come from the peace process with India, provided it is sustained.

## 1. Clarity of Roles, Responsibilities, and Objectives

●●● Enacted

**The government sector should be distinguished from the rest of the public sector and from the rest of the economy, and policy and management roles within the public sector should be clear and publicly disclosed.**

**Structure, functions, and responsibilities of government**

The government is composed of the central administration in Islamabad; the regional level comprising four provinces, one territory, and one capital territory; and the municipalities. The Constitution of the Islamic Republic of Pakistan and the "Rules of Business" of government define the roles and responsibilities of the federal and provincial governments, and internationally accepted statistical definitions of general government activity are applied. The provinces enjoy legal, fiscal, and financial independence.

**Coordination and management of budgetary activities**

The constitution sets the basic rules for budgetary activities. It requires all revenues and loans or loan repayments to be paid into a consolidated fund and other receipts to the public account.[1] It further stipulates the rules for payments from the consolidated fund.[2] Some essential expenditures, including public debt service, salaries of high-ranking government officials, and the administrative expenses of certain offices are automatically drawn from the consolidated fund. All other expenditures from the fund must be preceeded by a formal "demand for grants" by the federal government and authorised by the parliament.

The competencies of government agencies are defined in the "Rules of Business." The precise allocation of responsibilities for budget management is described in the "New System of Financial Control and Budgeting" introduced in 2000 which is further complemented by orders and instructions from the Ministry of Finances. The procedure for budget management at the provincial level replicates the central government system.[3]

The legal independence of the provinces creates some problems for policy coordination. For instance the new "Fiscal Responsibility and Debt Limitation Ordinance" will not apply to provincial governments and will have to be replicated through local legislation in order to bring about nationwide compliance. The government can exert influence on the provinces by imposing conditionality on loans issued to sub-national governments. A high degree of coordination is possible through collaboration between national and provincial executives, since a provincial government's consent is legally required for the introduction of a money bill at a provincial parliament.[4]

The government is currently working on a new revenue-sharing arrangement between the federation and the provinces, the purpose of which is to bring about an allocation of resources to the local governments that is more in line with their respective expenditure responsibilities.

While budgetary practices at the provincial level broadly replicate the federal standards, certain functions remain largely vested in the central administration. These include audit, accounting and taxation. Provincial authorities can borrow funds only with explicit consent of the federal government if they have any outstanding credit obligations to central administration.[5] Provincial governments bear the primary responsibility for funding health, education,

agriculture, and rural water supply. However, they remain heavily dependent on federal transfers. The main sources of federal transfers are the National Finance Commission (NFC) awards and federal grants and direct transfers.

**Relations between government and public sector agencies**

Even though the State Bank of Pakistan (SBP) enjoys considerable formal independence, it is required to consult with the government to ensure policy coordination. It is further allowed to lend money to the government with the total amounts subject to mutual agreement. A formal credit plan is agreed after discussions with international financial institutions, the government and the SBP. It is designed to ensure consistency with the government's overall macroeconomic objectives. The SBP has not recently played a major role in budgetary financing. Roughly quarterly data on SBP lending to the federal and provincial governments is provided on the SBP website.[6]

The SBP uses special funds to provide credit through commercial and development banks to a variety of entities. Such loans are primarily channelled to agriculture, industry, exports, and loan guarantees. The credit funds derive their initial financing from SBP profits in accordance with a joint decision by the Bank and the government. All loans, with the exception of export credit, are issued at commercial rates. The activities of the funds are reported in the SBP *Annual Report*. However, government support for such funding is not explicitly reported in the budget.

Publicly owned enterprises play a critically important role in the Pakistani economy with examples including the electricity utilities, gas distribution companies, refineries, and the largest banks. The government further has major stakes in the fertilizer industry. Many publicly owned companies are subject to administrative direction and regulation. Indeed, Pakistan Railways (PR) and the Post Office are government departments and especially PR receives regular subsidies.

Pakistan has, since the early 1990s, been pursuing a strategy of restructuring its public sector entities through deregulation, privatisation, and transformation. State-owned enterprises are now increasingly run by managers pursuing commercial objectives.[7] In spite of improvement over the past four years, serious problems remain, especially in the case of the two main power utilities, the Pakistan Water and Development Authority (WAPDA) and the Karachi Electric Supply Corporation (KESC). The budget constraints facing many PSE's are still not hard and, for instance, WAPDA and KESC are to be given subsidies of 49.8 bn ($0.87) rupees under the 2003-4 budget.[8] An attempt to privatise KESC last year failed.[9]

Public sector reform has resulted in major changes in the banking sector with the privatisation of United Bank Limited, MCB, Bank Al-falah, and Habib Bank. The Agricultural Development Bank of Pakistan – renamed as Zarai Taraqiati Bank Limited – is being restructured, whereas the SME Development Programme is designed to transform SME Bank for the purpose of privatisation.[10]

The government has, with external assistance, pursued an Oil and Gas Reform Programme designed to restructure and privatise companies in the sector. This has been accompanied by an overhaul of the regulatory framework involving the creation of the Oil and Gas Regulatory Authority (OGRA). The National Electric Power Regulatory Authority regulates heavily indebted power companies. The distribution centres of WAPDA electricity utility have been corporatised and privatised.[11]

Overall, the process of privatisation has benefited from the adoption of the "Privatisation Commission Ordinance" which provides legal cover to challenges, improves the transparency of the sales process, and governs the distribution of proceeds. During the past two years, 22 privatisations worth 35bn rupees ($0.61bn) have been carried out, as compared a total of only 59.5bn rupees ($1.04bn) in the previous eight years. The process is expected to continue and to involve large companies, including utilities.[12]

**Government involvement in the private sector**

While historically, the division between the public and the private sector has been blurred, the government is committed to increasing the private sector's role in the provision of goods and services. A programme of restructuring and privatising public enterprises was initiated in 1991 and the process has significantly accelerated since 2001.[13] The Privatisation Commission is entrusted with selling government assets and for offering concessions to operate them. The privatisation process constitutes an important element of fiscal consolidation with 90% of revenues allocated to debt retirement with the remaining 10% going to poverty alleviation.[14]

As part of the programme, a legal framework aimed at establishing a fair and transparent mechanism for privatisation has been put in place. Concurrently with privatisation, a number of public activities *vis-à-vis* the private sector are being redefined.

The government is significantly deregulating the economy, so as to create a more level playing field between public and private enterprises. Tariffs and other types of protection are being reduced. At the same time, regulators have been set up for the purpose of monitoring developments in particular sectors. However, the government has periodically interfered with their operations. For instance, OGRA has been prevented for setting consumer gas prices as required by the International Monetary Fund (IMF).[15]

## There should be a clear legal and administrative framework for fiscal management.

**Legal framework for budgetary activities**

Articles 80 to 88 of the Pakistani constitution lay down the budget procedures for which the Ministry of Finance (MoF) bears the ultimate responsibility. The federal government is required to present an annual budget statement to the National Assembly. All expenditures not included in the Federal Consolidated Fund are voted on by the Assembly. If necessary, the National Assembly may approve a Supplementary Budget Statement or an Excess Budget Statement.[16] The government in 1998 introduced a "new system of financial controls and budgeting,"[17] The existing budget procedures are described in a 1998 Finance Division manual entitled "Revised System of Financial Control and Budgeting."[18]

**Legal framework for taxation**

The main body responsible for tax administration in Pakistan is the Central Revenue Board, which exists as a division under the Ministry of Finance.[19]

Pakistan has historically an extremely complex legislative framework in the area of taxation, although all taxes do have an explicit basis in law. In addition to being inelastic and inefficient, the system of taxation is inequitable, providing considerable opportunities for discretionary practices. For example, more than a third of the Income Tax Ordinance consists of exemptions.[20]

The government initiated a systematic overhaul of the system of taxation in 2000 and some progress has been made in making the tax regime more transparent. At the same time, the government has been pursuing a medium-term programme for reforming tax administration since November 2001. The tax base has been widened to previously untaxed or under-taxed areas and Pakistan is following international practices by shifting the burden from imports and investment to consumption and incomes. At the same time, tax rates are being cut to stimulate economic activity

and to encourage compliance, which remains a major problem area.[21] The government has eliminated all so-called "tax whitener" schemes, which used to be a common instrument of tax evasion, and has conducted a tax survey and documentation exercise, which substantially increased the number of taxpayers.[22]

A pivotal element of the reform was the "Income Tax Ordinance" of 2001, which became effective in July 2002. The new ordinance significantly reduces the discretionary powers of tax authorities and self-assessment is permitted for all types of incomes and all taxpayers, although some measures have subsequently been rolled back due to a fall in receipts. Similarly, the reform has eliminated presumptive and non-adjustable taxes. The government has repealed the wealth tax of 1963. The use of excise duties is being reduced.[23]

At a time when the sales tax is establishing itself as the most important source of government revenue, a variety of steps are being taken to increase the efficiency of collection and the simplicity of administration. For instance, the number of audits of taxpayers is being limited to one a year.[24]

The government has simplified the system of tariffs with the maximum rate set at 25% and the number of slabs brought down to four. At the same time, a programme of trade liberalisation is being pursued. A Customs Administration Reform has streamlined a previously elaborate system of customs procedures.[25]

The government is committed to eliminating differential treatment of taxpayers. For example, higher corporate tax rates facing banks and private limited companies, as compared to public limited companies, are being gradually reduced.[26] Yet at the same time, new resources have been created for particular types of taxpayers. A special Large Taxpayer Unite has been launched in Karachi and five more medium taxpayer units for income tax are being established. While the measures are clearly primarily efficiency-improving, they do also provide potential for inconsistency in the treatment of different types of taxpayers. A tax ombudsman's office has been established to deal with dispute resolution and 5-7 general taxpayer facilitation centres are set to open by July 2004.[27]

The gradual computerisation of tax administration is reducing direct interaction between taxpayers and officials. Similarly, communication of changes to tax laws and general information to taxpayers has seen dramatic improvement through increased reliance on the internet by the Central Board of Revenue.[28]

## Ethical standards for public servants

The "Government Servants (Conduct) Rules" of 1964 is the main legal document governing the behaviour of public servants in Pakistan. The rules address conflict-of-interest issued by requiring public servants to declare their assets each year and by prohibiting them from conducting business or entering into agreements that may conflict with official duties.

Low pay and a lack of effective supervision has made corruption, especially at the sub-national level, deeply entrenched. The government is pursuing an anti-corruption strategy and, for example, the 1973 "Civil Servants Act" has been amended to specify the rules governing the dismissal of civil servants.[29]

The authorities have enhanced the competences of the National Accountability Courts in order to facilitate court proceedings against people charged with official corruption. New human resources have been assigned to the sector to cope with the backlog of cases.[30]

## 2. PUBLIC AVAILABILITY OF INFORMATION

●● Intent declared

**The public should be provided with full information on the past, current, and projected fiscal activity of government.**

**Central government operations**

The new "Fiscal Responsibility and Debt Limitation Ordinance" requires the federal government to ensure transparency by providing the National Assembly with three economic policy statements in each financial year. These consist of the Medium-term Budgetary Statement included in the Annual Budget Statement, the Fiscal Policy Statement by the end of December, and the Debt Policy Statement by the end of December.

As part of rectifying the state of Pakistan's public finances after decades of financial mismanagement, all budgets will soon have to conform to the requirements of the "Fiscal Responsibility and Debt Limitation Ordinance."

The budget documents do not clearly distinguish ongoing costs of government policies. However, such data are prepared by the MoF. Current expenditure is broken down to "permanent" expenditures and New Item Statements which, in turn, are distinguished as "new" or "temporary."

The government has a persistent tendency to overestimate revenues.[31] This in turn has contributed to unrealistic budget estimates and has necessitated cutbacks during the year. The MoF's staff of Financial Advisors is responsible for monitoring budget execution.

**Public sector operations**

The authorities compile general government fiscal statistics, but they are often provided with a long time lag. The MoF now publishes provisional quarterly data of central and provincial government fiscal activity on its website. [32]

The federal budget details central government grants to provinces, but comprehensive reports on provincial receipts and spending are presented only to the provincial assemblies. The MoF's "Economic Survey" provides an overview of federal and provincial budgets in the preceding three years. The SBP includes data on the combined federal and provincial budgets in its "Annual Report" based on a combination of budget documents and SBP data.

The Controller General of Accounts (CGA) prepares "Combined Finance and Revenue Accounts for the Federal and Provincial Governments of Pakistan" from audited accounts of each level of government. However, the materials have tended to be compiled with a considerable delay and are deemed in some instances to be inaccurate. There have been systematic efforts in recent years to improve the quality of data reconciliation and the timeliness of data dissemination.

## A commitment should be made to the timely publication of fiscal information.

**Debt reporting**

The quality of information on public debt information has improved dramatically in recent years. The MoF's *Economic Survey* now provides a comprehensive overview of debt servicing costs and a breakdown of domestic debt broken down into permanent, floating, and unfunded debt. Broad trends of overall public debt, accompanied by recent developments, are also discussed.[33]

The MoF is currently developing procedures for compiling and disseminating quarterly external debt data which would be made available within three months. Medium-term plans exist to publish separate data for central government external debt and publicly guaranteed debt, as well as for the separate publication of short-term external debt and for a quarterly debt service schedule.[34]

The State Bank of Pakistan also compiles data on public debt. Quarterly data is provided on the external debt and liabilities, on service costs, and on the stock of outstanding domestic debt.[35]

**Advance release calendars**

While the MoF is committed to regular provision of government fiscal data and the statistics on its website are updated accordingly, there are no formal advance release calendars as yet.[36]

## 3. Open Budget Preparation, Execution, and Reporting

●●● Enacted

### Fiscal policy objectives, macroeconomic framework, and risks

**Fiscal policy objectives**

Fiscal policy objectives are clearly identified in the budget documents and highlighted in the budget speech of the minister of finance. In addition, budgets are now placed in a three-year macroeconomic framework with targets set for all key variables.[37]

The National Development Council, which brings together the premiers of the federal and the provincial governments, has approved a 160 billion rupees ($2.81bn) development plan for the 2003-04 fiscal year. General targets are set also in the context of this programme. Related to this is a "Poverty Reduction Strategy" which envisages increased expenditures on poverty relief.[38]

**Macroeconomic framework**

The MoF produces an "Economic Survey" covering the current macroeconomic situation in the country, as well as future prospects. The "Survey" is always included in the budget documents submitted to the parliament in connection with a new finance bill. However, the MoF does not publish its macroeconomic model, nor is there a formal mechanism for consultations involving independent experts.[39]

The 2003-04 budget was prepared in the context of a three-year macroeconomic framework extended from 2003 to 2006. The framework sets target predictions for GDP growth, inflation, gross investment, fiscal deficit, current account deficit, and foreign exchange reserves.[40] In addition, budgetary planning has been carried out within the framework of the Poverty Reduction and Growth Facility 2002-2004 agreed with the IMF in 2001.[41]

**Fiscal risks**

The MoF does not at present publish any systematic analyses of sensitivity of its budget estimates to changes in economic conditions. Some discussion of macroeconomic factors bearing on the budget estimates is provided in the "Economic Survey" but these do not amount to a formal assessment of fiscal risks.

A major source of fiscal risks comes from a substantial build-up of nonperforming loans due to lax lending practices by public commercial banks and development financial institutions. Financial sector reforms pursued since 1997 have significantly reduced the number of non-performing loans but the problem remains to be fully settled. Similarly, the enormous losses of the public sector enterprises, led by two government-owned power utilities, have not been properly tackled and remain a potential threat to fiscal consolidation. The total impact of the implicit and explicit contingencies associated with PSE's on the federal budget was 100 billion rupees ($1.75bn) – or 2.5% of GDP – in 2002-03. While this figure is expected to decline, a thoroughgoing reform of the system is required.[42]

The government has revived a highly controversial *Taamir-e-Watan* programme as part of its poverty reduction drive. Under the programme, members of the National Assembly and of the Senate are asked to identify small

development schemes in their constituencies which are then funded with public money. The system is potentially open to serious abuse, although the total grants to be made in 2003-4 are still limited to 3.6 billion ($0.06bn).[43]

A still significant fiscal risk is posed by non-performing loans, especially in the banking sector. The Corporate and Industrial Restructuring Corporation was established in 2000 as an autonomous MoF unit with the main task of recovering overdue loans on behalf of state-owned banks and development financial institutions.[44]

President Musharraf has promised to oversee a gradual transition to representative government. It remains to be seen what the effects of this will be on economic policy. The army remains one of the most efficient organisations in the country, whereas many past civilian governments have been associated with corruption and inertia and have proven highly vulnerable to populist pressures. The adoption of a formal fiscal rule with the "Fiscal Responsibility and Debt Limitation Ordinance" should, however, significantly reduce the fiscal risks posed by political pressures.

## Fiscal sustainability

The budget documents provide no formal information regarding fiscal sustainability, but the issue is recognised as the central challenge facing the Pakistani government following decades of lax policy. A string of large deficits in the 1990s increased the public debt-to-GDP ratio from an already high 91.3% in 1990-1 to 103% in 1999-2000. By the end of the decade, the debt amounted to 630.4% of total government revenue with debt servicing costs taking up almost 64% of the total revenues.[45] This situation left Pakistani government finances extremely vulnerable to exogenous shocks.

The government's tax reforms appear to have significantly contributed to a reversal of the country's fiscal prospects. The authorities have further successfully exploited the current strong macroeconomic situation to bring the country's debt burden under more effective control. The overall fiscal deficit has declined from an average of nearly 7.0% of GDP in the 1990s to 4.5% in 2002-3. The debt-to-GDP ratio has once again been brought down to 90% whereas the share of debt servicing costs in total revenues has been reduced to 27%. The government has also effectively capitalised on the lower cost of borrowing.[46]

The redistribution of the tax burden has increased the share of direct taxes from 18% of total tax revenues in 1990-91 to 32% in 2002-03, thereby reducing the effect of business cycle fluctuations on government revenues. At the same time, the share of customs and excise duties in total indirect tax revenue has fallen from 82% to 34%.[47]

The new "Fiscal Responsibility and Debt Limitation Ordinance," which is expected to be passed into law very soon, is a response to the pressing need for debt reduction so as to free up resources for development spending. Under the ordinance, the government is required to report regularly on fiscal developments and to set targets for debt reduction. A 60% debt-to-GDP ratio is set for 2011-12 and an annual debt reduction strategy laid out.[48] Government borrowing is limited to development expenditures.[49]

The improved outlook for Pakistan's fiscal situation was a key factor prompting international rating agencies to upgrade the country's long-term sovereign credit rating in late 2003.[50]

## Budget presentation

### Data reporting

Pakistan joined the IMF's General Data Dissemination System (GDDS) in November 2003 and data on its statistical production and dissemination practices is consequently available on the IMF website.[51]

Under its GDDS membership, the MoF has made several commitments to improve data quality and dissemination standards. There are short-term plans to develop an advance release calendar to be posted on the MoF website and to compile and disseminate monthly data within one month. The MoF is further developing a methodology statement for government operations data. In the medium term, the government is undertaking to implement a revised chart of accounts, as well as a new accounting model which would be compatible with the eventual implementation of accrual accounting. The government further intends to adopt the IMF's "Government Finance Statistics Manual."[52]

## Budget execution and monitoring

After legislative approval, the Finance Division of the government formally communicates budget to the line ministries and their accounts-general. The Finance Division keeps an appropriation ledger, which records initial budget distributions and subsequent adjustments.[53]

The principal accounting officer (PAO) of each government entity is responsible for controlling spending. Drawing and disbursing officers have the duty to ensure that payment claims are approved in accordance with the "Schedule of Authorised Expenditure." No request exceeding the available funds can be approved without a formal legal contract. In such an event, the PAO has the responsibility for locating the necessary funds. He is required to submit a statement of excesses and surrenders to the Finance Division (or provincial department) in a form and at a time required by the Division. Excess expenditure can only be approved from surplus grants and all savings are returned to the government. If necessary, a supplementary grant can be approved by the Finance Division, provided that the excess expenditure was beyond the control of the agency involved and cannot be reasonably postponed. The supplementary grants have to be approved by national or provincial assemblies during the next budgetary cycle. All interim expenditure is governed by the MoF standing orders. The procedures at the federal and provincial levels are identical.[54]

### Accounting basis

All accounting of fiscal flows currently takes place on a cash basis with the procedures explained in government accounting manuals. The government is currently working on initial preparations for the eventual introduction of accrual accounting. The use of accrual accounting is likely to begin very gradually. Data classification broadly conforms to GFS fiscal reporting requirements.

The use of the new accounting model has begun with the 2003/04 federal budget, although the old and new systems will be used concurrently at least until the publication of the 2004/05 budget.

### Procurement and employment

Federal employees are appointed through a competitive examination administered by the Federal Public Service Commission.[55]

Formal procurement regulations exist but are not issued under the umbrella of a procurement law. They are not always observed and the monitoring of compliance remains imperfect. The government is currently setting up a Public Procurement Regulatory Authority, which will develop a procurement law and oversee its implementation.

Even the government recently admitted that corruption in Pakistan remains "pervasive and deeply entrenched" and is seen as particularly bad on the sub-national level. Transparency International last year ranked Pakistan 77th out of 102 countries in its corruption perceptions survey which, however, marked an improvement on the previous year. The government is pursuing a national anti-corruption strategy in order to improve the situation. A National Accountability Bureau was established in 1999 and the 1947 "Prevention of Corruption Act" revised simultaneously. The government now enjoys extensive powers to investigate alleged cases of corruption.[56]

## Fiscal reporting

The central government fiscal data currently comprises the budgetary operations of the federal government and the public sector development programme. It excludes the *Zakat* extrabudgetary fund, social security funds, and locally financial operations of provincial and municipal governments. Data on interest payments is given separately and broken down into domestic and foreign. The system of classification broadly conforms to the IMF "Manual on Government Finance Statistics." The data is provided on a quarterly basis with a delay of two months.[57]

Under the "Fiscal Responsibility and Debt Limitation Ordinance," the government is required to present the National Assembly with a medium-term budget statement with a three-year rolling fiscal framework. The annual fiscal policy statement is required to specify how the budget targets relate to the debt reduction strategy. An annual debt policy statement explains borrowing strategies and potential risks. An annual "State of the Economy" report will assess the performance of the economy against the targets set by the government.[58]

## 4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY

●● Intent declared

### Data quality standards

The government has significantly improved the quality of fiscal data in recent years. A federal Fiscal Monitoring Committee tracks fiscal flows and manages efforts to improve data quality. Similar committees are being created at the provincial level. The Accountant General Pakistan is fully involved with the MoF in the preparation of fiscal reports, which are published on a quarterly basis, accompanied by commentary on data quality. The Pakistan "Improvement of Financial Reporting and Accounting" (PIFRA) project has overseen the creation of a centralised debt management unit.[59]

### Independent scrutiny of fiscal information

**Independent Audit**

The office of the Auditor General enjoys constitutional authority and reports directly to the president. At present, the Auditor General is responsible for both auditing and accounting functions, although the government has begun the process of separating the two functions.[60]

The PIFRA project is supporting institutional reform and policy initiatives designed to improve auditing and accounting standards. A central objective of the programme is to develop the Auditor General's office into an independent supreme audit institution. Methodological reforms are designed to reduce traditional compliance audit in favour of more performance-type assessments.[61]

A great deal remains to be done to improve internal auditing procedures at government agencies. Considerable criticism has been expressed on reporting standards and the situation appears to be particularly bad at the provincial level.

Pakistan has endorsed the International Standards on Auditing, although information on their enforcement remains limited.

**National Statistics Agency**

The Federal Bureau of Statistics (FBS) is a department of Pakistani government's Statistics Division. The Statistical Act of 1974 authorises the Bureau to collect information for statistical purposes. The FBS has been given legislative assurance of independence. The FBS compiles statistics from many sources and produces a range of publications, including the Statistical Yearbook, Pakistan Statistics Handbook, etc. Among other things, it keeps an administrative record of public finance statistics compiled by the fiscal authorities.[62]

In connection with Pakistan's GDDS membership, the FBS is working on a systematic overhaul of its data collection and dissemination practices.[63]

## INTERVIEWS

In 2003, Oxford Analytica did not conduct in-country interviews in Pakistan for security reasons. The information contained in this report was drawn from correspondence with representatives of the State Bank of Pakistan, the Ministry of Finance, and the Federal Bureau of Statistics, experts from the Oxford Analytica global network, and various publicly available sources.

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[49] "Fiscal responsibility and debt limitation law on finance ministry's website," *Econo-list*, 12 July 2002, http://lists.isb.sdnpk.org/pipermail/econo-list/2002-July/002580.html.
[50] "Pakistan: Domestic woes tarnish external recovery," *Oxford Analytica Daily Brief*, 17 November 2003; "Pakistan: Revision reflects deficit success," *Oxford Analytica Daily Brief*, 2 December 2003.
[51] http://www.imf.org/external/np/sec/pr/2003/pr03198.htm.
[52] http://dsbb.imf.org/Applications/web/gdds/gddscountrycategorysummreport/?strcode=PAK&strcat=Sum1.
[53] http://www.adb.org/Documents/Books/Financial_Mgt/Pakistan/chap_06.pdf.
[54] http://www.adb.org/Documents/Books/Financial_Mgt/Pakistan/chap_06.pdf.
[55] "Pakistan: Policy and Legal Framework," http://www.saarcnet.org/newsaarcnet/countryprofile/pakistan/paksitan18.htm.
[56] "Pakistan: 2002 Article IV Consultation, Third Review Under the Poverty Reduction and Growth Facility Arrangement, and Request for Waivers of Performance Criteria—Staff Report; Staff Statement; Public Information

Notice on the Executive Board Discussion; and Statement by the Executive Director for Pakistan," *IMF Country Report*, No. 02/246, International Monetary Fund, November 2002.
[57] http://dsbb.imf.org/Applications/web/gdds/gddscountrycategorysummreport/?strcode=PAK&strcat=Sum2.
[58] "Pakistan: Selected Issues and Statistical Appendix," *IMF Country Report*, No. 02/247, International Monetary Fund, November 2002.
[59] http://www.dawn.com/events/imf/5.htm.
[60] "Presentation on Fiscal Reforms," Finance Division, Government of Pakistan, May 14, 2003, http://lnweb18.worldbank.org/sar/sa.nsf/Attachments/PDF2003-Fiscal/$File/Fiscal.pdf.
[61] World Bank, "Pakistan Country Update," http://www.worldbank.org.pk.
[62] http://www.statpak.gov.pk/depts/fbs/aboutus/aboutus.html.
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# OXFORD ANALYTICA

## PERU

## FISCAL TRANSPARENCY

**Country Report 2003**

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# PERU

## COMPLIANCE RATINGS

| *Fiscal transparency* | *2003* | *2002* | *2001* |
|---|---|---|---|
| Clarity of roles | ●●● | ●●● | ●●● |
| Availability of information | ●●●● | ●●● | ●●●● |
| Budget preparation | ●●● | ●● | ●●● |
| Accountability | ●●● | ●●● | ●●● |
| **Score** | **3.25** | **2.75** | **3.25** |

## OUTLOOK & COMMENTARY

Peru's efforts to increase fiscal transparency will mostly depend on the government's ability to maintain its fiscal reform programme in a highly politicised environment. The decentralisation process is likely to make some progress, giving greater transparency to the roles, responsibilities, and objectives of regional governments. However, success will mostly depend on the central government's resolve in fending off political interests.

The National Superintendence of Tax Administration (SUNAT) will continue to achieve important progress in widening the tax base and reducing evasion by streamlining tax collection through use of a more transparent and effective framework.

Peru's main weaknesses will likely remain the privatisation programme, the lack of performance-based budgeting, and the government's inability to bring the 'informal' economy into compliance with tax obligations. These hurdles could substantially obstruct efforts to reduce the fiscal deficit and enhance overall fiscal transparency.

# EXECUTIVE SUMMARY

## 3.25 Enacted

The government of Peru has attained moderate improvements towards increasing fiscal policy transparency in 2003. There was little progress in developing the institutional framework required by the decentralisation programme. The work of the National Decentralisation Council (CND), which is in charge of supervising the process of transferring resources to regional/municipal governments, has been noticeably criticised, while its inability to generate consensus has left many grey areas with regard to the delineation of the property of state assets and responsibilities over pension liabilities. In addition, the privatisation process of public assets and the policy to increase private sector involvement in the provision of public services came to a halt. These problems in both the decentralisation and privatisation programmes have shown that fiscal transparency (and fiscal policy itself) is highly vulnerable to political pressure.

The Law on Fiscal Responsibility and Transparency has provided for more feasible fiscal ceilings. The ability of the government to observe future fiscal deficit rules will enhance the credibility of the framework, which will facilitate the implementation of systems aimed at strengthening the monitoring of budget expenditure at all government levels. The Integrated System of Financial Administration of the Public Sector (SIAF-SP) has substantially improved the transparency and timely reporting of central government fiscal activities. Major progress should be achieved once the SIAF-SP is operational in all regional/local governments, decentralised agencies, and state-owned enterprises.

Peru's overall score has improved from 2.75 in 2002 to 3.25

## 1. Clarity of Roles, Responsibilities, and Objectives

●●● Enacted

**The government sector should be distinguished from the rest of the public sector and from the rest of the economy, and policy and management roles within the public sector should be clear and publicly disclosed.**

Peru has attained moderate progress in defining the structure, functions and responsibilities of the state, as established in the 1993 Constitution of Peru and complementary legislation. The highly anticipated decentralisation process -- aimed at redefining the government's functions and responsibilities -- has progressed very slowly in the last twelve months. In addition, the privatisation programme came to a halt, although the government has started a process to provide some public services through private sector concessions.

**Structure, functions and responsibilities of government**

The government's structure and responsibilities are clearly defined in the 1993 Constitution of Peru.[1] Peru has developed clear institutions that protect private ownership and economic initiatives, giving equal treatment to foreign and domestic investors since the early 1990s.

The public sector is defined as the central government, the decentralised government, independent agencies and the autonomous branches of government. The central government includes the ministries and government agencies, while the decentralised government includes the regional and municipal governments, independent regulatory agencies, the Office of the Comptroller General, the Central Reserve Bank of Peru (BCRP) and state-owned enterprises.

Since Peru is one of the most centralised governments in Latin America, with international assistance the government had embarked on a comprehensive process of fiscal decentralisation.[2] However, in the last twelve months the process suffered serious setbacks. Some commentators said that the decentralisation process was poorly conceived, driven by political interests focused on financing social programmes that now cannot be stopped.[3] The *Law on the General Framework for Decentralisation* established an inadequate plan for fiscal and management procedures at all government levels.[4] The law's main weakness is its requirement of reducing 25 regional governments into only eight -- a process that appears technically challenging and politically unfeasible. Other legal issues are effectively established, such as the accountability of regional and municipal governments over budget expenditure and limits on debt issues, but substantial progress is needed in defining the property of state assets and responsibilities over pension liabilities in order to report (and minimise) all fiscal risks.

The work of the National Decentralisation Council (CND), in charge of supervising the gradual process of transferring resources and responsibilities to regional and municipal governments -- mainly health and education programmes and some public investment infrastructure projects -- has been particularly criticised. The CND has had little success in generating consensus, since its resolutions are perceived as highly politicised and not representative of regional governments' interests. In this context, little progress was attained in passing legislation to transfer the allocation of central government resources, the authority to tax goods and services, and comprehensive decision-making powers.

**Coordination and management of budgetary activities**

The Ministry of Economy and Finance (MEF) controls the budget process.[5] The MEF's Budget Office arranges the proposed budget documentation, which for the fiscal year 2004 includes the budget of the central government, decentralised institutions (including regional and municipal governments), and independent regulatory agencies. State-owned enterprises administered by the State's Entrepreneurial Activities National Financing Fund (FONAFE), the BCRP, the Social and Health Insurance Agency (ESSALUD), and public universities lie outside the budget law.

**Relations between government and public sector agencies**

The constitution establishes the independence of the BCRP, regulatory agencies and the Office of the Comptroller General. However, the current institutional arrangements do not fully guarantee this legal independence. In particular, the concurrence of tenures of BCRP board members and officials from the Superintendence of Banking and Insurance (SBS) with the presidential and legislative terms casts doubts about the *de facto* independence of the appointed directors.[6] SBS officials still lack clear legal protection.

**Government involvement in the private sector**

State-owned enterprises are regulated and managed by the FONAFE, an agency that lies under MEF jurisdiction.[7] FONAFE approves their annual budget, including those of state-owned financial institutions, utilities and other energy and industrial enterprises. The government's plans to privatise many of these state-owned utilities, as well as other public assets, has been stopped.[8] Concerns remain over the institutional framework that oversees the management of state-owned enterprises -- there is consensus that there should be a more transparent allocation and performance evaluation of these enterprises.[9]

Public financial institutions do not normally engage in direct lending activities. Although these are subject to SBS oversight, the absence of effective independence of the SBS president can also potentially increase fiscal risks.[10] The BCRP may perform lending operations to private financial institutions facing financial distress, when guaranteed with first-class securities and for periods of no more than 30 days.

## There should be a clear legal and administrative framework for fiscal management

Peru's legal framework for fiscal management remains clear, although its fiscal responsibility framework, the approved fiscal deficit and multi-annual budgeting rules have been rarely observed. In May, the Law 27,245 on Fiscal Prudence and Transparency (LPTF) was modified through Law 27,958 on Fiscal Responsibility and Transparency (LRTF)[11], since a number of fiscal ceilings of the LPTF had been violated. Commentators expressed concern about the new, much broader definition of 'government' introduced in the LRTF, which has misled some analysts into thinking that the original targets will be met this year.[12]

**Legal framework for budgetary activities**

The constitution requires the government to present an annual budget bill to Congress; where the latter may not introduce new expenses. If Congress fails to approve the budget, the government may enact the budget bill by legislative decree.[13] The Law of Budget Management of the State of 1999 (LBMS) governs the budget process, establishing technical criteria and budgeting procedures[14]. The LBMS centralises the budget process in the MEF's Budget Office, which collates budget projects of the different government agencies and arranges the national budget bill. Although these projects are required to follow strategic planning criteria and meet the objectives of the National Strategic Plan, in practice there is a very weak link between the budget process and the general planning process.

The Budget Office has the authority to regulate the budget process, to design the annual disbursement programme, and to review budget execution to evaluate fiscal management and performance by government agencies. Commentators view the budget process in Peru as inefficient, and they have stressed that there has been no progress in introducing programme- and performance-based budgeting criteria.[15] The budget has usually been modified early in the fiscal year, which generates considerable differences between the initial appropriations and the final disbursed expenses. The executive has considerable discretion to modify appropriations that are authorised by the LBMS. In addition, commentators said that passing presidential Urgent Decrees to amend the budget, although frequently done in the past, is nevertheless illegal.[16] Minor changes within a given appropriation may be carried out through resolutions issued by the government agency responsible for executing the expenses. Budget cuts do not require congressional approval and are passed by the vice-minister of finance.

Together with the Annual Budget Bill, the administration submits the Financial Balance Bill and the Lending Authorisation Bill for congressional approval. The Annual Budget Bill includes all the appropriations, while the Financial Balance Bill includes the financial plan for the balanced budget requirement. The lending bill requests congressional authorisation to carry out the lending programme established in the financial balanced budget plan. The three laws are presented to Congress through a *Statement of Objectives*, which sets out the assumptions and criteria used to forecast revenues and the overall economic objectives of the budget.[17]

**Legal framework for taxation**

The constitution allocates authority to set taxes to Congress. Under congressional delegation, the executive branch can also set taxes through legislative decree. The executive has the authority to set tariff rates through Supreme Decrees but cannot introduce new taxes in emergency situations. The National Superintendence of Tax Administration (SUNAT) is responsible for tax collection and publishing tax laws, which are available on its website. With assistance from the Inter-American Development Bank, the government continues to expand financial administration and control systems for tax collection.

In 2003, substantial progress was made in strengthening SUNAT's legal and institutional framework to reduce tax evasion. Administrative changes have increased tax collections, and further changes to the tax code are being introduced as part of the 2004 budget draft -- including the controversial Financial Transactions Tax (ITB). The aim of the ITB (approved in early December 2003) is primarily to increase tax collection indirectly, by allowing all financial transactions to be registered for tax purposes, and thus making it easier to detect evasion of income and value-added tax.[18] The government is also trying to pass legislation to the remove tax exemptions held by regional governments in exchange for infrastructure funding, and sectoral exemptions for value-added tax might be eliminated by the end of this year.

**Ethical standards for public servants**

Ethical standards for civil servants are set out in the Code of Ethics of the Public Sector, which sets forth principles to guide the work and personal conduct of public officials.

## 2. PUBLIC AVAILABILITY OF INFORMATION

●●●● Compliance in progress

### The public should be provided with full information on the past, current and projected fiscal activity of government.

Peru remains committed to the IMF Special Data Dissemination Standards (SDDS).[19] The constitution recognises the right of all citizens to access adequate government information. The Law of Transparency and Access to Public Information of 2002 (LTAIP) further develops these concepts.[20] In compliance with these rules, Peru publishes a wealth of information on fiscal activity, available on the MEF's website.[21] Fiscal data is published in the monthly *Fiscal Transparency Newsletter* (BTF), which also compiles reports on relevant issues and publishes data that is not available on a regular basis.[22]

**Central government operations**

The MEF reports monthly on the central government's fiscal performance in the BTF. In addition to these reports, a detailed execution of the budget is available from the Integrated System of Financial Administration of the Public Sector (SIAF-SP).[23] The system includes information that compares the monthly cash disbursement and fiscal execution by government agency and programme.

**Public sector operations**

The MEF reports quarterly on the decentralised public sector, which includes the regional and municipal governments as well as other government agencies and non-financial public enterprises. The government provides reports on the fiscal activity of the consolidated public sector within 90 days of the end of the fiscal year, including financial public enterprises and the BCRP. The MEF's Economic Transparency website also posts fiscal information on macroeconomic projections, sectoral management and budget execution plans, and budget information by government agency.

Important progress has been achieved in connecting regional government in order to collate fiscal data. Commentators said that at present only statistics on external debt and overall expenditure are up to date. Nevertheless, municipalities are being involved in applying the SIAF system (currently used in approximately 1,300 of the 1,800 municipalities) in order to improve the accuracy of their accounting records and enhance the availability of procurement data.[24]

### A commitment should be made to the timely publication of fiscal information.

Article 22 of the LTAIP requires all government agencies to publish budgets, public investment projects with their level of execution, information on personnel, and public management assessment indicators on a quarterly basis. Article 23 requires the MEF to publish the consolidated public sector balance (including public financial institutions and other entities outside the annual budget) within 90 days of the end of the fiscal year. The LTAIP also mandates quarterly releases of public debt and fiscal sustainability information, contingent liabilities, and disclosure of fiscal risks.

**Debt reporting**

The MEF's Public Credit Office publishes a quarterly and weekly report on government debt and lending operations including offers of domestic and foreign bonds. The office also discloses information on the repayment schedules and debt servicing for the fiscal year and maturities and debt stocks. Information is also grouped by currency denomination and type of lending mechanism. The MEF's Economic Transparency website also publishes debt information, although this is not as detailed as data posted by the Public Credit Office. The BCRP also reports public and private debt data.

Some progress in providing information on pension liabilities and contingent liabilities was made in the last twelve months. In recognition of the threat that pension liabilities will represent in future, the government reformed the '2530' pensions regime, such that employees cannot join under the original framework of benefits.[25] Further improvements on reporting contingent liabilities stemming from the pensions system, such as the *bonos de reconocimiento* -- the lump-sum payment made when a worker moves from the public pension system into a private one (AFPs) -- need to be attained.[26] A comprehensive evaluation of the sustainability of the pensions system is not readily available.

**Advance release calendars**

The MEF does not make available an advance release calendar for central government and public sector data, although a calendar can be found on the IMF SDDS website.[27]

## 3. Open Budget Preparation, Execution and Reporting

●●● Enacted

### Fiscal policy objectives, macroeconomic framework and risks

Government agencies submit their budget proposals to the MEF's Budget Office. The Law of Budget Management of 1999 requires all government agencies to frame the budgeting process within multi-annual strategic plans but, in practice, this has rarely occurred. However, it is worth noting that the 2004 budget incorporates inputs from regional governments for the first time. This step is aimed at boosting the hitherto stalled fiscal decentralisation process by transferring social expenditure responsibilities with consensus from all government levels.[28]

The MEF's Office of Multi-Annual Planning is responsible for ensuring that government agencies follow multi-annual strategic plans; to this end the office has issued a series of guidelines. In addition, the MEF's Budget Office issues a series of directives that aim to improve the relationship between the planning process and budgeting of expenses and revenues. Although the Budget Office and several government agencies have signed management agreements to introduce performance-based budgeting, commentators reported minor progress in this area.

**Fiscal policy objectives**

The budget's *Statement of Objectives* contains the annual fiscal objectives and explains how the budget bill intends to meet its targets, as established in the Multi-Annual Macroeconomic Framework (MMM, *Marco Macroeconomico Multianual*). Some commentators asserted that many MMM objectives are never met since the MMM does not adequately incorporate how the requirements of long-term debt sustainability are achieved through short-term changes in fiscal policy.[29]

**Macroeconomic framework**

The fiscal process follows the underlying MMM, which covers the fiscal year and the following two years. The MMM includes a series of fiscal principles and objectives, forecasts of revenues and expenses, and the assumptions used to formulate the plan. The Office of Fiscal Affairs produces a follow-up report.[30]

**Fiscal risks**

The *Statement of Objectives* and the budget bill do not include fiscal risks or sensitivity analysis. However, there are well-established assumptions in the budget explanation about growth, inflation, exchange rate levels and interest rates. The government has started a comprehensive process of project feasibility, coordinated between the SIAF-SP and the MEF's Investment Office, under which any public sector project will need to incorporate a feasibility study as a requirement for approval. However, in order to quantify (and reduce) fiscal risks, stronger efforts on project monitoring should be implemented, since historically many regional projects have become unprofitable after a number of years of operation, in which case the government has had to provide substantial subsidies.

**Fiscal sustainability**

In April 2003, the MEF made available a special report on fiscal sustainability (included in a BTF) for 2003-13.[31] The analysis incorporates the impact of the latest changes in fiscal policy and overall macroeconomic outcomes as

established in the MMM 2004-06. Nevertheless, the scenarios would be further enhanced if additional details on pension liabilities for all government levels were included.

## Budget presentation

Budget presentation has improved; the 2004 budget draft contains additional information, disaggregated by programme and function, which was previously not available. Similar to last year, this year's budget includes spending execution and agency targets for the previous year, and makes an effort to establish a clear relationship between the annual budget and the MMM 2004-06.

### Data reporting

SDDS data on the general government operations are recorded in gross terms, except lending for policy purposes, which is recorded as net of payments. The classification of revenues, expenditures and financing comply with the requirements of the IMF's Government Financial Statistics Manual. Expenditures of the general government are organised by economic classification, divided in current and capital expenditure. Peru includes a classification of expenditures by function in the annual budget by priority public expenditure areas. The General Department of Social and Economic Affairs lists these areas and provides monthly functional reporting on social programmes. Net lending is included as capital expenditures.

## Budget execution and monitoring

The SIAF-SP follows up budget execution by central government agencies and a number of regional budgets and projects. The system monitors budget execution electronically and its reports are available on the MEF website. The information compiles the annual budget appropriation and the accumulated execution as well as the amounts programmed for execution during any given month.

### Accounting basis

Peru follows a dual system that registers income on a cash-basis and expenses on an accrual-basis. As a result, there are considerable budgetary lags, and Treasury disbursements are often made effective outside the scheduled dates. Commentators said that these problems are clearly observed by the end of the fiscal year, as a number of sub-national government departments spend up to 20% of their budget in December.[32]

### Procurement and employment

The government's Superior Council for Acquisitions and Contracting (CONSUCODE) administers the national register of contractors, and sets out guidelines for procurement. However, the procurement process in Peru is still considered inefficient, with low transparency in acquisitions and considerable bottlenecks in the decision-making process. CONSUCODE is currently developing a process of electronic procurement (*Peru Contrata*) integrated to the SIAF-SP, which will allow for transparent publication of procurement decisions and bidding procedures.

## Fiscal reporting

The MEF submits two reports every year to Congress, in compliance with the LRTF. These reports set out the progress made in achieving the fiscal policy goals stipulated in the MMM and the budget law, and record any budget cuts. The reports are available on the MEF's website and from its press office.

## 4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY

●●● Enacted

### Data quality standards

The BCRP collates national macroeconomic statistics and data, in line with the IMF's SDDS. The MEF and the BCRP, through the SIAF-SP system, verify the internal consistency of fiscal information.

### Independent scrutiny of fiscal information

The Office of the Comptroller General supervises the execution of the budget, public debt management and the activities of public institutions. After being in disrepute for its lack of independence and control over fiscal execution during the 1990s, the office has been undergoing a process of reform. In 2002, an Organic Law on the Office of the Comptroller General was approved, which strengthened its auditing powers.

In 2003, some progress was achieved in solving the office's serious problems of under-funding and lack of human and technical resources. Nevertheless, doubts remain about its independence over auditing and monitoring of public expenditure, since the office still requires budgetary approval by the MEF.

**Independent Audit**

The government has internal and external auditing procedures. Control offices carry out internal auditing, while the Office of the Comptroller General exercises external control activities. However, the shortage of resources could potentially hamper the capabilities of the Office of the Comptroller General to effectively audit fiscal accounts, budgetary execution and management of public resources at all government levels.[33]

**National Statistics Agency**

The central statistics organisation in Peru is the National Institute of Statistics and Information Technology (INEI).[34] The INEI is an independent institution; its website outlines the methodologies employed and its scope of activity.

## INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to Peru between 18 and 20 November 2003:

### Ministry of Economy and Finance

**18 November 2003**

| | | |
|---|---|---|
| Bruno Barletti | Director | SIAF-SP |
| Javier Kapsoli | | Economic and Social Affairs |

### Central Reserve Bank of Peru (BCRP)

**19 November 2003**

| | | |
|---|---|---|
| Jorge Estrella | Deputy Director | Public Sector Office |
| Hugo Perea | Head | Economic Modelling Unit |
| Adrian Armas | Deputy Director | Monetary Sector Office |

## ADDITIONAL INTERVIEWS

**18 November 2003**

| | | |
|---|---|---|
| Jorge Guzman | Resident Representative | International Monetary Fund |
| Guillermo Diaz | Director of Economic Studies | Banco Wiese Sudemaris |

**19 November 2003**

| | | |
|---|---|---|
| Jaime Vidal Henderson | Chief Adviser | Office of Comptroller General |
| Javier Nagamine | Senior economist | Superintendence of Banking and Insurance |
| Lucia Romero | Financial Analysis Department | Superintendence of Banking and Insurance |

**20 November 2003**

| | | |
|---|---|---|
| Eduardo Moron | Macroeconomics and Political Economy Area | Centro de Investigacion Universidad del Pacifico |
| Cecilia Blume | Lawyer | Former senior adviser, Ministry of Finance |

## NOTES

[1] Peru Constitution of 1993: www.leyes.congreso.gob.pe/Imagenes/Constitu/Cons1993.pdf
[2] See for example 'IADB Program of Modernization and Decentralization of the State in Peru' PE-0217. Profile II www.iadb.org/exr/doc98/pro/upe0217.pdf
[3] Interviews in Peru, 18-20 November 2003.
[4] *Ley de Bases de Descentralizacion*, Law 27,783 of 2002 (in Spanish only): www.leyes.congreso.gob.pe/Imagenes/Leyes/27783.pdf
[5] Ministry of Economy and Finance (*Ministerio de Economia y Finanzas*): www.mef.gob.pe
[6] Interviews in Peru, 18-20 November 2003.
[7] *National Fund of State Enterprise Activity* (FONAFE): www.mef.gob.pe/fonafe01.htm
[8] See IMF Country Report 02/27 of February 22, 2002. See: www.imf.org/external/pubs/ft/scr/2002/cr0227.pdf
[9] Interviews in Peru, 18-20 November 2003.
[10] Interviews in Peru, 18-20 November 2003.
[11] *Ley que Modifica la Ley 27,245 de Prudencia y Transparencia Fiscal*, Law 27,958 of 2003 (in Spanish only): www.leyes.congreso.gob.pe/Imagenes/Leyes/27958.pdf
[12] Interviews in Peru, 18-20 November 2003. The LRTF modified the targets for the fiscal deficit from 1% to 2%, and the target for real non-financial public expenditure from 2% to 3%. However, with the new definitions included in the LRTF, it appears that the latter target will be met (at 2%, which is the figure for all non-financial public expenditure), when in fact non-financial central government expenditure is 7%. Further, it is customary that every time the administration forecasts that the fiscal target will not be met it has requested Congress authorisation to run a higher deficit.
[13] Articles 78-80 of the Constitution.
[14] *Ley de Gestion Presupuestaria del Estado*, Law 27,209 of 1999 (in Spanish only): www.leyes.congreso.gob.pe/Imagenes/Leyes/27209.pdf
[15] Interviews in Peru, 18-20 November 2003. See Rossana Mostajo Guardia (2002). "El Sistema Presupuestario en el Peru." ILPES Serie Gestión Pública No. 17. CEPAL at: www.eclac.org/publicaciones//4/LCL1714P/sgp17.pdf
[16] Interviews in Peru, 18-20 November 2003. For example, between 1993 and 2000, the government issued 1,003 urgent decrees that increased spending by over one billion US dollars. See Mostajo Guardia (2002) p 19.
[17] See *Exposicion de Motivos, Proyecto de Ley de Presupuesto del Sector Publico para el Año Fiscal 2004* (statement of objectives, budget draft 2004, in Spanish only): http://transparencia-economica.mef.gob.pe/documento/default4.asp
and *Marco Macroeconomico Multianual* (MMM, in Spanish only): http://transparencia-economica.mef.gob.pe/proyeccion/doc/MMM2004_2006_REVISADO.pdf
[18] Interviews in Peru, 18-20 November 2003. A number of commentators expressed concern about potential 'side effects' stemming from the implementation of the ITB. For example, even though the 0.15% rate is very low, there could be serious financial distortions since it could discourage people from using the financial system. This might hamper financial intermediation and/or might result in people transferring money to other countries.
[19] IMF Special Data Dissemination Standard Site (SDDS) at: http://dsbb.imf.org
[20] *Ley de Transparencia y Acceso a la Informacion Publica*, Law 27,806 of 2002 (LTAIP, in Spanish only): www.leyes.congreso.gob.pe/Imagenes/Leyes/27806.pdf
[21] Interviews in Peru, 18-20 November 2003. Commentators said that the general presentation of fiscal data has been made substantially more 'user friendly' than before. See for example the *Economic Transparency* website of the MEF at: http://transparencia-economica.mef.gob.pe
[22] Boletin de Transparencia Fiscal (BTF, in Spanish only): http://transparencia-economica.mef.gob.pe/documento/default2.asp
[23] SIAF-SP at: www.mef.gob.pe/siaf/
[24] Interviews in Peru, 18-20 November 2003. The SIAF now has about 60 officials based around the country to introduce the SIAF in the municipalities.
[25] The '2530' pension regime effectively gave retired public sector employees a pension equivalent to the salary of the official who currently held the job. In addition, pensions were transferable to the spouse (after the employee's death) and from the spouse to a daughter (conditional on the daughter remaining single).
[26] Interviews in Peru, 18-20 November 2003. The central bank has a special reserve of two billion dollars (from privatisation revenues) that is solely used for issuing *bonos de reconocimiento*.

[27] IMF SDDS, Peru: advance release calendar: http://dsbb.imf.org/Applications/web/sddsctycatarclist?strcode=PER
[28] Interviews in Peru, 18-20 November 2003.
[29] Interviews in Peru, 18-20 November 2003.
[30] Follow-up report of *Marco Macroeconomico Multianual 2003-2005* (First half 2003, in Spanish only): http://transparencia-economica.mef.gob.pe/proyeccion/doc/Informe_Seguimiento_MMM2003_2005_ISem2003.pdf
[31] http://transparencia-economica.mef.gob.pe/propuest/DGAES/btfiscal/N21BTFInforme.pdf
[32] Interviews in Peru, 18-20 November 2003. This problem is exacerbated by the fact that any funds that are not spent during the fiscal year might be subtracted from the budgeted amounts for the next fiscal year.
[33] Interviews in Peru, 18-20 November 2003.
[34] See www.inei.gob.pe

# OXFORD ANALYTICA

## PHILIPPINES

## FISCAL TRANSPARENCY

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# THE PHILIPPINES

## COMPLIANCE RATINGS

| *Fiscal transparency* | *2003* | *2002* | *2001* |
|---|---|---|---|
| Clarity of roles | ●●● | ●●● | ●●● |
| Availability of information | ●●●● | ●●●● | ●●● |
| Budget preparation | ●●●● | ●●● | ●● |
| Accountability | ●●● | ●●● | ●●●● |
| **Score** | **3.50** | **3.25** | **3.00** |

## OUTLOOK & COMMENTARY

The Philippines have made some progress in enhancing fiscal transparency, in particular by strengthening measures aimed at tackling corruption in government procurement and employment practices. In addition, efforts to increase the overall quality of statistics and to fully implement performance-based budgeting were noted.

Improvement in other areas, such as the legal and administrative framework for fiscal management, will depend heavily on the government's ability to control fiscal imbalances amid the deepening political problems that continue to weigh down the economy. In this context, an important indicator will be whether the National Revenue Authority bill and a fiscal responsibility law are approved soon, or fiscal discipline and transparency are abandoned ahead of the presidential election in May 2004.

# EXECUTIVE SUMMARY

## 3.50 Enacted

The Philippines have made progress in increasing fiscal transparency, particularly by introducing a number of measures aimed at tackling corruption and fiscal mismanagement. The Government Procurement Reform Act has established a detailed process to overhaul government procurement by introducing clear rules and regulations, while the Government Procurement Policy Board now has the responsibility of ensuring that procurement complies with transparent and efficient practices. Improvements were also achieved by implementing accrual accounting and performance-based budgeting across several government agencies.

The government has proposed a number of additional measures to address several transparency weaknesses. Information on the stock of contingent liabilities and other fiscal risks is currently being collated, and should be incorporated in future budget calculations and/or fiscal sustainability analyses in the short term. The fragile condition of public finances has pressed the government to make further efforts to correct deficiencies in the tax system. One of the government's chief measures to revamp fiscal administration and transparency is the National Revenue Authority bill, now awaiting congressional approval. This would create a new revenue-collecting agency with fiscal and administrative autonomy.

The Philippines comply with the IMF's Special Data Dissemination Standard (SDDS) and publish a comprehensive range of fiscal information. The government has made progress in correcting the analytical deficiencies of statistical techniques. However, some concern about the Commission of Audit's standing as an independent fiscal auditor remains. A sound assessment of its independence might be made in the future, when local government units receive additional national government competences through an enhanced Local Government Code.

The Philippines' overall score has improved from 3.25 in 2002 to 3.50.

## 1. Clarity of Roles, Responsibilities and Objectives

●●● Enacted

### The government sector should be distinguished from the rest of the public sector and from the rest of the economy, and policy and management roles within the public sector should be clear and publicly disclosed

**Structure, functions, and responsibilities of government**

The structure, functions and responsibilities of the different branches of government are clearly set out in the Constitution of the Republic of the Philippines and the Administrative Code of 1987. In addition to the central or national government, the public sector comprises the Government-Owned and/or Controlled Corporations (GOCCs), the Oil Price Stabilisation Fund, the Bangko Sentral ng Pilipinas (BSP, the central bank), the Central Bank Board of Liquidators, two social security agencies, and an array of local government units (LGUs).

National government expenditure makes up about 50-60% of total government spending, the remainder being spent by the various layers of local government (provinces, municipalities, cities, and *barangays*). The Philippines launched a programme of substantial decentralisation in 1991, transferring powers and expenditure responsibility to lower levels of government. Because LGUs are less sophisticated than the national government, devolution may present a serious problem for fiscal transparency.

Commentators have suggested that LGUs have resisted computerisation because fearful of the increased transparency that this would bring, but lack of funds may also be a factor.[1] By late 2003, computerisation was largely complete in first and second-class municipalities, and the Department of Finance (DoF) was focusing on the smaller LGUs.[2]

**Coordination and management of budgetary activities**

Mechanisms for the coordination and management of budgetary activities are well established. The principal fiscal institutions are the DoF, the Department of Budget and Management (DBM), and the National Economic and Development Authority (NEDA).

The DoF has primary responsibility for managing the financial resources of the government, its subdivisions and associated agencies. It is responsible for formulating fiscal policy; generating and managing government resources; supervising the revenue operations of all LGUs; managing all public sector debt; and privatising government corporations and assets. The DBM is tasked with formulating and efficiently implementing the national budget, while NEDA assists with development planning, programming and budgeting.

**Relations between the government and public sector agencies**

The relationship between the government and the central bank is clearly established in the New Central Bank Act of 1993, which grants operational autonomy to the BSP. The BSP does not regularly extend credit to the government, but it can make provisional advances for expenditures authorised in the annual budget. Details of the BSP's claims on the government are publicly disclosed.[3]

Other public sector agencies include financial institutions; government corporations; and non-financial government corporations, many of which have their own subsidiaries. These corporations are collectively known as Government-Owned and/or Controlled Corporations (GOCCs). GOCCs are directly attached to individual government departments, and are required to submit annual audited financial statements to the secretary of the department under whose jurisdiction they fall.[4] Their financial results are included in the Consolidated Public Sector Financial Position (CPSFP). Their balance sheets, cash flow statements, and income statements are only included in the budget documentation when the government has provided a cash disbursement in a particular year. Financial information on them is, as for regular companies, available through newspaper reports, and official papers filed with the Securities and Exchange Commission (SEC).

**Government involvement in the private sector**

The two public social security funds of the Philippines, the Social Security System (SSS) and the Government Service Insurance System (GSIS), were under significant political pressure during the Estrada years, and made improper investments in the private sector. In this context, both social security funds are now subject to greater scrutiny, in order to avoid repeating past problems. For example, the Commission of Audit makes available the annual audits on the two public social security funds.[5] The mandates and economic objectives of GOCCs that operate alongside the private sector are established in their corresponding Republic Acts.

## There should be a clear legal and administrative framework for fiscal management

**Legal framework for budgetary activities**

Comprehensive budget laws and openly available administrative rules govern the disbursement of public funds in the Philippines. The president is required by the Constitution to submit an annual budget proposal to Congress each fiscal year. On this basis, the legislature adopts a General Appropriations Act for the upcoming fiscal year, committing public funds to government departments, agencies and corporations. A Development Budget Coordination Committee comprising the DBM, the DoF, NEDA and the BSP determines the desirable level of expenditure and debt for the president's budget submission.

Government funds are allocated to individual departments on the basis of budget estimates that each head of department, government agency and public corporation must submit to the DBM. These estimates set out the principal costs of submitted projects, current operating expenditures, capital outlays, sources of revenues, and contingent liabilities, such as government guarantees of the obligations of GOCCs.

Based on the General Appropriations Act, the secretary of the DBM draws up a *National Expenditure Program* for the upcoming fiscal year, and disburses authorised funds to individual departments on a quarterly basis. Nevertheless, the reliability of this sophisticated fiscal framework is weakened by the ability of the president to exercise special powers that include line veto powers over bills, including revenue bills. Exercise of the president's special powers have been sparing over history, but not insignificant, and have included change to planned budgetary expenditures.[6]

Upon the recommendation of the IMF, the government adopted a Medium-Term Philippine Development Plan (MTPDP) in 2001, which aims to bring about a substantial reduction in the annual budget deficit, reduce long-term public debt, and achieve a balanced budget by calendar year 2010 (the date was moved back from 2006).[7] However, the government has had difficulty attaining fiscal consolidation in the short term.[8] In this context, the government has sent a number of drafts to Congress -- such as a debt-cap 'fiscal responsibility' law and measures to increase tax revenues -- to have additional controls to ensure fiscal sustainability.[9]

**Legal framework for taxation**

An explicit legal basis for all taxes is provided in the Constitution and the National Internal Revenue Code, or Tax Reform Act of 1997.[10] The code tasks the Bureau of Internal Revenue (BIR) with the collection of taxes, fees and charges in the Philippines. It awards a wide-ranging competence to the head of the organisation, including the power to interpret tax laws; decide disputed cases; obtain additional information on tax returns; and summon individuals for tax inquiries.[11] Taxpayers may refer disputes to the Court of Tax Appeals.

The government launched a Comprehensive Tax Reform Programme (CTRP) in 1998 to lower the chronically high tax evasion rates and improve the country's tax administration by stamping out corruption in the BIR.[12] The fragile condition of public finances has encouraged the government further to review and correct deficiencies in the tax system, including proposals to remove tax exemptions, enhance the operational capabilities of the BIR and the Bureau of Customs (BOC), and impose new streamlined taxes on buoyant economic sectors while keeping the neutrality of fiscal incentives.[13]

In this context, the government's chief effort to revamp tax and customs administration is the National Revenue Authority (NRA) bill, which is pending congressional approval. The NRA law aims to replace the BIR by consolidating two previous bills seeking the creation of the National Authority for Revenue Administration (NARA) and the Internal Revenue Management Authority (IRMA). The NRA would be a new agency for collecting internal revenue with fiscal and administrative autonomy. It would independently select and appoint boards, selectively absorb current BIR employees, and be exempt from the Salary Standardisation Law -- all measures intended to tackle corruption and increase fiscal transparency.

**Ethical standards for public servants**

The Code of Conduct and Ethical Standards (1989) provides the legal framework and guidelines for public office service and procedures for tackling misconduct and other violations.[14] Further, the Anti-Graft and Corrupt Practices Act (Republic Act 3019) contains specific provisions to fight corruption in the government -- an issue that remains a primary concern for the Macapagal-Arroyo administration.[15] A BIR officer has noted that the annual performance reviews of all heads of government agencies, specified in the Code of Conduct and Ethical Standards, has "not reduced wastage and inefficiencies" and questioned whether other parts of the code were effective.[16]

## 2. PUBLIC AVAILABILITY OF INFORMATION

●●●● Compliance in progress

### The public should be provided with full information on the past, current and projected fiscal activity of government

Full public disclosure of all transactions by the state that involve the public interest is required by the Constitution.[17]

**Central government operations**

Data are disseminated on central government operations on a monthly basis and within three weeks of the end of the reference month.[18] Data cover budgetary and extra-budgetary activities, and are presented on a consolidated basis, with transactions between the budgetary and extra-budgetary elements eliminated. Data are disseminated on revenue; expenditure; the balance (deficit/surplus); and financing broken down into foreign financing and domestic financing.

An advance release calendar that gives one-quarter ahead notice of the precise release dates is posted on the National Statistical Coordination Board (NSCB) website. Data are preliminary when first released, and are subject to revision for five weeks after the end of the reference month.[19] NEDA provides a web service -- the *Economic Indicators Online* -- that monitors public sector performance and central government operations on a monthly basis, with a twelve-month lag.[20] The NSCB employs a similarly refined web service to publish a set of national economic and financial data, which conform to the IMF's Special Data Dissemination Standard (SDDS).[21]

**Public sector operations**

Data on the Consolidated Public Sector Financial Position (CPSFP) are disseminated on an annual basis, and within six months of the end of the reference period. The DoF publishes data showing both the original fiscal target and the actual outturn of the previous fiscal year. It also publishes a historical comparison of the annual outturns for the previous ten fiscal years.[22] Data cover the operations of the central government, including budgetary and extra-budgetary activities; the impact of central bank restructuring (which began in 1993); the operations of the fourteen major non-financial government corporations; the Oil Price Stabilisation Fund; the social security accounts; the BSP net income account; the six government financial institutions; and all LGUs. Data are disseminated on revenue; expenditure; balance (deficit/surplus); and financing for the central government and the fourteen major government corporations (broken down into domestic and foreign sources). Data are preliminary when first released and may be revised annually for up to three years.[23]

Fiscal comparisons are available for the outturns of the past ten fiscal years but not for the original fiscal estimates of these years. The DBM publishes the expected CPSFP for the ongoing and upcoming fiscal years, as well as a historical comparison of annual outturns for the previous three fiscal years. It also disseminates the full public resource budget, both consolidated and sectoral, for the years 2000-2002. Financial statements for all local government units are included in the budget documentation.[24] DBM has started preparing six-year fiscal projections as part of a comprehensive government effort to develop multi-year planning and budgeting.

Government agencies and corporations are required to include the flows of contingent liabilities in their annual budget estimates, and to report periodically to the secretary of finance on the status of their government-guaranteed

obligations. In theory, the CPSFP includes all quasi-fiscal operations and extra-budgetary contingent liabilities: the Budget of Expenditures and Sources of Financing reports the accrued debt and contingent liabilities stemming from the liabilities assumed by the national government.[25] In practice, the precise level of obligations from operations associated with the insurance scheme for bank deposits, unfunded liabilities of the public pension schemes, guarantees on risks associated with Build-Operate-Transfer (BOT) contracts, and loan guarantees extended to GOCCs and government financial institutions (GFIs), is very difficult to gauge. The DoF aims at reviewing all sources of contingent liabilities in order to include their present value in future budget calculations.

## A commitment should be made to the timely publication of fiscal information

**Debt reporting**

Data are disseminated on the total outstanding debt of the central government, including budgetary and extra-budgetary activities, on a monthly basis. Data comprise all liabilities of the central government, including debt liabilities for government securities such as Treasury bills and Treasury bonds, and re-lent loans to government corporations. Total outstanding debt is broken down by maturity into short, medium, and long term. Data are also disseminated on debt guaranteed by the central government. The breakdown of total debt is based on the residency of the debt holder into foreign and domestic. Data are released within ten weeks of the end of the reference month.

A regular notice is published for the release of the monthly National Government Outstanding Public Debt report.[26] The government also discloses monthly information on its cash operations, broken down into tax revenues from the BIR and the BOC and non-tax revenues, such as fees, charges and cash earned from privatisation. A comparison of annual outturns of the main fiscal aggregates is available for the 1997-2002 period, and monthly data for 2003.[27]

**Advance release calendars**

Advance release calendars, giving one-quarter ahead notice for the precise dates of disclosing data on central government operations, debt and public sector operations (and other data), are posted on the NSCB and Treasury websites.[28]

## 3. Open Budget Preparation, Execution, and Reporting

●●●● Compliance in progress

### Fiscal policy objectives, macroeconomic framework, and risks

**Fiscal policy objectives**

Annual budget proposals submitted by the president to Congress must include a statement setting forth the government's main budgetary focus for the year, the expected impact of the budget on development goals, and on monetary and fiscal objectives. Recent budget proposals of the Macapagal-Arroyo administration have been made within the broader development framework of the MTPDP, which sets out the key medium-term policy objectives of the administration: poverty reduction; curbing unemployment; agricultural and fisheries modernisation; and good governance.[29]

More importantly, as part of the government's reform efforts, the Medium Term Expenditure Framework (MTEF, available since fiscal year 2000) develops a three-year rolling budget where annual baseline budgets are formulated and only new spending proposals are reviewed during the budget drafting. The manual and automated systems design is set to start by the end of this year. The DBM has accepted the major final outputs of a number of agencies, and thus the formulation of performance indicators is expected to start soon. The budget will continue to be enacted annually, but future financial implications of new spending and saving decisions in any given year will be fully harmonised with medium-term fiscal targets and the government's development strategy.

**Macroeconomic framework**

Annual budget submissions are prepared and presented within the broad macroeconomic framework of the government. The broad macroeconomic assumptions for 2003-2006 of the Development Budget Coordinating Committee (DBCC) are now available as part of the NEDA economic updates.[30] Assumptions are also included as part of the Budget of Expenditures and Sources of Financing document for the relevant fiscal year.[31] The quantitative models used for budget calculations are not publicly available, but DoF and DBM officials have said in the past that their models are made available upon request.[32]

**Fiscal risks**

A number of government departments have internal calculations/analysis of fiscal risks, but these are not explicitly identified in the budget documentation. As such, the relationship between the National Expenditure Programme's provisions under a number of special purpose funds (such as the Calamity Fund, Contingent Fund, and Unprogrammed Fund) and their objectives is not fully substantiated.[33]

**Fiscal sustainability**

Government analysis of fiscal sustainability is not readily available. However, commentators have mentioned that the DoF has been working on estimating future liabilities of the social security funds but, because it is currently in progress, these figures have not been incorporated in budget calculations. The DBM and NEDA are conducting spending-efficiency reviews of government programmes and projects as part of the MTEF, in order to increase discipline over public expenditures.[34]

## Budget presentation

**Data reporting**

The Philippines subscribes to the SDDS, and meets its requirements for periodicity, coverage and timeliness. Data on central government operations are presented on a consolidated basis, distinguishing revenue, expenditure, balance, and financing. Expenditure is classified by economic, functional, and administrative categories. Data on central government debt comprise all liabilities of the national government and are broken down by maturity, the residency of the debt holder (domestic and foreign), and the issuer of the debt (such as government agencies and GOCCs whose loans the government guarantees). Data on public sector operations are presented on a consolidated basis (CPSFP), distinguishing revenue, expenditure, balance, and financing. Data on financing are disseminated for the public sector as a whole and for the central government and major government corporations separately, broken down into domestic and external sources of financing. The CPSFP presents the most accurate picture of the fiscal activity of the Philippine public sector, and accuracy has been improved through the quantification and inclusion of many government contingent liabilities in the balance.[35]

The government is attaining significant progress -- with technical assistance from the World Bank -- on a shift towards performance-based budgeting. In September 2002, the DBM conducted the first agency performance review (APR) to assess mid-year agency performance and accomplishments; this year's APR started in October. Performance targets are part of the requirements of agencies' submissions during the budget preparation, and the results of the APR are considered while arranging the budget draft.

## Budget execution and monitoring

Recognising the need for an integrated financial management information system, the Philippine government is taking several steps -- one of which is the full implementation of the Budget Execution and Accountability Tracking (BEAT) System -- to strengthen the DBM's expenditure management capability; streamline budget release procedures and improve front-line service; improve budget administration and accountability; and update budget analysis and decision making.[36]

**Accounting basis**

The New Government Accounting System (NGAS) -- introduced in January 2002 by the Commission of Audit (CoA, the supreme audit authority of the Philippines) -- is designed to simplify government accounting, improve the efficiency of monitoring public sector performance, and increase the transparency of government audits through civil society involvement. More importantly, the new framework shifts from cash- to accrual-based accounting and introduces modifications to the obligation-accounting techniques. It also mandates the introduction of valuation accounting for receivables and fixed assets, and envisages the full computerisation of government accounting and the development of viable internal control systems within government agencies over the medium term.[37] Accrual accounting was not in place in all government offices in late 2003.[38]

Government audits are currently performed by resident auditors who monitor agencies' compliance with government regulations and budget commitments. This system is to be replaced with the Audit Team Approach, using a team of roving auditors to carry out performance audits of individual projects, rather than of departments and agencies, in order to improve accounting efficiency and eliminate the corruption that characterised the resident auditing regime. A BIR officer noted in late 2003 that Congress had not passed the amendment to the Government Auditing Code to

institutionalise the Audit Team Approach.[39] The CoA has also adopted a Participatory Audit Program with civil society organizations, which has helped to improve the transparency of the government auditing process.[40]

**Procurement and employment**

The Philippine government has achieved substantial improvements in procurement methods and standards. In January, the Government Procurement Reform Act (GPRA, Republican Act 9184) was ratified. The GPRA establishes a detailed process to overhaul procurement, by introducing clear rules and regulations with regard to the e-procurement system (G-EPS) and guidelines for implementing the following phase (online payment facility and electronic bid systems). The reform has also created the Government Procurement Policy Board, which is charged with the responsibility of ensuring a government procurement system that is transparent, efficient, and free of corruption. The G-EPS has led to clear efficiency gains and less scope for corruption.[41]

The Compensation and Position Classification Act of 1989 regulates the remuneration of Philippine civil servants, GOCCs and certain employees of the central bank.[42]

## Fiscal reporting

The government submits regular, quarterly reports on the ongoing implementation of the national budget to Congress. As in the previous year, the General Appropriations Act for Fiscal Year 2003 (approved in March)[43] requires each government department and agency to submit a quarterly financial and narrative accomplishment report to the House Committee on Appropriations and the Senate Committee on Finance, with copies sent to the DBM, CoA, and the appropriate committee chairperson of Congress. The financial reports must include cumulative allotments, obligations incurred or liquidated, total disbursements, unspent balances, and the results of expended appropriations. In addition, the DBM must submit a quarterly report to the above two committees on any disbursements made from the special purpose fund, and on supplementary expenditures.[44]

## 4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY

●●● Enacted

### Data quality standards

Revenue forecasts prepared by the BIR and BoC proved overly optimistic in recent years and this has marred the credibility of the government's fiscal deficit targets. Revenue collection in late 2003 was closer to target.[45] Substantial differences between revenue collection targets and final outturns have brought concern about the precision of fiscal balance projections. In order to allay these concerns, various government departments -- such as the NSBC, NEDA and the DBM -- have continuously improved the quality and amount of data available, both for historical series and forecasts.

Data on central government operations and debt are compiled in accordance with the rules of the CoA contained in the 1992 Government Accounting and Auditing Manual. The NGAS establishes additional provisions for accounting methods and standards for LGUs and national government agencies. Further information on the methodology and sources used is available upon request from the contact persons listed on the Philippines' SDDS Meta Data website.[46]

The Philippines subscribe to the SDDS, a signal of its strong commitment to improving the quality of fiscal data. Previous weaknesses and time delays in data reporting are now being addressed. In particular, the government has attained progress in correcting the analytical deficiencies of national accounts data. The revised statistics for 2000-2002 were released in May (quarterly) and June (annual), and the departments involved aim to link the new time series with historical data by early 2004.

### Independent scrutiny of fiscal information

**Independent audit**

Under the Administrative Code, the CoA is given the authority to examine, audit and settle all accounts relating to the receipt of revenues and expenditure of funds by the government, its subdivisions and agencies, including government corporations. Where the internal control system of the audited agencies is deemed inadequate, the CoA may adopt measures -- such as temporary and pre-audits -- that are necessary to remedy these deficiencies. However, this function of the CoA is expected to diminish over time as the MTPDP aims to build a strong and independent internal control capacity in all government agencies since, as reported by the IMF, internal audits are perceived as unsatisfactory.[47]

The president appoints the CoA's chairman, who is required to submit an annual report on the results of operations and financial situation of all government agencies to the president and Congress. This report includes detailed recommendations of measures that are necessary to improve the efficiency and effectiveness of government operations. In practice, there is some concern about the CoA's standing as an independent auditor, as established by its status of constitutional commission.[48] A sound assessment of its independence might be made in future, when the LGUs receive additional national-government functions and fiscal competences through an enhanced Local Government Code.

CoA's annual analysis is supported by data on revenues, borrowings, expenditures, assets, liabilities, and residual equity. The annual report highlights the variance between original targets and actual outturns for different fiscal aggregates. Within two months of receiving this document, government departments, agencies and public corporations are required to submit a status report to the CoA on the actions they have taken to comply with the audit findings and recommendations. Additional copies of the status report are sent to the DBM, the House Committee on Appropriations, and the Senate Committee on Finance.

**National Statistics Agency**

The NSCB is the highest policy-making and coordinating body on statistical matters, charged with the task of maintaining an efficient government statistical system, formulating policy on government statistical operations, and coordinating statistical reporting at the various levels of government. The NSCB does not engage directly in data collection. The government agency responsible for generating general-purpose statistics and undertaking census and surveys is the National Statistics Office.

While the executive order that created the NSCB does not explicitly guarantee the organisation's institutional independence, it stipulates that the decisions of the NSCB on statistical matters are considered final. On its website, the NSCB lists its key objectives as the independence, objectivity, and integrity of the Philippine statistical system. The organisation maintains the most sophisticated website of all Philippine government agencies.

## INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to the Philippines between 11 and 12 December 2003, and a visit to Dubai (2003 Meeting of the Boards of Governors of the World Bank Group and the International Monetary Fund) on 23 September 2003:

### Department of Finance

**23 Septemeber 2003**

| | |
|---|---|
| Jose Isidro Camacho | Secretary of Finance |

**11 December 2003**

| | | |
|---|---|---|
| Napoleon Micu | Chief, Special Studies Division | Fiscal Policy and Planning Office |
| Stela Montejo | Chief, Fiscal Policy Division | Fiscal Policy and Planning Office |
| Visitacion Ugalino | Chief, Planning Division | Fiscal Policy and Planning Office |

### Bangko Sentral ng Pilipinas (BSP)

**23 September 2003**

| | |
|---|---|
| Rafael Buenaventura | Governor |
| Amando Tetangco, Jr | Deputy Governor |

**12 December 2003**

| | | |
|---|---|---|
| Editha Alido | Director | Department of Economic Research |
| Diwa Guinigundo | Managing Director of Research | Department of Economic Research |
| Iluminada Sicat | Bank Officer | Department of Economic Research |
| Jonathaniel Principe | Bank Officer III | Investor Relations Office |

## NOTES

[1] Interviews in the Philippines, 14-16 October 2002 and 11-12 December 2003.
[2] Interviews in the Philippines, 11-12 December 2003. The extent of computerisation of LGUs can be informally monitored by inspecting the LGU websites linked to the government portal at: www.gov.ph
[3] BSP statistics website: www.bsp.gov.ph/Statistics/ifs/IFS-10G.htm
[4] Administrative Code (1987), Book IV, Chapter 7
[5] www.coa.gov.ph/COA_htm/Audit/AAR.htm
[6] Administrative Code (1987), Book VI, Chapter 3, Section 11
[7] IMF Concludes 2003 Post-Programme Discussion on the Philippines, Public Information Notice (PIN) No. 03/101, 13/08/03; NEDA, 'The Medium-Term Philippine Development Plan 2001-2004 – Part 4: Good Governance and the Rule of Law', www.neda.gov.ph/mtpdp2001/ and interviews in the Philippines, 11-12 December 2003.
[8] For example, the fiscal deficit target for 2003 was increased from the original level.
[9] Taxes include excise on alcohol and tobacco ('sin' taxes) and vehicles. Further, the success in implementing the ongoing restructuring and privatisation in the power sector will help the government to allay fiscal concerns.
[10] Constitution of the Philippines (1987), Article VI, Section 28 & 29; National Tax Reform Act (1997)
[11] Taxpayer information: www.bir.gov.ph
[12] 'IMF Concludes Post-Programme Discussion on the Philippines', IMF PIN No. 02/41, 09/04/02. The CTRP law was passed in 1997 and became effective in 1998, but some provisions became effective only in 2001.
[13] Other measures, such as the long-awaited Special Purpose Vehicle Act (passed in January 2003) grant tax breaks and privileges for investors to create asset management companies that will acquire and invest in banks' non-performing assets and liquefy the financial system. This law appears crucial to help banks sell up sizeable amounts of bad loans and foreclosed assets, in order to reinvigorate the banking system and help rehabilitate failed businesses.
[14] www.nscb.gov.ph/ru11/aboutus/ccespoe.htm
[15] In July, the president ordered concentrated efforts against corrupt government officials to be pursued "with the same intensity as the present campaign against terrorism and illegal drugs". She ordered the removal of four officials (three from the BIR and one from the BoC) after they failed the 'lifestyle check' performed by the Department of Finance.
[16] Emmanuel C. Acuña, 'Congress, public expenditures and performance measurements', *The Philippine Star*, 13 December 2003, pp. 15, 17.
[17] Constitution of the Philippines (1987), Art. II, Section 28
[18] www.treasury.gov.ph/HTML%20Pages/Static/Statdata.html
[19] www.nscb.gov.ph/sdds/meta_fis_govtoper.htm
[20] http://localweb.neda.gov.ph/%7Eioneda/National/PubFinance.html
[21] www.nscb.gov.ph/sdds/calendar.asp
[22] www.dof.gov.ph/htm/cpsfp.htm
[23] www.nscb.gov.ph/sdds/meta_fis_puboper.htm
[24] www.dbm.gov.ph/dbm_publications/besf.htm
[25] Budget of Expenditures and Sources of Financing, Fiscal Year 2004, DBM, Tables B.21, B.23, D.5, D.7
[26] www.treasury.gov.ph/HTML%20Pages/Static/Statistics/sdds/pubdebt1.htm
[27] www.nscb.gov.ph/sdds/nsdp.htm; www.treasury.gov.ph/HTML%20Pages/Static/Statdata.html
[28] www.nscb.gov.ph/sdds/calendar.asp; www.treasury.gov.ph/HTML%20Pages/Static/Statistics/sdds/updates/arc.pdf
[29] Administrative Code (1987), Book VI, Chapters 2 and 3; MTPDP: www.neda.gov.ph/mtpdp2001/
[30] www.neda.gov.ph/TheEconomy/DBCC/DBCC%20Macroassumptions%20(MTPDP,BESF,Latest)-2003-06.xls
[31] www.dbm.gov.ph/dbm_publications/besf_2004/besf_2004.htm
[32] Interviews in the Philippines, 14-16 October 2002.
[33] Summary of Obligations and Proposed New Appropriations by Special Purpose Fund, FY 2002-2004: www.dbm.gov.ph/dbm_publications/nep_2004/general_intro.htm#nep_2004_table2-2
[34] The Medium-Term Philippine Development Plan 2001-2004 – Part 4: Good Governance and the Rule of Law
[35] Interviews in the Philippines, 11-12 December 2003.
[36] Interviews in the Philippines, 14-16 October 2002.
[37] www.coa.gov.ph/COA_htm/NGAS/ngasmanual.asp
[38] Interviews in the Philippines, 11-12 December 2003.
[39] Emmanuel C. Acuña, 'Congress, public expenditures and performance measurements', *The Philippine Star*, 13 December 2003, p. 17.

[40] 'The Medium-Term Philippine Development Plan 2001-2004 – Part 4: Good Governance and the Rule of Law'; World Bank, 'Combating Corruption in the Philippines: An Update', Report No. 23698-PH (2001), p. iii
[41] Interviews in the Philippines, 11-12 December 2003. See www.procurementservice.org Procurement Watch, a civil society-based monitor, has reported savings from the G-EPS of 53% from the Department of Health and 25% from the Department of the Environment and Natural Resources. Figures on savings from Emmanuel C. Acuña, 'Congress, public expenditures and performance measurements', *The Philippine Star*, 13 December 2003, pp. 15, 17.
[42] Interviews in the Philippines, 11-12 December 2003.
[43] The government was operating on its 2002 budget after both houses of Congress failed to finish drafting the bill before going into recess in November 2002.
[44] Administrative Code (1987), Book VI, Chapter 5, Section 33; DBM, General Appropriations Act for Fiscal Year 2003, General Provisions, Section 89:
www.dbm.gov.ph/dbm_publications/gaa_2003/gaa_links/GENPRO03.htm
[45] Interviews in the Philippines, 11-12 December 2003.
[46] www.nscb.gov.ph/sdds/meta_fis_govtoper.asp
[47] IMF, Philippines: ROSC—Fiscal Transparency Module, IMF Country Report No. 02/216, October 2002.
[48] Interviews in the Philippines, 14-16 October 2002. Given that the president appoints the CoA chairman, the latter's position might be subject to political pressures. In addition, the CoA sets the accounting standards on which its external audits are based. See also IMF, Philippines: ROSC—Fiscal Transparency Module, IMF Country Report No. 02/216, October 2002.

# OXFORD ANALYTICA

## RUSSIA

## FISCAL TRANSPARENCY

**Country Report 2003**

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# RUSSIAN FEDERATION

## COMPLIANCE RATINGS

| *Fiscal transparency* | *2003* | *2002* | *2001* |
|---|---|---|---|
| Clarity of roles | ●●● | ●● | ●● |
| Availability of information | ●●● | ●● | ●● |
| Budget preparation | ●● | ●● | ●● |
| Accountability | ●●● | ●● | ●● |
| **Score** | 2.75 | 2.00 | 2.00 |

## OUTLOOK & COMMENTARY

The Russian government has made a clear commitment to improving fiscal transparency standards under a number of medium- to long-term reform programmes. In particular, the transition to a modernised system of fiscal federalism will reduce waste and increase accountability. The ongoing tax reform is likely to create a significantly more streamlined and efficient system of taxation.

In spite of the gradual progress in administrative reform, fiscal transparency will continue to be hampered by a very gradual generation change among civil servants and incentives for unethical behaviour created by low pay. Even Putin's anti-corruption stance is unlikely to fundamentally improve standards in public procurement and other areas. The new system of regional administration remains to be tested and several problems with effective enforcement can be expected.

# EXECUTIVE SUMMARY

## 2.75 Enacted

The Russian government has made considerable progress towards improving fiscal transparency standards. The Ministry of Finance now runs a fairly comprehensive website, albeit most of it is still available only in Russian. Collaboration with independent consultancy companies and external funding have enabled the Ministry to provide comprehensive fiscal statistics for all levels of government. The government's budget bill is now based on fairly conservative assessments of possible macroeconomic scenarios for the country. However, the public availability of this information is still limited.

The Russian authorities recognise the IMF code of best practices as the ultimate standard in fiscal transparency. The government is continuing to implement the IMF's Special Data Dissemination Standard (SDDS) methodology and most data is already presented in a fully compatible format. However, full SDDS membership will still require additional reform.

Ambitious reform programmes are being pursued in the regional sphere and in taxation. New legislation is redefining and harmonizing the competencies of subnational governments and formalising inter-governmental fiscal relations. The move represents a critical step in the transition from the at times chaotic heterogeneous system created during the Yeltsin era. The tax reform has stalled somewhat but promises a potentially thorough overhaul of a hitherto untransparent and inefficient system. The Accounts Chamber has become an increasingly active and effective source of control on the fiscal sphere, although its work continues to be hampered by resource constraints. Indeed, comparatively little attention is often paid to enforcement, which is further hampered by the ineffective judicial system.

While the government has shown admirable willingness to reform legislation in various key areas, the implementation of the new regulations often remains incomplete. Efforts to combat corruption have met with limited success at best and considerable inefficiency is created by the underpaid bureaucracy.

Russia's overall score increases to 2.75 from 2.00 in 2002.

## 1. Clarity of Roles, Responsibilities, and Objectives

●●● Enacted

**The government sector should be distinguished from the rest of the public sector and from the rest of the economy, and policy and management roles within the public sector should be clear and publicly disclosed.**

**Structure, functions, and responsibilities of government**

The Russian constitution recognises three separate tiers of government: the federal government, the 89 regions consisting of the Oblasts and Republics and the local governments. Following many spontaneous declarations of independence during the Yeltsin era, the municipal scene remains highly fragmented and heterogeneous with thousands of small entities barely able to fulfil their functions.[1]

In compliance with its "Programme for the Development of Fiscal Federalism in Russia for the Period Until 2005," which was approved in 2001, the central administration is engaged in an ambitious reform of the division of responsibilities between different levels of government. The Federal Law "On Basic Principles of Organisation and Legislative (Representative) and Executive Public Authorities of the Subject Entities of the Russian Federation" was amended in July and a new law "On Local Self-Administration" was passed this October.[2]

**Coordination and management of budgetary activities**

The Budget Code sets out budget preparation, execution, and reporting functions. The majority of these responsibilities lie with the Ministry of Finance. Within the Ministry, budget preparation and budget execution roles are separated with the Federal Treasury Department responsible for the latter.[3]

The five federal extrabudgetary funds have been integrated in the Federal Treasury system. The three main ones – the Pension Fund, the Social Insurance Fund, and the system of Compulsory Medical Insurance Funds (federal and regional) – are now fed from the unified social tax set up in 2001.[4]

The law "On State Secrets" still limits the information available on the Ministry of Defence. However, the Budget Code now applies to all federal ministries and since 2001, the responsibility for the execution of the MoD budget has been transferred to the Federal Treasury. Overall, the number of classified items in the federal budget has been steadily declining. For the first time in 2002, articles of the budget that set out allocations to the Interior Ministry and the Ministry of Defence were presented to the Russian parliament.[5]

The fiscal activities of the Presidential Administration are handled by the General Office of the administration and information about them is limited. However, audits are conducted and published by the State Accounts Chamber.[6]

The Russian system of intergovernmental relations has been hampered by a discrepancy between a high degree of decentralisation of resources which has coincided with an exceptionally high degree of centralisation of fiscal authority. A permanent working group on the reform of inter-budgetary relations in the country has operated at the Ministry of Finance since 1999 and considerable progress has been made towards establishing a system of fiscal

federalism.[7] Since 2000, transfers to the regions have been determined using a refined methodology based on objective indicators and an assessment of fiscal capacity .[8] Any legislation requiring joint responsibilities at different levels of government has to provide a breakdown of responsibilities. Non-funded federal mandates for the regions have diminished in number. Under Article 134 of the Budget Code, subjects of the Federation receiving federal transfers are required to keep their accounts at the federal treasury.[9]

In compliance with the "Programme for the Development of Fiscal Federalism," interregional fiscal relations are being further refined with the imminent amendment of the Budget Code and the Tax Code. The ongoing reform efforts are in part designed to reduce tax sharing in favour of a system under which revenues from individual taxes are completely attributed to particular levels of government. The plan is to completely transfer receipts from taxes with a mobile base, such as VAT, to the federal government with the less mobile personal and corporate income taxes going to the local level. Very few taxes are locally levied and administered and even then collected by federal tax authorities. Local authorities have limited leeway in setting the rates of local taxes and they cannot introduce taxes not included on a federally approved register. The number and level of local taxes has no bearing on transfers from the centre. Subnational governments are free to set up their own off-budget funds and statistical information about them is very scarce. Although some have been integrated in the main budget, for instance road funds in several regions still exist as separate entities.[10]

In spite of considerable progress, there is still some confusion of roles, especially in areas of joint responsibility such as education and capital expenditure.[11] This blurring of roles is further exacerbated by an often inefficient and at times oversized bureaucratic apparatus at the regional level which often devotes attention to administrative procedures at the expense of concrete problem-solving.[12]

Borrowing by subnational governments is controlled by the centre, albeit not effectively enough to prevent potential risks from arising. Subnational governments can only borrow in roubles. Bond emissions have to be registered with the Ministry of Finance. The total amount cannot exceed own revenue before federal transfers and servicing costs cannot exceed 15% of total annual expenditures. Municipal debts are registered at the regional level but regional debts are not registered at the federal level. The Ministry of Finance collects information about regional debt, but the practice is not backed up by legislation. There is no mechanism for intervention so long as basic criteria are adhered to, even though especially

Any effective reform of the Russian system of intergovernmental relations is ultimately crucially dependent on proper administrative reform which has been laid out in the 2001 "Presidential Strategy for Administrative Reform," little of which has been implemented thus far. However, a special Commission on Administrative Reform was set up in July and is expected to deliver its results in January. Administrative reform looks likely to emerge as one of Putin's central priorities during his likely second term with concrete action prepared for 2004.[13]

Even as the ultimate direction of federal reform remains unclear, there is a broad-based consensus on de-politicising interbudgetary relations and on establishing a closer correspondence between the responsibilities of individual authorities and their economic base.[14]

## Relations between government and public sector agencies

The Central Bank of the Russian Federation (CBR) provided the government with budgetary support for some time after the 1998 default. However, such lending is illegal under the new CBR Act. All government debt to the Bank has been acknowledged and mostly restructured into tradable securities.

The government works closely with the extrabudgetary funds. The Pension Fund invests part of its holdings into government Eurobonds.

State property administered by the Ministry of Ownership Relations (*Ministerstvo imushchestvennykh otnoshenii*). The Russian Fund of Federal Property (*Rossiiskii fond federal'nogo imushchestva*) is responsible for all sales of state property.[15] The government currently owns just under 10,000 "unitary state-owned enterprises," as well as stakes in over 4,000 joint-stock companies.[16]

The government is pursuing restructuring plans in the main public utilities, most notably electricity, gas, and railways.[17] The restructuring of the electricity company United Energy Systems (EES) is fairly far advanced and considerable progress has been made also in the case of the state railways.[18] However, little change has occurred in the gas sector where Gazprom retains a monopoly status.

**Government involvement in the private sector**

Even though the Russian economy has been profoundly transformed as a result of an ambitious privatisation over the past decade, a great deal of property remains at least partially in government hands. At least partially publicly owned companies are still estimated to account for up to 40% of the combined turnover of the Russian corporate sector, although much of this is attributable to the leading utilities (Gazprom, RAO UES, etc.).

In June 2003, the federal government owned stakes of less than 100% in a total of 4,200 companies. There are plans to further reduce this involvement in accordance with plans extending to 2006. Among other things, the government is planning to dispose of all stakes of less than 25% in the course of 2004 and of all stakes not exceeding 50% in the course of 2005.[19]

Even though corporate governance standards are improving, elements of government involvement in the private sector remain largely non-transparent. Examples include irregularities with the sale of government assets to the private sector and support to companies through tax-offset mechanisms. Despite this, the government has made some progress in strengthening governance in the private sector in 2003. Although direct subsidies to companies have become relatively rare, regulated energy prices constitute a major indirect subsidy.

The discretion of public servants with regard to taxation and lands allocation is still widespread. Bureaucratic procedures for business start ups, for approving investment projects, and for issuing construction permits remain major problems.[20] The situation appears particularly numerous at the regional and local levels due to interference from rent-seeking officials.

The Ministry of Anti-Monopoly Policy is responsible for the regulation of government involvement in the private sector and has been reasonably successful, although the control of large government utilities remains much less strict.

## There should be a clear legal and administrative framework for fiscal management

**Legal framework for budgetary activities**

The Budget Code establishes the legal framework for budgetary activities. The presentation of extra-budgetary funds to the legislatures for each level of government must coincide with that of the annual budget law.

The Federal Treasury collates extra-budgetary fund data and reports on the execution of these funds to the Federal Assembly. The three main extra-budgetary funds – the Social Insurance Fund, the Compulsory Medical Insurance Fund and the Pension Fund – are in the process of being integrated into Federal Treasury accounting and reporting.[21] There is still not enough oversight of extra-budgetary activities. The MoF acknowledges this problem and plans to amend the Budget Code with special provisions.[22] The fragmented public sector, where administrative responsibilities are shared by a number of ministries, agencies and administrations, appears to significantly hinder any efforts to eradicate extra-budgetary activities.

**Legal framework for taxation**

The 1998 Tax Code, which was further amended in 2000, provides the legal basis for taxation. A special Ministry of Taxes and Fees was set up and tax administration radically overhauled to improve efficiency and compliance. Tax legislation and regulations are publicly available through publications provided by tax offices, as well as being posted on the web. However, the system has historically been highly convoluted with a large number of taxes with limited impact on revenues. Yet only five taxes generate some 90% of federal budget revenues.[23]

Russia has since 2001 been pursuing a gradual reform designed to simplify the system of taxation, diminish double taxation, and to reduce the overall tax burden.[24] One target of the reform is to shift the tax towards raw material extraction and to reduce the rates on labour and profits.[25] Main measures so far have included the introduction of a flat income tax, the lowering of the corporate tax jointly with the abolition of exemptions and holidays, and a simplification of the VAT regime.[26]

Discrepancies between tax regulations and practices remain, although they are diminishing in number. They are more common at the regional level where tax pledges by companies to fund particular public goods are at times exchanged for tax exemptions, bankruptcy protection, and other privileges.[27]

Tax enforcement remains another great problem area. Some unofficial estimates now suggest that the share of the unrecorded "shadow" economy might exceed 50% of GDP. The expectations that a significant proportion of it would register as a result of the tax reform are yet to be borne out. In particular, the social tax is punitive to many small and medium-sized companies and tax-evasion is a matter of survival Cuts are planned in these taxes in 2005-6. Enterprises often evade taxes to avoid interference by rent-seekers, especially at the local level.[28]

**Ethical standards for public servants**

The 1995 law "On the Principles of Civil Service" constitutes the basic code governing the behaviour of public officials. A plan to improve ethical standards of behaviour for public servants was set out in a presidential decree entitled "On Approval of General Principles of Official Conduct for Public Officials in the Russian Federation," adopted in August 2002. A draft "Code of Conduct of Public Officials" passed the first reading in the *Duma* in May 2002 but the second reading has been repeatedly rescheduled since then. A more systematic administrative reform package is expected to be adopted next year in accordance with the federal programme "Reform of the State Service of the Russian Federation (2003-2005)."[29]

As genuine as the government's commitment to administrative reform appears, corruption remains deep-seated in Russia. Russia was ranked 86th out of 133 countries in the corruption perceptions index of Transparency International. Many officials receive very modest salaries and the monitoring of their behaviour is typically far from adequate. Studies conducted on corruption perceptions in Russia point to serious problems, but also to considerable interregional variations.[30] While the existing laws should be adequate to effectively tackle the problem of corruption,

their implementation is often half-hearted and unsystematic. The police are widely perceived as the most corrupt professional group in the country and the courts lack the necessary resources to effectively handle their workload. Many high-profile arrests have been carried out for political reasons.

## 2. PUBLIC AVAILABILITY OF INFORMATION

●●● Enacted

**The public should be provided with full information on the past, current, and projected fiscal activity of government.**

**Central government operations**

The website of the Russian Ministry of Finance now presents comprehensive information on the fiscal activities of the government. Data on the revenues and expenditures for the central and the general government, as well as for central government debt, is provided conformity with the SDDS.[31] The classification is primarily administrative.

The disclosure of contingent liabilities, tax expenditures and quasi-fiscal activities still requires significant improvement. The Budget Code states that public guarantees have an upper limit and constitute a debt obligation as part of the sovereign internal debt of the Russian Federation.[32] They are thus fully recorded. The Russian government has been generally reluctant to issue guarantees on a large scale.

As required by the Budget Code, the government is reviewing its provision of non-essential services. These commitments originated from entitlements from other legislation and cover a plethora of activities. They have tended to include quasi-fiscal activities in the form of unreported tax expenditures such as subsidies to large enterprises; payments in kind at non-market clearing prices to support inefficient state-owned enterprises; and tax offsets against government arrears (e.g. discounts on tax payments and higher prices on arrears).[33] Considerable progress has been made towards rationalising the system with the share of "expenditure on the national economy and industry" in the federal budget steadily falling.

Off-budget activities have declined in importance in most areas. However, in sectors such as education and health, off-budget fiscal streams account for as much as 50% of the total resources.[34]

The availability of comprehensive data on future fiscal activity remains an area of relative weakness. The Ministry of Finance this year prepared a three-year fiscal plan for the second time in a row. Such documentation is presented separately on the federal budget and on the general government. This information is only published as background material for the government. This documentation typically does not explicitly present different scenarios, although they are prepared by the economic department of the Ministry.[35]

**Public sector operations**

In accordance with the Budget Code, the consolidated budget, consisting of the federal and sub-national budgets, is presented to the *Duma*. Quarterly and annual reports on extra-budgetary funds are prepared separately to the main budget. At the federal level, all earmarked funds fall under the Treasury's control.

Data on the implementation of the general government budget is presented on the MoF website on a monthly basis.[36]

The Ministry of Finance this prepares a three-year fiscal plan for the general government and parts of this are provided to the public through the government's website.[37]

## A commitment should be made to the timely publication of fiscal information.

**Debt reporting**

The Ministry of Finance collates and discloses public debt data. Central government debt consists of the federal budget debt as well as domestic and external debt. The data are classified by original maturity. Short-term debt is presented separately. Accumulated debt, including interest costs on discounted securities without coupons, is termed at par value. Financial instruments are broken down as securities, loans and deposits.[38]

**Advance release calendars**

Currently, the Central Bank of Russia (CBR) and the MoF produce advance release calendars for debt information and for central and general government operations.[39]

## 3. Open Budget Preparation, Execution, and Reporting

●● Intent declared

### Fiscal policy objectives, macroeconomic framework and risks

**Fiscal policy objectives**

The government discloses its basic government objectives in the Annual Budget Law. In addition, various medium- to long-term programmes on economic and social development of the country address fiscal plans.[40] The 2003 Budget Law was the first one to explicitly specify priority areas for public expenditures. However, the relationship between the targets and actual budgetary allocations is often somewhat tenuous.[41]

**Macroeconomic framework**

The MoF's Macroeconomic Department, in consultation with the IMF and outside research institutions, prepares the macroeconomic framework for the budget.[42] However, the economic model used is not published. Additional forecasting is carried out by the Ministry of Economic Development and Trade which prepares the longer-term scenarios of socio-economic development.[43] The vast majority of the macroeconomic data is not yet incorporated in the published budget documents, although elements of it are published as background material for the government's meetings.[44]

**Fiscal risks**

There are no formal assessments of fiscal risks in the budgetary documents. However, the Ministry of Finance preprares fiscal risk scenarios jointly with the draft budget. Some observers have expressed concern about the lack of clarity of the methodology used to calculate fiscal risks. The Ministry of Finance currently formulates even its base scenario on very conservative assumptions, partly in order to control spending by the parliament.[45]

The main fiscal risk facing Russia comes from the country's high economic dependency on the hydrocarbons sector. The recent strong economic performance has been to high degree driven by high oil prices. A sudden drop would have major direct and indirect repercussions potentially capable of fundamentally upsetting the current economic situation. A 1% change in the average annual oil price is estimated to change budget revenues by 0.3% of GDP.[46] A decline in the oil price below €19/barrel would turn the federal budget surplus to a deficit. While a €30/barrel price would yield an estimated surplus of 330.6bn roubles, a €10/barrel price would result in a nearly comparable deficit of 295.5bn roubles.[47] A negative market reaction to a precipitous drop in oil prices might result in serious short-term difficulties is raising external funding, thereby threatening sustainability.[48]

Potentially significant contingencies result from irresponsible, and imperfectly monitored, behaviour by regional governments. For example, the Federation recently bailed out the Nizhnii Novgorod region which was unable to pay its Eurobond tranche. More significantly, the central government ultimately intervened after regions mismanaged a 2002 decision to increase public sector salaries by an average of 90%. Instead of rationalising their costs or finding new revenue sources, they permitted substantial wage arrears to accumulate.[49] There are some suspicions that the

federal authorities would be willing to bail out regions and significant companies in financial difficulty in order to protect Russia's credit rating.

**Fiscal sustainability**

Russia has in recent years established a high degree of fiscal stability and this looks set to continue, although the encouraging results still have to do a great deal with the strength of the oil and gas sector. The previously significant problem of foreign debt has been brought under control with the debt-to-GDP ratio set to reach 24% next year with servicing costs amounting to 15% of the federal budget. Russia's overall public sector debt levels, at some 35% of GDP are deemed to be sustainable even in the event of a serious exogenous shock which would most likely come from a drop in oil prices. However, a severe shock could significantly reduce the availability of resources for structural reform, thereby undermining the longer-term growth prospects of the country.[50] The hydrocarbons sector should offer Russia reasonable prospects of ensuring fiscal sustainability for the longer term, as well. Under current output levels, Russia's oil reserves are projected to last for another 20 years and gas reserves for 80 years.[51]

The Budget Code sets out rules concerning the government deficit: the federal budget deficit must remain below total budgetary investment including interest expenditures; current expenditure cannot rise above current revenue for all levels of government; and regions must ensure that their deficit stays below 5% of their revenues (excluding federal grants) and cannot exceed their investment expenditure.[52]

In order to improve its ability to deal with short-term contingencies, the government intends to transfer its approximately 200 bn rouble financial reserve into a stabilisation fund as of next year. The 2004 draft budget proposes to transfer an expected budget surplus of 0.5% to the fund which would ultimately be used to counteract threats posed by exogenous shocks.[53] The fund is to be replenished from export duties on oil and petroleum products, an oil extraction tax (if the oil price exceeds $18.5/barrel), and from additional transfers from budget revenues which are determined on an annual basis. The fund is expected ultimately to reach 8.7% of GDP. The fund's holdings can only be invested in foreign securities and currencies. Transfers to the budget are only possible if the oil price falls below a predetermined level. The fund is expected to be sufficient to counter the effects of an oil price drop to $12 over a period of three years.[54] Some analysts have expressed scepticism about the realism of the plan.

The main longer-term threat comes from the unfavourable demographic situation with an ageing population and a low retirement age. The government is currently reforming the pension system starting with the introduction in 2002 of a funded scheme in addition to the old pay-as-you-go system. However, the notional defined contribution scheme continues to have serious shortcomings. While the planned reform is fiscally sustainable on most scenarios, its solvency depends of steadily declining replacement ratios, which may turn out to be politically unacceptable.[55]

## Budget presentation

**Data reporting**

The annual law "On the Federal Budget" follows a functional classification of expenditure and revenue items on which parliamentary decisions need to be taken. A comparable system is used at the subnational level .[56]

The Federal Budget Code details the system of data classification used in budget documents at all levels of government.[57] In spite of steady improvement, expenditure classification still excludes economic categories and combines administrative and functional categories. Furthermore, the functional classification system used in budget

preparation at the spending-agency level lacks an activity/programme structure that would help to provide a basis for monitoring unproductive spending.[58] In spite of their shortcoming, the Russian classifications broadly comply with international standards and a pilot scheme for the introduction of International Accounting Standards is in place.[59]

## Budget execution and monitoring

The *ex ante* control of public sector expenditures has improved dramatically as a result of the reform of the Federal Treasury which provides analytical statements on the budget execution.[60] The situation of the regional level continues to be quite mixed. In most regions, the Federal Treasury executes budgets, whereas in other cases the control is purely *pro forma* or even absent. Advanced regions, such as St Petersburg have set up their own treasuries. The Ministry of Finance conducts some internal control with occasional spot checks.[61]

The MoF now publishes monthly and quarterly data on the execution of the budget on its website. Monthly data is available on each regional government.[62]

In spite of a generally positive trend, the relationship between budgetary allocations and actual spending remains far from perfect. However, this does not appear to be primarily due to the Treasury system, which is relatively strong. Rather, shortcomings on budget management at the ministerial level and in connection with specific policies bear most of the blame.[63]

### Accounting basis

Virtually all fiscal flows in Russia are reported on a cash basis. The Ministry of Finance is currently holding discussions concerning the unified methodology for accounting principles, although many difficulties remain.[64] Russia has signalled that it intends to move towards a system of data reporting on an accrual basis, gradually replacing the cash based system. However, no concrete plans exist at the moment and few changes can be expected in the short run, in large part due to the need to retrain personnel.[65]

### Procurement and employment

The Budget Code, the 1997 presidential decree On Public Procurement Tenders, and the 1999 Law on Public Procurement provide the main procurement regulations. Local level public procurement is done on the basis of the law On Local Public Services. All tenders are announced publicly at least 45 days prior to the deadline in the weekly newspaper – "Competitive Tenders" – of the Federal Centre of Project Finance (*Federal'nyi tsentr proektnogo finansirovaniia*). However, the vast majority of them have a predetermined results shaped by personal connections. Foreign bidders are often shut out by the legal provision to consider them only if a good or service is not available from domestic producers or cannot be produced economically by Russian companies.[66]

In spite of the formal codification of the process, the adoption of open and transparent procurement procedures has moved slowly. According to the Ministry of Economic Development and Trade, there were only 10,000 open tenders during the first half of 2003. This compares to 142,000 closed tenders or single-quote purchases.[67]

The Ministry of Finance and the Ministry of Economic Development and Trade have adopted a programme for monitor procurement at the federal and regional levels. However, control is imperfect and mainly purely procedural. All tenders are potentially subject to investigation by a *Duma* committee but this option is seldom exercised and naturally insufficient for comprehensive control.[68]

The Labour Code is the main law governing employment-related issues.[69] A 1996 presidential decree on searches for civil service vacancies stipulates an open and competitive application and appointment process. However, hiring decisions are often far from transparent and the official search a mere formality.[70]

## Fiscal reporting

The Treasury provides summary reports on the budget execution to the *Duma* on a monthly basis and within one month of the reference month. The MoF also publishes quarterly reports on budget execution with relevant commentaries.[71] Audited annual reports are provided within twelve months of the year-end. Final accounts of the consolidated government are also provided.

## 4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY

●●● Enacted

### Data quality standards

The quality of fiscal data disseminated by the authorities has increased dramatically in recent years. Most observers deem Russian fiscal data to be comprehensive and quite accurate. Information on fiscal activities is disseminated in a timely fashion. In many areas, methodological discrepancies between Russian organisations, and deviations from international standards, create problems from the viewpoint of consistency and reliability. A particular problem exists with expenditure data classified by type, which is published with a long delay of up to a year.[72] As a rule information on the methodological aspects of data collection is not available. The MoF is actively working on further improving data quality standards and remains fully committed to the goal of SDDS membership as soon as possible.

### Independent scrutiny of fiscal information

**Independent Audit**

The principal body responsible for auditing government activities in Russia in the Accounts Chamber (*Schetnaia palata*) of the Russian Federation (ACRF). The 1994 federal law "On the Accounts Chamber" grants the body institutional independence. The appointments of the director, his deputies, and the currently 11 auditors is evenly shared by the two chamber of the State *Duma* and all appointments are made for a six-year term. The Accounts Chamber is currently working on several legislative incentives to clarify its role and increase its competencies.[73]

The ACRF is legally responsible for controlling the timely execution of the federal budget and to evaluate the validity of income and expenditure categories in it. It can investigate any discrepancies and recommend measures for their elimination in the budget, as well as in extrabudgetary funds. The ACFR is further responsible for auditing the use of state property (including privatisations). The Chamber has unfettered access to treasury data and is legally required to report to the parliament on the execution of the federal budget on a quarterly basis. The Chamber can conduct special *ad hoc* investigations on particular areas of the budget and particular activities of the extrabudgetary funds. Such operations are carried out in conformity with annual and longer-tem plans. Additional investigations can be requested by a minimum of one-fifth of the deputies of either chamber of the federal parliament.[74] Some observers have voiced concern over ways in which various *ad hoc* activities and responsibilities to provide analysis and recommendations can compromise the ACRF's ability to carry out its core functions.[75] Limited resources in general make a systematic audit of all aspects of federal finances impossible and in-depth analysis is possible only on a very selective basis. The ACRF is beginning to introduce performance audits on a fairly systematic basis.

The audit of subnational governments in Russia remains more problematic. The ACRF is authorised to review the books of regional and local authorities, as well as other entities, only in as much as they use federal funds.[76] This provision is typically applied only to so-called targeted funds, specially earmarked for particular projects. However, most federal funds are untargeted. The accounts of regional governments are audited by regional auditing chambers which are created by, and accountable to, regional parliaments. Municipalities typically set up committees for external audit. However, there is thus no unified nationwide standard on the subnational level and the quality and

scope of audits varies a great deal. The provision to employ external auditing firms is seldom exercised.[77] All organisations with a minimal state stake of 25% are subject to a compulsory annual audit and a 2002 decree governs the procedure for appointing the auditors for such audits.[78]

Under a 2002 decree, the Ministry of Finance has a separate Department for the Organization of Auditing Activities whose remit includes all sectors of the Government both at the federal and at the regional and local levels. The department is a regulatory and supervisory body responsible for the formulation of a unified national auditing policy, for ensuring adequate regulation of the auditing professions, and for ensuring acceptable professional standards in the profession.[79]

**National Statistics Agency**

The main administrative authority responsible for the compilation and dissemination of statistical data in Russia in the State Committee on Statistics (*Goskomstat*) which in addition to its central operations in Moscow has offices in the 89 regions and 2,200 districts of the country. *Goskomstat* enjoys organisational independence as an organ of executive power but no legally enshrined independent status.[80]

The fiscal data disseminated by *Goskomstat* is compiled by the Ministry of Finance in accordance with a joint agreement. *Goskomstat* is not able to conduct checks to verify the quality of fiscal data once an agreement has been concluded. Most fiscal data are compiled by the Government Finance Statistics unit of the Ministry of Finance which was created in 1999. The unit publishes a yearbook, albeit with a considerable lag. Considerable methodological problems remain with expenditure data.[81] While the quality of fiscal data is generally good, there are evident incentives on the local level to misrepresent things. There is as of now no effective performance accounting in the financial sphere.

*Goskomstat* is working with the government on improving standards but its work is frequently constrained by limited budgetary resources, especially at the regional and local level. There is close collaboration with Eurostat in several areas.[82]

## INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to Russia 10-14 November, 2003:

### Ministry of Finance

**10 November 2003**

| | | |
|---|---|---|
| Oksana Sergienko | Head of Division | Department of Macroeconomic Policy |
| Vadim Maksimov | Official | Department of Macroeconomic Policy |

### Central Bank of the Russian Federation

**11 November 2003**

| | | |
|---|---|---|
| Nadezhda Ivanova | Director | General Economic Department |
| Ekaterina Prokunina | Deputy Director | General Economic Department |

## ADDITIONAL INTERVIEWS

**10 November 2003**

| | | |
|---|---|---|
| Vadim Kleiner | Director of Research | Hermitage Capital Management |

**11 November 2003**

| | | |
|---|---|---|
| Bob Foresman | General Director | Dresdner Kleinwort Wasserstein LLC |
| Elena Panfilova | General Director | Transparency International – R |

*Carnegie Foundation Round Table on Tax Reform*

| | | |
|---|---|---|
| Kakha Bendukidze | General Director | United Engineering Works (*Ob"edinennye Mashinostroitel'nye Zavody*) |
| Arkadii Dvorkovich | Deputy Minister | Ministry of Economic Development and Trade |
| Evsei Gurvich | Director | Economic Expert Group |
| Gennadii Lebedev | Vice President | OOO "Vangard" |
| Ol'ga Mosina | Economist | Centre for Economic and Financial Research CEFIR |
| Tat'iana Popova | Aide | Federation Council |
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**12 November 2003**

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**13 November 2003**

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**14 November 2003**

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| Peter Westin | Chief Economist | Aton Bank |

In addition, we corresponded with:

| | | |
|---|---|---|
| Katerina Bezgachina | Coordinator | ACRC/Transparency International – Russia |

## NOTES

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# OXFORD ANALYTICA

## SOUTH AFRICA

## FISCAL TRANSPARENCY

**Country Report 2003**

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# REPUBLIC OF SOUTH AFRICA

## COMPLIANCE RATINGS

| *Fiscal transparency* | *2003* | *2002* |
|---|---|---|
| Clarity of roles | ●●● | ●● |
| Availability of information | ●●●● | ●● |
| Budget preparation | ●●● | ●●● |
| Accountability | ●●●● | ●●●● |
| **Score** | 3.50 | 2.75 |

## OUTLOOK & COMMENTARY

South Africa is steadily improving its fiscal transparency standards and the commitment to meet international best practices is widely shared. All fiscal statistics will be internationally compatible as of 2004. Further progress can be expected in bringing extra-budgetary funds under government umbrella. Increasingly efficient auditing practices should create further incentives for accurate accounting and reporting. Privatisation will similarly contribute to greater transparency.

Fiscal transparency will continue to be hampered by corruption, especially on the part of low-paid public officials. It is still unclear as to whether the economic implications of HIV are properly assessed and understood.

# EXECUTIVE SUMMARY

## 3.50 Enacted

South Africa's fiscal management and transparency remain high by international standards and the country's economic data are deemed to be of high quality.

The Public Finance Management Act (PFMA) enforces very strict transparency requirements, including timely reporting and procedures for accountability. Recent legislation has extended the requirements of the PFMA to provincial and local governments. Internal controls for compliance with the PFMA have also been improved, for instance through the formation of the joint-budget committee for parliamentary budget oversight. A new economic reporting format has been developed with effect from April 2004.

The government statistics tables published by the South African Reserve Bank now comply with the latest IMF standards. While the PFMA does cast a net over most extra-budgetary institutions, the absence of a legal requirement for the publication of contingent liabilities and extra-budgetary activities results in limited availability of information in these areas. Persistent inconsistent programme classification across provincial budgets makes comparisons across functions difficult.

Progress has been made in integrity assurance. New Treasury control measures include an early warning system to detect over, and under spending and the continuous inspection and monitoring of the budget execution through legal reporting requirements. Accounting standards have also been upgraded and the state procurement policies have been reformed.

South Africa's overall rating increases to 3.50 from 2.75 last year.

## 1. Clarity of Roles, Responsibilities and Objectives

●●● Enacted

**The government sector should be distinguished from the rest of the public sector and from the rest of the economy, and policy and management roles within the public sector should be clear and publicly disclosed.**

**Structure, functions, and responsibilities of government**

The structure of government and its relations to the rest of the public sector are well defined in the South African constitution.[1] South Africa has three tiers of government consisting of the central government, the nine provinces, and the municipal level. The constitution assigns functions regarding taxes, revenues, oversight roles and responsibilities to the different tiers.

**Co-ordination and management of budgetary activities**

The fiscal functions in the constitution are translated into practice through the institutional arrangements of the Medium Term Expenditure Framework (MTEF) and the accountability provisions of the Public Finance Management Act (PFMA) of 1999. The constitution assigns joint responsibilities for a number of functions to the national and provincial spheres, which complicates the division of roles. Considerable progress has been made in clarifying the relationship between the various tiers of government, for example under the new Municipal Systems Bill. Forums have also been established to coordinate intergovernmental finances.[2] The National Treasury conducted a PFMA Compliance Survey in 2003 in all national and provincial departments, measuring both compliance and qualitative improvements related to the PFMA and Treasury regulations. From this, the "Normative Measures for Financial Management" document was developed, which enables the relevant treasuries to report bi-annually to Cabinet and the Executive Councils on specific aspects of financial management.[3] The national government in 2003-4 accounts for 38.9% of the general budget, with the provinces' share 56.9% and that of the municipalities 4.3%.[4]

Extra-budgetary activities continue to be funded on the authority of separate legislation and through earmarked revenue. The PFMA provides the regulatory framework for most extra-budgetary institutions by classifying all boards, commissions, companies, corporations, funds or entities established by national legislation or owned by the state as public entities. Moreover, the PFMA standardises the budgeting and reporting requirements of all such institutions and ensures the accountability of the accounting authorities of these public entities. However, the absence of a legal requirement for the publication of contingent liabilities and extra-budgetary activities is a concern.[5] The National Treasury furthermore publishes a subset of extra-budgetary funds as part of the budget documentation since 2003.[6] A further development on this issue has been the passing of the Municipal Finance Management Act by the National Assembly.[7] The PFMA is currently being updated.

Legislative supervision over the budgetary process is improving with the joint Budget Committee now having the main oversight role.[8] The quality of fiscal management was cited by *Fitch* as the main reason for its decision to upgrade of South Africa's long-term foreign currency rating from BBB- to BBB in May 2003.[9]

**Relations between government and public sector agencies**

While the South African Reserve Bank is independent from the government remains clear, the relationship between the two is consensual and there are formal reporting requirements. The SARB Act does not specify the conditions or terms of loans and advances to the government, even though limits to such lending are imposed. In August 2003 the SARB balance sheet shows loans to the government sector worth R503 million and holdings of government securities worth R10.8 billion.[10] However, these figures do not represent loans in the conventional sense but, rather, relate to losses on the oversold forward book of the SARB. The SARB Act stipulates that any profit or loss on forward exchange contracts entered into by the Bank shall accrue to the government.[11]

The Treasury and the SARB have formulated and implemented a strategy for dealing with the outstanding balance on the gold and foreign exchange contingency reserve account (GFECRA), which was mainly built up in recent years as part of dealing with the above losses on the oversold forward book.[12] Under its provisions, the SARB will be able from time to time to restructure its holdings of interest bearing government bonds, held in its monetary policy portfolio, by way of switching some of these bonds for other government bonds and/or through the outright sale of certain bonds.

The SARB continues to provide the normal fiscal agency functions to government, for example, organising auctions for government debt. It also acts as the "government's banker" through holding the Exchequer account. The Bank further serves as a government agent for exchange rate policy. Neither of these functions is explicit in the SARB Act, but they are described in the activities of the Bank's departments which are responsible for them. There remains room, however, to improve transparency in the performing of the agency functions, such as the impacts of reducing the NOFP on the exchange rate. The SARB is involved in the country's relations with international financial institutions and maintains close contact with various other central banks, foreign private financial institutions, and certain foreign governments.

The Department of Public Enterprises is charged with the responsibility to direct the restructuring of state-owned enterprises. The SOE's under the jurisdiction of the Department are Transnet, Telkom, Eskom, Denel, Alexkor, Aventura, and Safcol.[13]

**Government involvement in the private sector**

The government has since 2000 pursued a comprehensive privatisation programme, but remains the sole owner or a major shareholder in a number of large public entities. Telkom, the state telecommunications company, is expected to be divested in 2004. Good progress is also being made towards the sale of a number of non-core public assets.[14] Information on the government's privatisation programme is provided in the budget documentation. The section entitled "Public Enterprise Restructuring and Corporate Governance" in *the Budget Review* provides a summary of restructuring programmes for Non Financial Public Enterprises (NFPE's). Following the IMF's recommendation in this regard, the government now conducts independent audits for all privatisations.[15] NFPE's perform significant Quasi-Fiscal Activities (QFA's). NFPE annual reports disclose these activities, while the Treasury only reports on the amounts allocated to them.[16]

South Africa has in recent years pursued a programme of promoting public-private partnerships in various sectors of the economy. Details on all new projects are posted at the National Treasury website. Treasury regulations compel national and provincial departments to secure authorisation from the National Treasury when forming such partnerships.[17]

The Public Investment Commissioner is responsible for investing and managing public funds in private companies. He reports all of its activities in a transparent manner, indicating the scale of government involvement for all companies.[18]

## There should be a clear legal and administrative framework for fiscal management.

**Legal framework for budgetary activities**

The South African constitution spells out the division of responsibilities between the national and provincial spheres of government. Functional areas of concurrent responsibility are listed in Schedule 4 of the Constitution (for example health, housing, education, and welfare services). Exclusively provincial functions are listed in Schedule 5 (for example abattoirs, ambulance services, provincial roads and traffic). Other functions remain exclusively at the national sphere (for example justice, defence and foreign affairs).[19] Some of the latest legislation governing budgetary activities include the Division of Revenues Act (No5 of 2003) and the Finance Act (No.48 of 2002). All legislation and regulations remain openly available on the government's web pages. New legislation relating to government finances which are listed in the Annual Report of the National Treasury.[20]

Concerns have been expressed in the past about shortcomings in parliamentary oversight.[21] However, the recent formation of the joint budget committee, is a major step towards remedying this. The membership of this committee is drawn from both the National Assembly and the Council of Provinces. The committee's main focus is budget compliance at individual departments. With this oversight role now being allocated to the joint budget committee, the Portfolio Committee on Finance operates more at the overall financial policy level.[22]

The "adjustments budget", which is usually published around November of each year, is available on the website of the National Treasury and deals with expenditures which have been announced in the main budget, but not yet allocated to a particular department, as well as unforeseen and unavoidable expenditure which have arisen since the main budget.[23]

**Legal framework for taxation**

Taxes are raised in accordance with the latest Taxation Laws Amendment Act (Act 30 of 2002) and regulations, which are published by the South African Revenue Service (SARS) in guidebooks and distributed to all taxpayers with their tax returns. Further recent legislation in this regard are the Revenue Laws Amendment Act (No.74 of 2002) and the Division of Revenue Act (No.5 of 2003). SARS posts all information, as well as all its prescribed forms, on its website.[24] The rights and obligations of the state *vis-à-vis* the taxpayer and *vice versa* are disclosed in the SARS 1997 code of conduct. A SARS client charter, published in the 1998 *Budget Review*, sets out the rights and obligations of taxpayers.[25] A special unit of the SARS deals with the internal auditing of tax collection.[26] The SARS is continuing to develop and implement new taxation legislation, as well as developing tax collection systems to become more accessible and transparent.[27] In 2003/2004, the Service will focus on developing a comprehensive compliance strategy that provides an integrated response to taxpayer behaviour.

Provincial taxes are being governed by the Provincial Tax Regulation Process Act (No. 53 of 2001). The Treasury has made it clear, however, that the provincial taxes are specified in the Constitution and are therefore subject to a legislative framework. The constitution specifies the areas in which the provinces can levy taxes and the PTRPA indicates the process to be followed should they actually want to levy such taxes.[28] This year saw the introduction of an improved Division of Revenue Act, which upgraded reporting requirements in line with the PFMA.

**Ethical standards for public servants**

The code of conduct for public officials is published on the Department of Public Services and Administration's website.[29]

Transparency International last year ranked South Africa 36th among 102 countries in its corruption perceptions index.[30] There is considerable anecdotal evidence of persistent and widespread malpractice and incompetence by public officials. Recent high-level scandals have involved Deputy President Jacob Zuma and the minister of defence.[31]

Auditors' reports routinely uncover discrepancies. For example, audits conducted by the Auditor General's Office reveal that only 3.8% of the Eastern Cape provincial budget has been properly accounted for in the six financial years between 1996 and 2002. The share in the 2001/2 financial year was 17.7%. Minimal supporting documentation was produced to justify expenditures.[32] 63% of those recently polled in the province think that most provincial officials are corrupt.[33]

Even though corruption remains a serious problem in South African society, awareness of it is in no small measure due to recent successes in combating it, thereby revealing several high-profile instances. The national prosecuting authority has a staff of over 3,500 and has seen a rapid increase in its financial resources.[34]

## 2. PUBLIC AVAILABILITY OF INFORMATION

●●●● Compliance in progress

**The public should be provided with full information on the past, current, and projected fiscal activity of government.**

**Central government operations**

The Treasury continues to expand the breadth and depth of disclosed budgetary information largely as a result of the MTEF and the PFMA. Information is now made available at various phases of the budget process. The budget documentation for consolidated government contains several indicators of the fiscal stance and compares estimated indicators of the fiscal stance with actual outcomes, such as the Tax-GDP Ratio.

The South African authorities recently introduced the Government Finance Statistics (GFS) classification as the basis for reporting in all financial publications of government. As a result, the Treasury has introduced a new economic reporting format that comes into effect on 1 April 2004. The new classification of expenditure will replace the existing standard item of classification as well as the GFS classification used in the 2003 Budget. In developing the new classification, the Treasury first adopted the GFS classification standards, as well as the accounting standards set by the International Federation of Accountants as the basis for the reform. The new classification is a South African version of the international standards, and provides for the classification of receipts, expenses, financing and debt. It also shows the impact of transactions in these items on the cash flow and balance sheet of government.[35] In 2004, economic reporting will replace the existing "standard item" and GFS classification. A new standard chart of accounts, which underpins the new format will also be implemented for all national and provincial departments.[36] The development of the new chart of accounts is complete and implementation is scheduled to start in advance of the 2004/2005 financial year.

A process is currently underway to verify the historical data for all national departments, which have already been re-classified into the new economic format. The data will be made available to departments as a downloadable spreadsheet. In the budget, expenditure will furthermore be classified in terms of both economic and functional categories. [37]

While the PFMA and the *Medium Term Budget Policy Statement* establish a central list of extra-budgetary institutions, consolidated reporting by government on its extra-budgetary activities is still not a legal requirement. However, reform efforts are ongoing and in 2003, a number of entities were brought into the documentation, such as the Central Education and Training Authorities and the South African Revenue Services (SARS).[38] In the *Budget Review*, information continues to be published on a range of national funds and accounts, including skills development funding, international development co-operation and consolidated information on social security funds.

Forecasts for the two following years to the budget are available in the *Budget Review*. Full outturns are provided for the past three fiscal years of which the first two are audited outcomes and the most recent one a preliminary estimate.[39]

Budget documentation does not provide information on quasi-fiscal activities (QFAs) and only limited information on tax expenditures. It also does not include a statement of financial assets and liabilities or of net worth. There are

some concerns that the schedule of contingent liabilities is defined too narrowly. The national budget excludes contingent liabilities such as university debt, non-departmental organisations, research councils, government agencies and social security and other funds. However, independently audited financial statements of institutions such as the Reserve Bank, NFPEs, and Public Financial Institutions (such as the Development Bank of Southern Africa, the Land Bank, etc.) are available on the websites of these institutions at the end of each financial year.[40]

The National Treasury recently introduced an early warning system that compares monthly actual expenditure with planned expenditure. Monthly expenditure trends are extrapolated to annual expenditure and compared to the planned expenditure. No specific adjustments are made for cyclical demand or spending trends. If expenditure deviates beyond a set target, the department dispatches liaison officials to investigate the cause of over- or under-spending. Provincial governments have instituted different systems to control over-expenditure. These early warning systems are supported by the PFMA, which requires departments to submit monthly actual expenditure reports to the relevant treasuries.[41]

The existing provisions in the PFMA set out conditions for the use of funds in emergency situations, which must then be appropriated in the next adjustments budget. The PFMA also requires the adjustments budget to provide for "unforeseeable and unavoidable expenditure." The eventualities that may give rise to either of these sets of expenditures are not defined in any kind of detail.

**Public sector operations**

The absence of a legal requirement for the publication of contingent liabilities and extra-budgetary activities remains a major gap in South Africa's transparency requirements.[42] The *Budget Review* contains information on financial guarantees furnished by the national government, but does not cover all potential shortfalls that may have to be covered by the budget, such as those incurred by public entities or public enterprises. According to the Treasury, however, the PFMA covers the future disclosure of these activities and planning is underway to extend the legal requirements in order to ensure full coverage. The Treasury also confirmed that a statement on the main central government tax expenditures is not included in the budget documentation.[43]

Pronvicial governments produce budget documents more or less comparable in structure and scope to the national ones. However, the published versions are often harder to obtain and less complete. Data on the fiscal activities of subnational governments is included in the general government accounts.[44]

## A commitment should be made to the timely publication of fiscal information.

**Debt reporting**

The National Treasury's monthly press release, *the Statement of Revenue, Expenditure and Borrowing* contains data on transactions affecting the direct liabilities of central government. This release is also the source for data on domestic and foreign loan transactions. The Treasury publishes an annually audited *Statement of Public Debt* within 12 months following the end of a fiscal year. These are classified by residual maturity. Data on debt guaranteed by the central government is also disseminated.[45]

**Advance release calendars**

In line with the IMF's SDDS requirements, an advance release calendar which gives one-quarter-ahead notice of precise release dates for fiscal data, is posted on the SARB. A notice to this effect is also published on the IMF's Monthly Release of Selected Data.[46]

## 3. Open Budget Preparation, Execution and Reporting

●●● Enacted

## Fiscal policy objectives, macroeconomic framework, and risks

### Fiscal policy objectives

South Africa's fiscal objectives are clearly specified in the budget documentation where they are placed in a consistent macroeconomic framework. The release of budget information starts with the publication of the *Medium Term Budget Policy Statement* in October/November, which details the macroeconomic framework, principle fiscal targets, the division of revenue, and main functional divisions of expenditure. Since 2001, this is followed by the *Division of Revenue Bill published* in the *Government Gazette* in December. After that, the budget itself is presented in February.[47]

### Macroeconomic framework

The macroeconomic framework, as a backdrop for fiscal policy, is set out in the *Medium Term Budget Policy Statement*, includes macroeconomic projections up to 2005 and key fiscal trends. Descriptions of new policies, such as tax and expenditure policy changes are also made available. Changes in fiscal rules include discursive assessments of risk.

Up until 1999, the government based its macro-economic forecasts on models from the Reserve Bank, the Council for Scientific and Industrial Research and the University of Stellenbosch. Although these were not open to independent assessment, they were generally seen as credible. As from the start of the 2000 fiscal year, the Treasury developed its own in-house model to make macro-economic forecasts. While it is not openly available, the Treasury invited five universities in 2003 to comment on the model.

### Fiscal risks

The *Medium Term Budget Policy Statement* discusses assessments of fiscal risk. Low and high economic forecast scenarios are sketched including an indication of factors that could affect them. Further indicators of risk can be found in the contingent liabilities table. According to the IMF, however, there is scope for presenting more comprehensive information on fiscal risks and tax expenditure.[48]

HIV/AIDS infection is generally recognised as having reached pandemic proportions in South Africa and affects over one-tenth of the population as a whole, but one-fifth of the working-age population. The economic repercussions of the epidemic are potentially enormous. Under the most pessimistic scenario, 10-15% of the population could die from HIV and its complications and labour force growth could slow down to zero. The costs of managing the epidemic are likely to prove high, especially if it is to be properly contained. At the same time, the effects of the disease will reduce government revenues. The IMF estimates the potential effect on government finances by 2010 at 3% of GDP.[49]

**Fiscal sustainability**

Key indicators of fiscal sustainability are also provided, from 1996 onwards, such as the conventional deficit, the primary balance and the current balance. All budget balances are expressed in terms of GFS classifications.[50]

South Africa has managed its public debt very conservatively and official external debt currently amounts to only 8% of GDP.[51]

## Budget presentation

**Data reporting**

The South African Constitution requires the National Treasury to introduce uniform expenditure classifications in the interest of transparency, simplicity and comparability. A new GFS-compliant economic reporting format has been adopted and will be implemented in January 2004.

Budget documentation must supply information by department and programme, and also include information on measurable objectives for each programme. Currently, expenditure is classified first by department, then by programme. Since 2001, the National Treasury publishes the *Estimates of National Expenditure* (*ENE*) as part of the budget documentation. The *ENE* reports on the objectives, policies, funding and activities of departments down to the sub-programme. It also furnishes information on the measurable objectives for each programme. The *Statement of Revenue, Expenditure and Borrowing* includes revenue, expenditure (including separate data on total interest payments); the balance (deficit/surplus); and financing broken down by debt instruments.[52]

During the course of the fiscal year, information on budget implementation is published each month, while quarterly reports will supply information on progress with service delivery. Departmental annual reports, which must be submitted five months after the end of the fiscal year, include a range of personnel and programme information, as well as the audited end-year financial statements. Starting in 2003, annual reports have assessed performance against its measurable objectives as set out in the budget.[53]

## Budget execution and monitoring

**Accounting basis**

The *Budget Review* publishes a clear statement on the accounting basis and policies adopted in the budgets and accounts of the national government. The same policies legally apply to the provincial budgets, but are not consistently stated in the provincial documentation.[54] Payment arrears for public entities and national departments are published as part of their financial statements and are available on the respective websites of these institutions.

Historically, the national budget has been prepared on an adjusted cash basis. At present, however, the Treasury is in the process of changing from a cash base of accounting to an accrual basis in order to comply with the Generally Recognised Accounting Practices (GRAP) standards to be issued by the Accounting Standards Board (ASB). The ASB was established in 2002. The ASB has adopted the International Federation of Accountants (IFAC) standards as the basis for developing the South African standards. To date, policies have been drafted for ten of the twenty approved IFAC standards.[55]

**Procurement and employment**

Information about the Office of the State Tender Board is provided at the Treasury website. All tender bulletins, documents, and contracts are listed.[56]

The South African public procurement procedures have been criticised for being unnecessarily complex and costly. Moreover, regulations are not always observed in practice, leading to inconsistent application and corruption. Even though the extent of corruption is difficult to assess, various auditors' reports have pointed out numerous irregularities. Especially low-paid officials frequently accept and expect enabling payments to process tenders. In its 2002-05 Strategic Plan, the National Treasury noted that important progress has been made in reforming procurement practices.[57]

As of 2003, a significant part of procurement has been decentralised from the State Tender Boards to government departments for more than fifty percent of departments.[58] Where before the regulations required that the procurement of all goods and services must be done only through the State Tender Board, the amended regulations now allow for accounting officers of national departments to procure goods and services either through the State Tender Board or alternatively in terms of the PFMA.[59]

The National Treasury sets out clear employment regulations on its website. A competitive applications and appointment process is legally required, although the degree of adherence remains difficult to measure.[60]

## Fiscal reporting

In accordance with the PFMA, audited statements on spending by provincial and national departments, legislatures, constitutional institutions, public entities and enterprises must be presented to the relevant legislatures within seven months after the end of the fiscal year. Most entities complied with the new deadlines for reporting in 2001. A mid-year report on budget developments is presented to Parliament.

## 4. ACCOUNTABILITY AND ASSURANCE OF INTEGRITY

●●●● Compliance in progress

### Data quality standards

As a member of the SDDS, South Africa meets the IMF standards for the timeliness and quality of fiscal data.[61] The government has fully implemented the recommendations of the latest IMF review which, among other things, requires the introduction of a new external debt data category. Compliant quarterly figures for external debt have been available since September 2003.[62] South Africa currently exceeds the requirements of the IMF codes in areas such as (1) legislated commitments to the public availability of a wide range of fiscal information, (2) the presentation of a budget policy statement to parliament in advance of the annual budget and a comprehensive rolling MTEF; and (3) the timely reporting of data on general government.

Fiscal data is consistent and reconciled. Changes in the stock of debt, for example, are reconciled with the reported budget balance. Fiscal and monetary data, however, are not yet reconciled.[63]

### Independent scrutiny of fiscal information

**Independent Audit**

The constitution guarantees the existence and independence of an Auditor-General whose work is supervised by an Audit Commission composed of parliamentary and presidential appointees. The procedures for the appointment and dismissal of the Auditor-General are clearly specified. The Auditor-General's work is governed by the 1992 "Audit Arrangements Act" and the 1995 Auditor-General Act."[64]

The constitution requires the Auditor-General to conduct audits of the accounts, financial statements, and financial management of all national and provincial state departments and administrations, all municipalities, and various other entities.[65] The office conducts regularity (financial accountability, compliance), performance, information systems, forensic, and sustainable development audits. Performance audits are selective and focus on areas deemed most important. Reports on government entities are submitted, as appropriate, to national (Standing Committee on Public Accounts) or provincial parliaments, the latter delegating their powers to the Provincial Public Accounts Committee.[66]

The annual reports of the Auditor-General and the Treasury's internal audit committee are published in the Treasury's *Annual Report*. In practice, the funding mechanism in place for the Auditor General further strengthens their independence: it does not receive an allocation from a budget department or directly from the national revenue fund, rather it invoices the entities that it audits on a time basis. All departments and public entities must budget for their audits in the same way as the private sector. The Auditor-General reports to parliament on the financial integrity of government accounts on an annual basis. The Auditor General's report is publicly available on its website.[67]

While the work of the Auditor-General's Office seems to be of a high standard, the Auditor General in 2002 expressed some disappointment at the lack of follow-up to its recommendations.[68]

**National Statistics Agency**

Statistics South Africa is an independent institution whose work is regulated by the Statistics Act of 1999. Its central operations are complemented with provincial offices. It collates and publishes high quality, reliable data on economic outcomes and on the national government accounts. National, provincial, and local accounts are compiled. Most of the information is easily accessible through the Statistics South Africa website.[69]
Statistics South Africa recently set up a Quality and Methodology division to improve statistical standards and a number of methodological innovations have been introduced. Statistics South Africa has initiated an international training programme to improve the quality of its staff and plans exist to set up an internal training unit. Pre-release calendars are available for virtually all categories of statistics.

Statistics South Africa publishes a comprehensive annual report on its activities.[70]

## INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals in South Africa between 17 September and 25 November 2003:

### The National Treasury

**21 October 2003**

| | | |
|---|---|---|
| Kuben Naidoo | Head | Fiscal Policy Section |
| Neil Cole | Director | Budget Reform |

### The South African Reserve Bank

**17 September 2003**

| | | |
|---|---|---|
| Johan van den Heever | Deputy Head | Reviews and Statistical Research Department |

**21 October 2003**

| | | |
|---|---|---|
| Ernie Van der Merwe | Chief Economist and head | Research Department |

**25 November 2003**

| | | |
|---|---|---|
| Sage de Clerck | Economist | Research Department |

## ADDITIONAL INTERVIEWS

### University of South Africa

**21 October 2003**

| | | |
|---|---|---|
| Philip Mohr | Professor | Department of Economics |

### Rand Merchant Bank

**22 October 2003**

| | |
|---|---|
| Rudolf Gouws | Chief Economist |
| Etienne le Roux | Economist |

## NOTES

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[3] National Treasury, *Annual Report*, 2002-2003, p.44, www.treasury.gov.za.
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[12] The Gold and Foreign Exchange Contingency Reserve Account Defrayal Act (Act. No.4 of 2003) was passed and published in the *Government Gazette* on 28 March 2003.
[13] http://www.dpe.gov.za/main.asp?ID=5; http://www.dpe.gov.za/main.asp?ID=152.
[14] IMF, *Article IV Consultations with South Africa*, 2002, www.treasury.gov.za
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[21] C. Barberton, "South Africa: Transparency and Participation in the Budget Process", April 2002.
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[25] C. Barberton, "South Africa: Transparency and Participation in the Budget Process", April 2002. Document provided by officials of the National Treasury of South Africa in September 2002. ("Transparency & Participation in Process Report 2002")
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[28] Interviews conducted in South Africa, 17 September-25 November 2003.
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[31] "Corruption in South Africa: Just how bad is it, really?," *The Economist*, 31 July 2003.
[32] http://www.psam.ru.ac.za/ptlbudgetEC.asp.
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[35] Interviews conducted in South Africa, 17 September-25 November 2003.
[36] Details of this are provided in T*he Guidelines for Implementing the New Economic Reporting Format*, National Treasury, 2003.
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[39] Interviews conducted in South Africa, 17 September-25 November 2003.
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[41] Interviews conducted in South Africa, 17 September-25 November 2003.
[42] C. Barberton, "South Africa: Transparency and Participation in the Budget Process", April 2002.
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[55] National Treasury*, Annual Report*, 2002-2003, p.49 at www.Treasury.gov.za.
[56] Office of the State Tender Board, http://www.treasury.gov.za.
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[64] Audit Arrangements Act No. 122 of 1992; Auditor-General Act No. 12 of 1995, both reproduced at: http://www.agsa.co.za.
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# OXFORD ANALYTICA

## SOUTH KOREA

## FISCAL TRANSPARENCY

**Country Report 2003**

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# SOUTH KOREA

## COMPLIANCE RATINGS

| *Fiscal transparency* | *2003* |
|---|---|
| Clarity of roles | ●●●● |
| Availability of information | ●●●● |
| Budget preparation | ●●● |
| Accountability | ●●●● |
| **Score** | 3.75 |

## OUTLOOK & COMMENTARY

South Korea should continue to make steady progress towards meeting the highest international standards for fiscal transparency practices. The availability of information on central government operations will continue to improve from an already high level. Moreover, government's efforts to improve the reliability and publicity of sub-national levels of government information are likely to produce positive results in the near future.

Even when the number of extrabudgetary funds is likely to be reduced, the government will continue to rely on these funds for its operations. Once the 'National Fiscal Management Plan' becomes operational in 2004, the country's analysis of fiscal sustainability is likely to improve. The sustainability of the National Pension System will continue to produce uncertainties, but changes to the system will depend on the government's ability to achieve political consensus for reform.

# EXECUTIVE SUMMARY

## 3.75 Compliance in progress

South Korea complies with many of the standards set out in the IMF's 'Code of Good Practices on Fiscal Transparency', and the government has publicly expressed a commitment to further improve fiscal transparency. Since the 1997 financial crisis, the country has been restructuring its fiscal sector through better transparency and accountability, disclosure of fiscal information, and end-user-oriented fiscal management.

New legislation and the ongoing implementation of consistent measures on budgetary and auditing procedures, government procurement and employment, and data availability have significantly overhauled most of the fiscal framework.

South Korea complies with the IMF's Special Data Dissemination Standard (SDDS), and publishes a comprehensive range of fiscal information. However, efforts could still be made to improve the integration of statistics and records of sub-national levels of government.

Fiscal transparency could be enhanced through improving the disclosure of quasi-fiscal activities from public sector institutions in the national budget, and assessing major fiscal risks. In addition, the government should prepare comprehensive studies or reports on fiscal sustainability, including projections of contingent liabilities and the financial requirements from the pension systems. Moreover, further reforms in the use of extrabudgetary funds are still necessary.

A 'National Fiscal Management Plan', starting in 2004, is expected to further improve the country's system of analysis and reporting of the medium-term expenditure framework, and to provide analysis on fiscal sustainability.

South Korea's overall score is 3.75.

## 1. Clarity of Roles, Responsibilities and Objectives

●●●● Compliance in progress

**The government sector should be distinguished from the rest of the public sector and from the rest of the economy, and policy and management roles within the public sector should be clear and publicly disclosed.**

**Structure, functions and responsibilities of government**

South Korea's government structure is explained in the national Constitution[1] and in supportive administrative law. The structure and functions of the government are clearly described on the country's official website[2] and in the different governmental websites. Under Korea's presidential system, the president performs his executive functions through the State Council, made up of 15 to 30 members and presided over by the president. The prime minister is appointed by the president and approved by the National Assembly.

The roles of the executive, legislative, and judicial branches are clearly defined and there is a demarcation of roles between different levels of government with explicit tax powers and expenditure responsibilities specified in the Local Public Finance Act and accompanying legislation. Fiscal reform has been steadily implemented over the past five years to improve all areas of fiscal management. More specifically, fiscal reform has aimed to achieve increased accountability and transparency in government operations.

According to the Constitution, local governments deal with matters pertaining to the welfare of local residents, manage properties, and may, within the limit of laws, enact provisions relating to local autonomy regulations.[3] In 1988, the government initiated a revision of the 1949 Local Autonomy Act. Following the new law, there are 16 higher-level local governments, including seven metropolitan city governments and nine provinces, and 232 lower-level local governments.[4] The division was made to make smoother the transition in stages from a centralised system of government to local autonomy.

The Local Finance and Economy Bureau assists local governments in establishing sound finances. Revenues of local governments include local tax and non-tax income. To meet a lack of revenue, the central government provides subsidies to local governments. The Ministry of Government Administration and Home Affairs (MOGAHA) formulates a mid-term finance plan for local governments every year to enhance the efficiency and soundness of finances of local governments. The MOGAHA also conducts in-depth deliberations on the issuance of bonds and investment and borrowing projects.[5]

**Coordination and management of budgetary activities**

The Ministry of Planning and Budget (MPB) co-ordinates and prepares the national budget. Under the country's organisational chart, the Ministry of Finance and Economy (MOFE) is responsible for revenue projections and for constructing the macroeconomic framework.

According to South Korea's legal framework, extrabudgetary funds can be established to operate funds for projects in specific areas, separately from the national budget. After the financial crisis, the expanded social safety net and the greater demand for credit guarantees have driven up the size of funds operations. According to the government, the fund system has delivered positive benefits by allowing flexible financing for developing specific areas, including

housing, support for rural areas, culture, sports, welfare and labour. However, as the number of funds kept increasing and their total size reached twice that of the national budget, negative aspects began to emerge.[6]

In order to improve the transparency of funds, the Basic Act on Fund Management was revised twice, in 1999 and 2001, to set the stage for fundamental reform of the fund system. The funds are now reviewed every three years in order to assess their position. Moreover, a summary status of funds is published annually and available through the MPB website. Since 2001, both the special accounts and the funds have begun to be reported to the National Assembly, increasing transparency in their management.[7] The consolidation of these accounts remains one of the greatest challenges for the future.

The continuous reliance on extrabudgetary funds, each managed by different line ministries, and the extensive use of earmarking of various revenue sources, have complicated the management of overall public finances. Twenty-two 'special accounts', and fifty-five 'funds'[8] have been used during the 2003 fiscal year. Individual laws regulate the extrabudgetary funds and information on the execution of these funds is publicly available. The control and review of both the special accounts and the funds is exercised by the MPB, mainly through the Public Funds Policy Bureau. Scrutiny of funds has increased recently, and the parliament is now required to approve an operational plan for the use of funds.

Commentators have expressed their concerns regarding the existence of both 'special accounts' and 'funds', given the fact that there is no clear distinction between the two.[9] Even when the government claims that the use of funds is necessary to provide flexibility in public finances in order to meet unpredicted spending, the number of these extrabudgetary funds has been decreasing in recent years.

**Relations between government and public sector agencies**

Non-financial public enterprises are, on the whole, run on a purely commercial basis although some public enterprises perform roles that are essentially fiscal in nature (mainly in executing public infrastructure spending).

The institutional relationship between the government and the Bank of Korea (BoK) is clearly outlined in its regulations and annual reports. The BoK's operational autonomy is tempered by the need to perform its monetary and credit policies. However, commentators express concerns over perceived ambiguities in the BoK Act as it relates to government participation in the monetary policy-making process.[10]

**Government involvement in the private sector**

In 1998, the government launched a major privatisation programme with the understanding that transferring ownership to the private sector was a fundamental solution to the inefficiency of state-owned enterprises (SOEs).[11] The privatisation programme helped to overcome the foreign exchange shortage that triggered the 1997 financial crisis. Following the 1998 programme, eight former SOEs have been privatised.[12] During 2003, the government has continued its efforts to privatise the remaining three SOEs.[13]

The privatisation programme is implemented by the MPB, following instructions from the Privatisation Steering Committee and in coordination with the line ministry responsible for the state-owned enterprise. The privatisation process is fair and transparent and is subject to internal financial and performance audits as well as oversight by the Board of Auditing and Inspection (BAI).

The government owns a number of financial institutions that concentrate lending to achieve specific policy goals. Lending by these institutions is conducted at market rates and on a commercial basis. Government grants to these institutions are included in the budget documentation and operational balances are publicly available through each institution.[14]

The Framework Act on the Management of Government-invested Institutions promotes the rationalisation of operations of government-invested institutions and efficient administration of government investment therein by prescribing fundamental matters to ensure an autonomous and responsible operation system of such invested institutions. [15]

## There should be a clear legal and administrative framework for fiscal management

**Legal framework for budgetary activities**

The Budget and Accounts Act, enacted in February 2001, provides general procedures and objectives for the national budget and accounting and the fundamental matters related thereto. The management and accounting of goods and national property are subject to such conditions as prescribed in other legislation, but matters for which no special provision has been made are subject to conditions provided for this Act.[16]

The budgetary cycle of South Korea is explained and publicly available in the MPB website. In October each year, the budget proposal is transmitted to the National Assembly upon approval by the cabinet and the president. It is then the subject of deliberations during November in the Special Committee for Budget and Accounts, with the National Assembly approving the budget in the early days of December each year.

**Legal framework for taxation**

Tax laws are publicly available and a summary of tax legislation is provided on the MOFE website. According to the constitution, taxes, duties, fees and charges must have an explicit legal basis enacted by the National Assembly. The director of the National Tax Service (NTS) is appointed by the president and is considered a very important position in the country's bureaucratic hierarchy, requiring confirmation by the National Assembly.[17] Legislation does not grant any kind of special legal protection to the director of the NTS.

Since 2000, tax collection has been increasing and evasion is not considered a problem in South Korea.[18] National taxes are collected in accordance with the National Tax Collection Act (NTCA), with the objective of securing tax revenue in a predictable manner. The principles of the NTCA may also be applied to the compulsory collection of local taxes and other public charges. Korea has a National Tax Tribunal, which solves disputes between the National Tax Service and taxpayers.

The Basic Act for National Taxes, which contains details of taxpayer rights, tax dispute procedures, and the application of tax law, takes precedence over the general provisions and procedural regulations in the NTCA.

**Ethical standards for public servants**

Ethical standards for public servants are set forth in the recently approved *Code of Ethics for Public Officials,* that is perceived as a major improvement over the previous general guidelines for public officials.[19] Korea also has an Ethics and Public Service Act, mainly establishing the process by which public officials have to disclose information on their assets before taking office.

In January 2002, the National Assembly passed the Anti-Corruption Act, and the Commission Against Corruption was established.[20] The Commission has the authority to take all necessary measures to prevent corruption, including the design of new anti-corruption policies, but it does not have powers of investigation.[21]

In general, laws and regulations regarding the operation of the central government are enforced and publicly available. However, public officials need to be better trained in the details of both the Code of Ethics and the Anti-Corruption Act. Commentators suggested that current corruption scandals are closely linked to the inadequate financial framework of the country's political parties, rather than to its fiscal operations. [22]

## 2. PUBLIC AVAILABILITY OF INFORMATION

●●●● Compliance in progress

**The public should be provided with full information on the past, current and projected fiscal activity of government.**

Public provision of information on fiscal activity is adequate at the national level, although the standards of sub-national levels of government information are variable. This is in part because full local autonomy was re-established in 1995 and higher and lower-level local governments are still in the process of setting up adequate information systems.[23] At the national level, the standards of data presentation by different ministries have been harmonised, although some programmes provide greater detail of activities than others. The MOFE publishes a wide range of fiscal information on its website, while the MPB publishes proposals and consolidated reports on national budgets.[24] Information is publicly available both in Korean and in English. The MPB is working with sub-national levels of government in order to harmonise the presentation of budgetary documentation.[25]

**Central government operations**

Under the Budget and Accounts Act, the MOFE has the responsibility for collecting, compiling, and submitting final data on the central government to the National Assembly. The MOFE also has the responsibility for compiling and disseminating statistics on general government operations. MOFE's publishes all this information on its website, and updates it on a monthly basis.

The MPB releases a *Daily Economic Indicator* bulletin, with information about major South Korean economic indicators such as interest rates, stock prices, exchange rate, and imports and exports. International economic indicators are also provided.

Information on the sources and methodology for compiling the central government element of the general government data is published by the MOFE in the annual *Government Finance Statistics.* This publication disseminates detailed data for the reference year showing the revenue and expenditure of the central government element of the general government data, classified in accordance with the IMF's Government Finance Statistics (GFS) Manual.

The MPB publishes proposals and consolidated reports of national budgets. The budget for 2003 includes statements on fiscal activities of the public administration. It also presents information on major expenditures projected for the year, listed by category. Quality processes are primary driven by the accuracy required under budget reporting systems, which ensure accurate and internally consistent fiscal data at central levels.

Budget documentation provides a mid-term fiscal plan for the following three years, including a general macroeconomic framework for the following year. Starting in 2004, the government will introduce a *National Fiscal Management Plan* (NFMP), strengthening the system of analysing and reporting the country's medium-term expenditure framework.

**Public sector operations**

The MPB discloses information on central government budgets and the decentralised agencies under direct budgetary control. Information on social security institutions and public enterprises is publicly available but it is not presented in a systematic and comprehensive format.

In the past, published information on tax expenditures has been partial. However, coverage of publicly available information has been recently expanded and is being periodically updated. Neither the MOFE nor the MPB disclose periodic assessments of contingent liabilities and quasi-fiscal activities.

Data on the execution of the budgets of local government levels are compiled and published by the MOGAHA. The annual *Financial Yearbook of Local Government,* published by the MOGAHA, disseminates data for the reference year on the revenue and expenditure transactions of the local government element of general government data, broken down by level of local government.

## A commitment should be made to the timely publication of fiscal information.

Information about the size and balance of the consolidated budget, revenue and expenditures by general account, and the size of the budget by general and special accounts is publicly available through the MPB website. Moreover, information on changes in fiscal legislation is also contained in the budget documentation, as well as in the MOFE and MPB websites. South Korea meets the specifications of the IMF's Special Data Dissemination Standard (SDDS) for the coverage, periodicity, and timeliness of all data categories.

**Debt reporting**

Data on foreign exchange reserves of the government is publicly available. The government also provides annual information on the level and composition of central government debt, which is published in the press and posted on MOFE's website. Moreover, information on the government's external liabilities and assets is regularly published on the MOFE's website and through the *Korean Economic Update* report.

**Advance release calendars**

South Korea, as part of its compliance with the SDDS, disseminates advance release calendars for fiscal information. An advance release calendar which gives at least one-quarter-ahead notice of the approximate release dates, and at least one week ahead notice of the precise release dates, is available on the National Statistical Office's website. A regular notice to this effect is published in the *Monthly Economy Bulletin* published by the Economic Analysis Division of the MOFE.

## 3. Open Budget Preparation, Execution and Reporting

●●● Enacted

### Fiscal policy objectives, macroeconomic framework and risks

**Fiscal policy objectives**

Budget documentation specifies clear fiscal objectives, together with a statement of priorities of major government programmes. Fiscal policy formulation and implementation focuses mainly on the central government, without specific reference to the incidence and importance of sub-national levels of government. The budget is guided by an underlying medium-term framework that is revised and published on an annual basis.

The government is not bound by any formal fiscal rules approved by the legislature, although it can only issue debt up to the limits approved annually by the legislature and must return to the legislature to get approval for additional borrowing. The 2003 budget contains some general guidelines towards restoring budgetary balance during the year, with the goal of ending the issuance of debt-financing bonds.

**Macroeconomic framework**

The budget documentation contains macroeconomic forecasts both for the current budget year and the following one. However, the macroeconomic projections that are publicly available are not very detailed. The macroeconomic model underlying those forecasts or the key parameters that influence the estimates of fiscal aggregates are not publicly disclosed. Long-term forecasts or scenarios are not published beyond those contained in the medium-term economic forecast.

In an effort to build consensus, final macroeconomic assumptions are prepared by the Office of Fiscal Planning at the MPB, based on the macroeconomic forecasts prepared by public agencies and quasi-public research institutes.[26]

**Fiscal risks**

Budgetary documentation does not provide an assessment of the major fiscal risks. The fact that South Korea has been over-performing in its budget estimations makes the introduction of fiscal risk a low priority for the government.[27] Fiscal risks are incidentally considered in the government's fiscal projections, but they are not quantified.

**Fiscal sustainability**

There are no comprehensive government studies or reports on fiscal sustainability. After the financial crisis, a report entitled *Medium Term Expenditure Framework* was prepared in 1999. Although this document includes some general remarks on fiscal sustainability, the government has not regularly updated it. Starting in 2004, the NFMP is expected to include analyses on fiscal sustainability.

It is important to note that in South Korea, the mechanism of passing supplementary budgets during the fiscal year implies the possibility to enact additional spending during the fiscal year beyond that set out in the original budget.

The sustainability of the National Pension System (NPS) has become increasingly important in South Korea. The system was introduced in 1988 and will become fully operational in 2008. The Minister of Health and Welfare has established the National Pension Corporation (NPC), a non-profit corporation entrusted to conduct the administrative activities of the NPS, with a view to increasing the professionalism and performance of the system.[28] In an effort to stabilize the fund, the income replacement rate for average income earners with a 40-year insured period has been lowered from 70% to 60%. Also, beginning in 2013, the current pension eligibility age will begin to increase by one year every five years until reaching 65 in 2033. In addition, financial recalculation will be made every five years from 2003 to adjust contribution and benefits levels appropriately and maintain the long-term sustainability of the system.

Commentators have suggested that the pension system as it stands today will not be able to work in the long term. However, changes to the pension system need to be approved by the National Assembly, and an agreement in the near future could prove difficult to obtain.[29]

## Budget presentation

Following constitutional provisions, the National Assembly deliberates and decides upon the national budget bill. The executive formulates the budget bill for each fiscal year and submits it to the National Assembly within ninety days before the beginning of the fiscal year. The National Assembly decides upon it within thirty days before the beginning of the fiscal year.[30] If it were necessary to amend the budget, the executive may formulate a supplementary revised budget bill and submit it to the National Assembly.

Supplementary budgets are considered common practice in South Korea. At present, the government submits on average two supplementary budgets per fiscal year to the National Assembly. The core objective of the supplementary budgets is to correct original revenue and expenditures forecasts in the main budget that could change due to unforeseen circumstances, so as to maintain a balance budget performance. Supplementary budgets are usually accompanied by an explanation of changes, and are publicly available. Some commentators have argued for a gradual elimination of these additional budgets.[31]

The National Assembly is not allowed, without the consent of the executive, to increase the sum of any item of expenditure, or to create any new item of expenditure in the budget submitted by the executive. However, it plays an in-depth role in budget preparation.

Budgetary information is available on the MPB website and information there is considered reliable. The South Korean budget consists of five parts: the general provision, revenue and expenditure, multi-year expenses, authorised carry-over and contract authorisation.

### Data reporting

Data are disseminated for the following components: revenue; expenditure; the balance (deficit/surplus); and financing, broken down by currency into foreign currency financing and domestic currency financing. The data are recorded on a cash basis, and are presented on a consolidated basis, with transactions between the central government and the local governments eliminated from the data.

Budget documentation available for the 2003 fiscal year distinguishes revenues and expenditures of the general account and major expenditures by category. Although central government budget classifications adhere to international standards of reporting, government data do not strictly adhere to such standards and only information on the economic classification for the consolidated central government is available monthly. Moreover, the 2003 budget provides a limited enumeration of programmes under certain categories.

Quality and timeliness of information on sub-national jurisdictions do not follow similar standards of disclosure and availability as those for the national government. However, the central government is helping local governments to strengthen their budgetary information systems. In particular, the executive is trying to include local government's final accounts in the national consolidated budget documentation.[32]

## Budget execution and monitoring

The annual budget of the country is made and executed following the calendar year. The main budget is the original budget approved by the National Assembly for a fiscal year. If under certain circumstances the main budget for a fiscal year is not approved before the beginning of that fiscal year, the government may temporarily continue spending at a rate equivalent to the previous fiscal year's budget. Transactions relating to the execution of the budget are recorded and are available for both internal and external audit.

The implementation of the budget during the financial year is primary the responsibility of the executive branch of government. However, the parliament may be involved during the year, particularly in approving supplementary budgets. Moreover, the MPB holds monthly finance review sessions which seek to ensure timely implementation of the budgets, including supplemental funds.[33]

A pilot 'performance-oriented budget system' was introduced in 2000. However, this system was stopped in 2002 because its results did not improve the budgetary process. Having learnt from this experience, the government now intends to introduce, from 2004 onwards, a new pilot 'Performance Management System'. This new system will be built around 'performance indicators' developed by each ministry with the technical assistance and supervision of the MPB. The government expects to have this new system fully operational by 2008.[34]

### Accounting basis

The Treasury bureau, part of MOFE, is in charge of establishing the government's accounting policy. Accounting standards are generally perceived as effective, generating timely and reliable information on consolidated central government activities.

South Korea uses a cash-based accounting system. The government is preparing a new 'Government Accounting Act' with the intention of introducing an accrual-based accounting system by the year 2005.[35] Once this new accounting system has been adopted, the government also expects to adopt the IMF's GFS Manual of 2001.[36]

### Procurement and employment

South Korea has well-established procedures for procurement and employment, and they are usually followed in practice. Procurement procedures are based on the Government Procurement Act[37], and are subject to audit and inspection by the BAI.

The Public Procurement Service (PPS) is a central government agency that purchases and provides goods and services needed for the operation of various government organisations. Information about procurement and tendering is publicly available in both Korean and English, and regularly updated through the PPS website.[38] Since becoming a member of the Agreement on Government Procurement (AGP), procurements valued above the threshold specified in the agreement have been conducted on an international competitive basis.[39]

The MOGAHA establishes norms for the ethical conduct of civil servants, which are perceived as clear and accessible. Moreover, the ministry also provides personnel administration for civil servants and manages national

and local administrative organisations. There is competitive recruitment within the civil service. Moreover, the Central Officials Training Institute provides training for South Korean government officials.

## Fiscal reporting

The MPB and the MOFE are required by law to report fiscal information to the National Assembly. Final accounts for the consolidated central government are prepared, externally audited, and submitted to the legislature for its approval within nine months of the end of the year. Reports for aggregate sublevels of government accounts are available annually with a delay of eleven months from the end of the year, with no intra-year reporting.

Budget amendments made by the National Assembly are publicly available. Moreover, information on economic and financial indicators, budget revenues and expenditures, balance of the consolidated budget, and multi-year expenses is annually updated at the MPB website. At the same time, the monthly *Korean Economic Update* provides detailed information of economic trends. Some commentators have suggested that, in order to improve overall fiscal management, better coordination between the MOFE and the MPB is required.[40]

MPB and MOFE are working on a draft version of a 'National Public Finance Act' in order to further improve fiscal reporting mechanisms and to engage the civil society in the control of fiscal accounts.[41] Once the ongoing process of consultation has concluded, the government will submit the draft act to the National Assembly.

## 4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY

●●●● Compliance in progress

### Data quality standards

Fiscal data is disseminated and regularly updated by the MOFE and the MPB websites in accordance with South Korea's SDDS commitment. Budget data reflects recent revenue and expenditure trends and policy commitments, and also specifies clear fiscal objectives. Fiscal policy formulation and implementation is mainly focussed on the central government with less information publicly available on sub-national levels of government. Although the national government is seeking to improve fiscal policy reporting from lower levels of governments, there is still a lack of consistency on the presentation and quality of this information. In recent years, the Korea National Statistical Office has been strengthening the mechanisms of reporting local government data.

### Independent scrutiny of fiscal information

**Independent Audit**

The BAI, a constitutionally independent body, is established under the direct jurisdiction of the president and exercises external supervision over the whole executive branch. The BAI inspects and examines the settlement of the revenues and expenditures of the state, the accounts of the state and other organisations specified by law, and the job performances of the executive agencies and public officials.[42] The BAI inspects the closing of accounts of revenues and expenditures each year, and reports the results to the president and the National Assembly in the following year. The annual reports are usually submitted by September of the following year and are publicly available.

The BAI has the authority to audit the financial accounts of central and local government agencies, government corporations, and related organizations. The board is also vested with the power to inspect abuses of public authority or misconduct by public officials while performing their duties. The chairman of the BAI is appointed for four years by the president, subject to the approval of the National Assembly, and cannot be dismissed except under impeachable circumstances. BAI's role has been strengthened in recent years, and today it is perceived as a real independent institution, with full institutional and operative capacity.[43] In addition to the external audit function exercise by BAI, every government office also has its own internal auditing and inspection unit.

**National Statistics Agency**

The Korea National Statistical Office (KNSO) is the central government authority in charge of statistics. It has the responsibility of coordinating the national statistical services as well as compiling fundamental statistics and disseminating integrated statistical information. As an independent central government authority, KNSO is under the supervision of the MOFE, but as far as technical matters are concerned, it responds directly to the appropriate ministries. KNSO fiscal statistics comply with the standards for integrity and quality set out in the SDDS.

South Korea's Statistics Act ensures the reliability of statistics and the efficiency of the operation of the statistical system through a comprehensive coordination of statistical activities.[44]

## INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to South Korea between 27 and 29 October 2003:

### Ministry of Planning and Budget (MPB)

**29 October 2003**

| | | |
|---|---|---|
| Choi Sang Dae | Director | Fiscal Cooperation Team - Fiscal Planning Office |
| Byung Duck Kim | Deputy Director | Public Funds Policy Bureau |
| Sokjin Chang | Research Analyst | Fiscal Cooperation Team - Fiscal Planning Office |

## ADDITIONAL INTERVIEWS

**27 October 2003**

| | | |
|---|---|---|
| Kenneth H. Kang | Resident Representative | International Monetary Fund |
| Youngsun Koh | Research Fellow | Korea Development Institute |
| Phil Ellis | Second Secretary & Head of Economic Section | British Embassy in Seoul |
| Chris J. B. Sims | Political Secretary | British Embassy in Seoul |

**28 October 2003**

| | | |
|---|---|---|
| Geo-Sung Kim | Secretary General | Transparency International Korea |

**29 October 2003**

| | | |
|---|---|---|
| Ki-Baeg Park | Head, Research Division | Korea Institute of Public Finance |
| John M. Kim | Centre for Fiscal Analysis | Korea Institute of Public Finance |

## NOTES

[1] Constitution of the Republic of Korea, 1948.
[2] Getaway to Korea, at www.korea.net
[3] Constitution of the Republic of Korea, Article 117.
[4] Higher-level local governments basically serve as intermediaries between the central and lower-level local governments. Lower-level local governments deliver services to the residents through an administrative district system.
[5] In addition, every year the central government allocates 15% of national tax revenue to local governments to reduce financial disparity among local governments and to supplement anticipated budget shortfalls.
[6] 'How Korea Reformed the Public Sector: 1998-2002', Ministry of Planning and Budget, 2003, p.127.
[7] Interviews in Seoul, 27-29 October 2003.
[8] These extrabudgetary funds used to be called 'Public Funds', but the government has renamed them as 'Funds.'
[9] Interviews in Seoul, 27-29 October 2003.
[10] Interviews in Seoul, 27-29 October 2003.
[11] 'How Korea Reformed the Public Sector: 1998-2002', Ministry of Planning and Budget, 2003, p.62.
[12] National Textbook Co.,Ltd.; Korea Technology Banking Corp.; Pohang Iron and Steel Co.; Daehan Oil Pipeline Corp.; Korea Heavy Industry and Construction Co.; Korea Telecom Corp.; and Korea Tobacco and Ginseng Corp. In addition, Korea General Chemical Corp. ended up being liquidated.
[13] Korea Electric Power Co.; Korea Gas Co.; and Korea District Heating Co.
[14] The Korean Development Institute is currently working on a project to encourage the inclusion of operational balances of these companies in the budget.
[15] Framework Act on the Management of Government-invested Institutions, available at www.mpb.go.kr
[16] Budget and Accounts Act, available at www.mpb.go.kr
[17] The confirmation hearing is not exactly a ratification process, but if the National Assembly does not confirm the appointment, the president has to nominate another candidate.
[18] In late 1999, the Government introduced a system of tax deduction for the use of credit cards. This incentive boosted the use of credit cards across the country, improving the registration of transactions and boosting tax revenues.
[19] Interviews in Seoul, 27-29 October 2003.
[20] The Commission is made up of nine commissioners who are appointed in equal proportions by the president, the National Assembly and the Supreme Court.
[21] Korean civil society is campaigning in favour of giving the Anti-Corruption Commission investigatory powers, but this is not likely to occur in the near future.
[22] President Roh Moo-hyun has recently offered to relinquish his post, depending on the outcome of a corruption inquiry into illegal campaign funding. Roh said he will quit if his associates are found to have accepted illegal donations worth a tenth or more of the amount taken by the opposition Grand National Party (GNP). This offered followed an admission by Lee Hoi-chang -- the GNP candidate whom Roh defeated in last year's presidential race -- that his party had illegally accepted 50 billion won (42 million dollars) during the campaign.
[23] Until 1995, South Korea was an extremely centralised country, with all fiscal and budgetary decisions being taken by the central government. Since then, fiscal decentralization has become one of the most important issues for the government, which is now focusing on the accountability aspect of the decentralisation programme.
[24] Ministry of Finance and Economy, at http://english.mofe.go.kr/main.php; Ministry of Planning and Budget, at www.mpb.go.kr
[25] Interviews in Seoul, 27-29 October 2003.
[26] The Korea Development Institute, the Korea Institute of Public Finance, and the Korea Institute of External Policy are among the most important research institutions that help the government in building its macroeconomic forecasts. In addition, forecasts prepared by the Bank of Korea are also taken into account. The MPB provides a common forum of discussion among these institutions to analyse and discuss the projections and to prepare its own assumptions.
[27] Interviews in Seoul, 27-29 October 2003.
[28] Information on both the NPS and the NPC, including information on revenue management, is publicly available at www.npc.or.kr
[29] Interviews in Seoul, 27-29 October 2003.

[30] Constitution of the Republic of Korea, Article 54.
[31] Interviews in Seoul, 27-29 October 2003.
[32] Interviews in Seoul, 27-29 October 2003.
[33] A special department has recently been created in the MPB in order to strengthen the review of extrabudgetary funds.
[34] Interviews in Seoul, 27-29 October 2003.
[35] Interviews in Seoul, 27-29 October 2003.
[36] At present, South Korea follows the 1986 version of the GFS Manual.
[37] Government Procurement Act, 1994, available at www.moleg.go.kr
[38] Public Procurement Service website, at www.pps.go.kr
[39] In September 2002, the PPS established a nationwide integrated Government e-Procurement System that enables all procurement from 'purchase request' to 'payment' to be processed online, and provides a higher level of efficiency and transparency in the public procurement operations.
[40] Interviews in Seoul, 27-29 October 2003.
[41] Interviews in Seoul, 27-29 October 2003.
[42] Constitution of the Republic of Korea, Article 97.
[43] Interviews in Seoul, 27-29 October 2003.
[44] Statistics Act, available at www.nso.go.kr/eng/about/act.shtml

# OXFORD ANALYTICA

## SRI LANKA

## FISCAL TRANSPARENCY

**Country Report 2003**

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# SRI LANKA

## COMPLIANCE RATINGS

| *Fiscal transparency* | *2003* | *2002* | *2001* |
|---|---|---|---|
| Clarity of roles | ●●● | ●●● | ●● |
| Availability of information | ●●● | ●●● | ●●● |
| Budget preparation | ●●● | ●● | ●● |
| Accountability | ●●● | ●●● | ●●● |
| **Score** | 3.00 | 2.75 | 2.50 |

## OUTLOOK & COMMENTARY

Legislative and administrative changes to monitor over the next year include: the development of a Public Audit Act; the establishment of a unitary Revenue Authority, expected to be operational by 2005; the implementation of medium-term budgeting, introduced in the 2004 budget; the progress of the Public Finance Act, expected to be enacted in 2004; and the progress of the Freedom of Information Act. Also in 2004 a new Foreign Exchange Management Act is due to be enacted. The new Fiscal Management Responsibility Act (FMRA), enacted in January 2003, should further improve transparency and accountability in fiscal management over the following year, particularly in the area of fiscal reporting.

November 2003 saw a bout of political instability. Further political instability is a possibility, as is the threat of the president calling fresh elections. The peace process is still very much on hold, though renewed conflict is unlikely. While the economic reform process is not likely to be substantially threatened, the uncertainty affects business and investor confidence, which had improved since the ceasefire was agreed in February 2002. The government may now be more cautious in pushing through the more controversial economic reforms, but none of these have a bearing on monetary or fiscal transparency. The government's medium-term projections and the fulfilment of its economic and reform objectives depend on a continued peace and the easing of domestic political frictions.

# EXECUTIVE SUMMARY

## 3.00 Enacted

Over the course of 2003, the Government of Sri Lanka has continued to show its commitment to the concepts set out in the IMF Code on Fiscal Transparency and has made progress in ensuring the implementation of the code. Sri Lanka's economic recovery, which began in late 2002, has continued this year. The ceasefire agreed in February 2002 with the Liberation Tigers of Tamil Eelam has continued. Peace talks between the group and the United National Front (UNF) government appear to have stalled however. Macroeconomic management has improved, the commitment to fiscal consolidation has continued, and structural reforms have been deepened, though not without certain delays. Efforts have been made to strengthen the regulatory environment to enable further reforms to the financial system, taxation and the tax administration.

The new Fiscal Management Responsibility Act (FMRA), enacted in January 2003, is improving transparency and accountability in fiscal management. It aims to ensure responsible fiscal management and a prudent fiscal policy strategy and to facilitate periodic public and parliamentary scrutiny of fiscal performance. More responsible fiscal management will in turn help, *inter alia*, reduce the budget deficit. The budgetary system is now more open and accountable, and the timeliness of data has improved. Under the new legislation, the government must now present to parliament its fiscal policy, objectives, targets budget projections. A Mid Year Fiscal Position Review is now also published. Under the FMRA, the government must reduce the budget deficit to 5% by 2006 -- it is more or less on target with this. It must also reduce total public debt to 85% GDP by 2006.[1] The government is now also required to detail before parliament all additional pre-election expenditure in a pre-election Budgetary Position Report. The act also entails the imposition of limits on government guarantees.

The legal framework outlining the role of the public sector is well developed, but administrative practice within the public sector could benefit from further improvement. Work has begun to reform public sector administration and to subject public authorities to market discipline. As of 2003, the enforcement of strict deadlines for submission of performance reports by public corporations, authorities, enterprises and departments has been introduced.

Sri Lanka already supplies a variety of fiscal data, and information on exemptions and subsidies is readily available. Nevertheless, there is still insufficient data on the implementation of specific budgetary programmes. As of 2003 half-yearly data are tabled in the parliament and made available for public consumption. The government has launched an 'E-Lanka' project to provide government services online which has enabled better public access to information, but technology in other areas, such as data collection and processing, requires further improvement.

Sri Lanka's overall score has improved from 2.75 in 2002 to 3.25.

## 1. Clarity of Roles, Responsibilities, and Objectives

●●● Enacted

**The government sector should be distinguished from the rest of the public sector and from the rest of the economy, and policy and management roles within the public sector should be clear and publicly disclosed.**

**Structure, functions, and responsibilities of government**

The legal basis for government in Sri Lanka is provided by the 1978 Constitution. The arrangements under this constitution were tested in 2002 when, for the first time, the prime minister and president were from opposing parties. This uncomfortable cohabitation led to a political crisis in November 2003 when, whilst the prime minister was abroad, the president suspended parliament and took control of three ministries. Following talks upon the return of the prime minister parliament resumed, though the tension continues. There remains the threat of elections and further instability. The president has the right to dissolve parliament 12 months following the last election – this date was reached in December 2002. The IMF suspended the second trance of US$576 million under the Poverty Reduction and Growth Facility which was to come in December, due to the recent events. The IMF has postponed the disbursement until the political conflict between the president and the government is resolved.

The government has begun to 'de-politicise' the public services, including through the establishment of an Independent Public Service Commission (PSC).[2] However, the effectiveness of the PSC is still questionable due to the president's reluctance, in some cases, to accept the nominations of the PSC for public sector appointments. It has however limited political interference in the public services to a great extent.

The IMF, in concluding that fiscal policy was "generally transparent", observed that "the legal and administrative framework is reasonably well developed and appears to be closely observed. The government compiles and publishes detailed fiscal accounts of the central government. All donor inflows are channelled through the budget. Extrabudgetary funds are minimal. Public corporations maintain separate and aggregate accounts."[3]

**Coordination and management of budgetary activities**

The prime minister and government prepared, presented, and passed two budgets in parliament during 2002 and one during 2003 (presented in November, slightly delayed due to the political crisis). During the course of 2002 the government embarked on an ambitious and wide-ranging programme of economic reform, which was progressing well until the recent political crisis and should continue, if a little more cautiously, given the recent events.

There is no budget committee in parliament unlike many other commonwealth countries. However, the present government is contemplating one.

Sri Lanka has eight Provincial Councils (PCs) responsible for their own budget process and the provision of some key public services. The PCs continue to rely heavily on central government grants, and ambiguities in the relationship between the two levels of government remain. Any political settlement of the country's internal conflict is likely to involve a major overhaul of the provincial council system, including the possibility of further fiscal decentralisation to the Northeast, but precise details of such a framework remain unsettled.

Sri Lanka has devolved some power to the provinces although the devolution was incomplete and the system is very complex with parallel systems of administration and poor accountability mechanisms, and with provinces having very few revenue raising options. There is concern about the extent of corruption at the local level.

**Relations between government and public sector agencies**

One of the primary tasks identified by new government has been the trimming of Sri Lanka's sizeable and under-performing public sector. Many senior figures in the government have shown a genuine commitment to reform, divestment, privatisation and promoting the private sector as the engine of growth.

The sale of state-owned enterprises has met most international and private expectations.[4] However, neither privatisation nor the restructuring of state owned enterprises is complete. The Public Enterprise Reform Commission (PERC) is the lead authority in coordinating the privatisation process. The PERC publicises details of most aspects of the privatisation process, including upcoming, current and completed transactions. Its website is regularly updated, and contains detailed information, often in all of Sri Lanka's three official languages, including a schedule of privatisation programmes.[5]

The privatisation of public enterprises is progressing smoothly. Major divestments to date by the government include shares in Lanka Marine Services, Pelwatte sugar factory, Shell Gas Lanka, Sri Lanka Telecom, and the Sri Lanka Insurance Company. Complete divestment of a partial sale of some bus services, and the sale of a further share of Sri Lanka Telecom occurred in late 2002. In 2003, the government divested its share holdings in some five-star hotels. The petroleum sector has been liberalised. The state-owned Ceylon Petroleum Corporation's monopoly was done away with by the entry of Indian Oil Corporation (IOC) in petroleum refining and retailing. There is likely to be another multinational company entering the petroleum market during 2004. The state-owned Co-operative Wholesale Establishment (CWE) has been divested. The State Pharmaceutical Corporation (CPC) is lined up for divestiture during 2004. Despite this progress, some 75 commercial public corporations remain in government hands, in addition to fully integrated public services such as the railways and post.

A multi-sector regulatory authority is in the process of being set up. The legislation to set up the authority -- to be known as the Public Utilities Commission of Sri Lanka (PUCSL) -- was passed in 2003 and is in the process of being implemented. The PUC is empowered to regulate electricity, water supply services, and petroleum product markets. The electricity sector will be the first to be regulated. A regulatory manual for the PUCSL is being currently developed.

**Government involvement in the private sector**

Despite giving a generally positive assessment, a recent IMF report noted that the distinction between government departments, non-commercial public enterprises and commercial ones is not always clear.[6] There is also a risk that policy and management roles within partially privatised enterprises are not clear.

Planned reform of the financial sector, particularly the broadening of government financing away from captive sources of funding such as the Employee Provident Fund (EPF), is currently in progress. The EPF has been removed from CBSL control but is still in the hands of the government. There are plans to improve management of the state-operated pension schemes -- EPF and the Employees' Trust Fund (ETF) -- through mergers, private fund management, some foreign portfolio investments, improved collection and management reforms to reduce evasion. There are no plans to privatise however.[7]

A Financial Services Act (FSA) is being drafted that will aim to: develop a system for regulating the securities market, insurance and private provident funds; improve accounting and auditing standards; and prevent money laundering.

The government has established committees to oversee the restructuring of the country's two largest state banks -- the People's Bank and the Bank of Ceylon. Acting on concerns about a lack of clarity, these committees have produced reports outlining the relationship between the two banks and the government. While the Bank of Ceylon has been meeting its quarterly performance targets, the insolvent People's Bank is in the process of being restructured. A new law to set up an asset management company is ready to be presented to parliament. This new asset management company is expected to take over the bad loan portfolio (non-performing loans) of the People's Bank.

## There should be a clear legal and administrative framework for fiscal management

**Legal framework for budgetary activities**

The legal basis for fiscal activity in Sri Lanka is provided by the 1978 Constitution. A new Fiscal Management Responsibility (FMR) Act was passed in January 2003. The new legislation sets clear limits on budgetary activities and the fiscal process. Importantly, budget deficits will need to be reduced to 5% of GDP (by end of 2006) and total government liabilities reduced to 85% (by 2006) and then 60% (by 2013) of GDP. The government enacted the FMRA to ensure that the financial strategy of the government is based on principles of responsible fiscal management, and to facilitate periodic public and parliamentary scrutiny of fiscal performance. Section 3 of the Act sets out its fiscal objectives, and a number of stages at which the government is required to account to parliament and the public on its record in the management of the economy. Responsibility is cast directly on the Ministry of Finance to ensure fulfilment. Substantial deviations from announced targets are required to be placed before parliament. Under the new act, the government is now also required to detail before parliament all additional pre-election expenditure and the fiscal consequences of all new policies that are to be introduced, in a pre-election Budgetary Position Report. This also applies to any political party making promises during election campaigning; parties should provide fiscal implications of such promises to the Elections Commissioner. This report is made available to the public. The act also entails the imposition of limits of government guarantees.

Starting in the 3rd quarter of 2003, those government departments which do not submit their accounts and performance reports in due time will have their funding curtailed.

**Legal framework for taxation**

There is a clear legal basis for taxes in several pieces of legislation, most notably the Inland Revenue Act, No. 38 of 2000 and Value Added Tax Act, No. 14 of 2002. These Acts are published in the *Gazette*, and are available at a small fee from the Government Publications Bureau. The Department of Inland Revenue maintains a basic website that provides summary information on the range of taxes in operation.

Administering Sri Lanka's tax system was acknowledged to be growing increasingly difficult, with a narrowing tax base, numerous and *ad hoc* exemptions, and multiple taxes on the same transaction. As a result, revenue-GDP ratios have been declining in recent years. In 2002 the government embarked on major tax reform aimed at streamlining taxation and, in the process, making it more transparent. Many of the reforms have been consistent with recent IMF recommendations.[8] The tax administration system has been simplified and the tax base widened over the last couple of years. New measures included the abolition of the Goods and Services Tax and the National Security Levy, and the imposition of a new dual rate VAT. A slightly amended tax system was introduced on 1 August 2002. A number of measures aimed at simplifying personal tax were also introduced. VAT was extended to banks and other

financial sector organisations in January 2003. Options to further rationalise tax exemptions and incentives are being considered. While honouring all existing incentives, the government has promised new incentives only in certain sectors and for certain investments. The government hopes to stimulate private sector development through further simplification of the tax system.

A Revenue Management Advisory Committee, composed of experienced tax administrators and representatives of trade chambers, was established in May 2002, and charged with advising on the establishment of a new consolidated revenue authority. This authority will eventually incorporate the present Inland Revenue, Customs, and Excise Departments and the revenue-collecting arm of the Board of Investment. The IMF has been advising in this process and the Asian Development Bank (ADB) has pledged to provide funds for technical assistance.[9] The exact nature and effectiveness of this new authority remains to be seen. The Revenue Authority Act is currently delayed due to a legal challenge to the proposed legislation by the Customs Department. The new revenue authority will likely come into existence in 2005. It will improve efficiency greatly, and to an extent transparency. There is significant corruption under current arrangements.[10] The authority will help improve tax administration and help increase tax collection.[11]

The creation of the new authority should rectify any lack of clarity generated by the dual role hitherto played by the BOI. The body retains the authority to override tax legislation.[12] An electronic data information system is being installed in the Customs Secretariat. Finally, moves in early 2002 to create a simplified and transparent two-band tariff system, could not be implemented during 2003, due to revenue considerations. According to the 2004 budget the tariff band will be reduced from six to five and surcharge on imports reduced to 10% from 20% effective January 1, 2004.

**Ethical standards for public servants**

Apart from the *Establishment Code*, there continues to be a lack of a single, publicly available code of ethical standards for public servants. This is despite calls by the country's leading chamber of commerce for the government to "publish a code of ethics and governance to apply to the executive, legislators, public officials including the requirement for effective declaration of assets by all key officials."[13] However, the proposed public administrative reforms (PAR) are expected to incorporate a code of ethical standards. These reforms are currently in draft form.

In the government's strategy "Regaining Sri Lanka", one of the stated objectives is to establish a code of ethics and standard of professional conduct for all professional and industry associations. The priority action for end of 2002-2003 was to formulate and publish a code of ethics and standards of conduct; form disciplinary procedures and ensure that their membership annually renews their pledge to abide by the Code and Standards and disclose any professional-conduct related complaints to the association.

## 2. PUBLIC AVAILABILITY OF INFORMATION

●●● Enacted

**The public should be provided with full information on the past, current, and projected fiscal activity of government.**

**Central government operations**

Sri Lanka is making a concerted effort to further improve the quality of its fiscal information, including through the production of enhanced budget documentation and information on underlying macroeconomic conditions. The new FMRA stipulates that the minister of finance provide a statement which includes, *inter alia*, expenditure not outlined in the budget (almost all public expenditure is covered in the budget now anyway), to address the previous lack of coverage of some off-budget activities. The public has access to a wide range of timely information. The Ministry of Finance (MOF) and several of its internal departments maintain a website with links to a variety of information. The budget papers for 2002 and 2003 were available soon after the presentation of the budget, and relevant information, including new tax schedules, were posted regularly over the course of 2003.

The Department of Fiscal Policy and Economic Affairs (FPEA) within the MoF publishes a range of secondary data on past, current and projected fiscal activity. Most notably, the Department publishes an annual report *Trends in Public Finance* and supplements this with monthly economic updates. Much of this information, both current and archival, is now available online.[14] In addition, Sri Lanka disseminates information on fiscal activity via the Central Bank of Sri Lanka (CBSL). The Bank's *Annual Report* contains a "Summary of Government Fiscal Operations".

Expenditure data continues to be disaggregated according to function, including information on revenue transfers to subnational levels (i.e. Provincial Councils), and social security expenditure. The revenue data is also disaggregated according to the source of revenue. The published data still does not, however, include information on tax-expenditures/incentives. Little the information available on government operations provides details on specific budget programmes or measures.

The new Fiscal Management Responsibility legislation requires the minister of finance to issue a Fiscal Strategy Statement at the time of the budget and, where necessary, at other times during the year. The objectives for such a requirement are "to increase public awareness of the government's fiscal policy and to establish standards for evaluating the government's conduct of fiscal strategy". The statement should, amongst other things, specify the government's medium term fiscal policy, including fiscal objectives and targets for three years ahead, and explain broad strategic priorities. The minister of finance issued the first Mid Year Fiscal Position Report in June 2003. A Freedom of Information Act has been in draft stage for several years but it is not known when it will be enacted. The government has also embarked on an 'E-Lanka' project to provide government services online. This was officially launched in November 2002. The Information and Communication Technology Agency (ICTA) was set up in July 2003 to implement the "E-Sri Lanka roadmap". These measures should facilitate greater public access to government information.

**Public sector operations**

The accounts of quasi-corporations, such as the railways and postal services, are included with the government data. Other public sector enterprises publish regular reports detailing their operations. However, much more could be

done to improve the clarity of these operations. Sri Lanka's private sector has called for greater transparency in this area, especially through "web enabled central databases, covering public sector procurements, infrastructure projects, consultancy services, privatisations, vacancy advertisements, and resource mobilisation plans."[15] During 2003, a Railway Authority has been created from the former 'Department of Railways'. The railway authority is expected to operate in line with market principles. Restructuring of the Postal Department has commenced, but there is a long way to go to inculcate market principles. The labour unions in the Departments of Railways and Post have been quite disruptive in the restructuring process.

Financial reporting of public corporations is poor. Non financial public enterprises have however improved their accounting and reporting standards. State financial institutions, particularly the state banks, are currently undergoing a major transition in the transparency of their accounts. They now have proper accounts published and internal audits are carried out. Public institutions, of which there are many (though the majority are marginal) have very poor reporting standards.[16]

In 2003, all government departments and public corporations were required, for the first time in 50 years, to adhere to strict deadlines for submission performance reports and annual accounts to the Ministry of Finance. According to the budget speech by the finance minister around 90% of these entities have met these deadlines. The Ministry of Finance has re-established the Public Enterprise Division (which incorporates public corporations and authorities) to oversee and enforce strict fiscal discipline. The public enterprises that do not adhere to the above are punished by way of halting their finances from the Treasury. The timeliness -- if not necessarily the quality -- of these financial statements has certainly improved.

The Economic Management Law, currently being drafted, will oblige the government to report to parliament, on a bi-annual basis, on the progress that has been made by each ministry in implementing economic reforms. According to this law, the budgets for respective line ministries will be directly linked with progress made in implementing reform.

Parliament has a Public Accounts Committee (PAC) and a Committee On Public Enterprises (COPE), both headed by members of the opposition. These two committees are empowered to scrutinise public sector accounts including public enterprises. In 2002 the government reintroduced opposition chairmanship of these committees. The committees tend to be very closed and un-transparent in their proceedings.

## A commitment should be made to the timely publication of fiscal information.

Sri Lanka subscribes to the IMF General Data Dissemination System (GDDS) and efforts are being made to comply with the more rigorous standard Special Data Dissemination Standard (SDDS). SDDS is expected to become effective in 2004.[17] The IMF's most recent Report on the Observance of Standards and Codes (ROSC) for Sri Lanka concluded that the government has made good progress on meeting most of the SDDS specifications on timeliness, coverage and periodicity of data categories.[18] Monthly data dissemination is still not timely.

In the budget speech of 2003, the minister of finance announced, "starting in the 3rd quarter of 2003, those government departments which do not submit their accounts and performance reports in due time will have their funding curtailed."

A Strategic Communication Unit has been set up at the Ministry of Economic Reforms in order to disseminate information regarding privatisation and other economic reforms to the general public.

**Debt Reporting**

Sri Lanka continues to meet requirements on debt reporting, including breakdowns by holder, instrument and currency. These data are produced with three months' timeliness, while broader aggregates are disseminated on a monthly basis.

**Advance release calendars**

In June 2002, the CBSL announced a number of enhancements to its statistics, including the provision of more detailed estimates and the implementation of an advance release calendar, aimed at bolstering public information flows. [19] An advance release calendar is now released. The release of CBSL data is also now accompanied by a media release and/or press conference explaining any revisions.

## 3. Open Budget Preparation, Execution, and Reporting

●●● Enacted

### Fiscal policy objectives, macroeconomic framework, and risks

Every September 15 the central bank presents a state of the economy report to the Ministry of Finance in order for the latter to prepare the budget for the following year, which is usually presented to parliament in November of each year.

The 2004 budget presented in November 2003 continued Sri Lanka's progress towards greater compliance with the precepts of the IMF code on fiscal transparency. While some uncertainty remains, particularly due to the recent political crisis, there is considerable confidence in the government's budget process, the quality of its estimates, the small likelihood of overruns, and reasonable assessment of fiscal risk.

**Fiscal policy objectives**

The FMR Act is leading to a far more open and accountable budgetary system. The Ministry of Finance is now required to give budget projections. Fiscal policy was not openly declared before this law.

Budget preparation continues to take place within a broad fiscal framework agreed between the IMF and the Sri Lanka government, and in the context of the Article IV consultation process and the terms of the 2001 Stand-by Agreement (SBA).

The 2004 budget carries forward plans to rebuild and restructure the Sri Lankan economy. It focuses on consolidating revenue generation. The budget was prepared within the medium-term fiscal consolidation strategy indicated in the FMRA of 2003. The government continues to follow the detailed action plans in their paper of December 2002, "Regaining Sri Lanka". At the heart of this programme is major change in the relationship between public and private sectors. The government is placing a major share of the responsibility on the private sector for accelerating economic growth. The programme also clearly defines the role of the government in economic activity as a facilitator providing a conducive policy environment rather than as an active player directly involved in economic activity.

**Macroeconomic framework**

The macroeconomic situation continued to improve in Sri Lanka in 2003. Economic growth accelerated, inflation decreased, the fiscal deficit was contained, the financial market was more stable, and interest rates declined. Current policy aims to continue the medium-term fiscal consolidation process in a sustainable manner, while providing the necessary support for long-term economic growth. The objectives are to reduce public debt to a sustainable level, stimulate economic growth and increase employment opportunities and earning capacity, to ensure consistent economic development over the medium term. Debt reduction is to be achieved through reducing the budget deficit and further privatisation. There is also a series of policy measures to improve revenue performance. The government aims to contain inflation and to attract further foreign direct investment.

Reconstruction and development of the war-ravaged North-eastern parts of the island is still a high priority, though this is likely to be mostly donor-funded.[20] Sri Lanka has adopted an economic programme for 2003-2006, which

'aims to reduce poverty through private-sector led growth. This strategy focuses on creating the conditions for a vibrant private sector and a sound fiscal position, and for helping to establish lasting peace by relief, rehabilitation, and reconstruction (RRR) efforts.'[21]

According to the FMRA, the ruling government is mandated to reduce the fiscal deficit to a maximum of 5% of gross domestic product by 2006, and to cut it to 4% of GDP in the medium term. The 2004 budget focuses on consolidating revenue generation, as spending, especially military, has been kept in check amid an ongoing bid to end the country's protracted ethnic conflict.[22]

**Fiscal risks**

The 2002 budget documents clearly identified areas of fiscal challenge, notably macroeconomic slowdown, the poor state of public finances, growing public debt, under-investment in social sectors, and vulnerability to external shocks. However, no detailed quantification of these risks was provided. The FMRA does stipulate that the minister of finance provide a statement on contingent liabilities (including guarantees and indemnities), expenditure not outlined in the budget (almost all public expenditure is covered in the budget now anyway), and any ongoing negotiations that may be relevant.

**Fiscal sustainability**

The cessation of hostilities in the country's internal conflict has boosted the government's ability to meet its fiscal targets, particularly as military expenditure has dropped in real terms, and this trend is expected to continue in 2004. However, with a permanent peace still some way off, the risk of renewed high military spending remains real. The Fiscal Strategy Statement and Budget Economic and Fiscal Position Report submitted along with the Budget 2004 by the government in terms of the FMRA is publicly available online. This outlines the medium term (2003-2007) projections of the fiscal position of the country.[23]

## Budget presentation

**Data reporting**

Sri Lanka's budget data continue to provide a good overview of the government's fiscal position. Nevertheless, the data are still not presented in a manner that readily ties them to the results of budget programmes.

Up to now, the budget speech and documents generally identify the principal policy initiatives that the government intends to adopt during the coming fiscal year and in the medium term, but fail to provide comprehensive details. However, the FMRA provides a clear framework for better quality fiscal data that should permit greater analysis and accountability. The FMRA obliges government to report to parliament, on a bi-annual basis, on progress that has been made by each ministry in implementing economic reforms. Under the law, budgets for the respective line ministries are directly linked with progress made in implementing reform. In accordance with the FMRA a Fiscal Strategy Statement and Budget Economic and Fiscal Position Report was presented to the parliament along with the budget.

## Budget execution and monitoring

Previous budgets have suffered from the weak and failing administration of the tax system and from a poor technological base. Considerable budget overruns in the past, coupled with the absence of mid-session reporting, have called the execution and monitoring of budgets into question. The new government's continuing overhaul of

the tax system and its commitment to procedural and technological upgrades in monitoring augurs well for transparency. A mid-year Fiscal Position Report and a final Budget Position Report, which have been introduced with the Fiscal Management Responsibility Act, will certainly improve monitoring.

As of the 2004 budget, presented November 19, 2003, information that compares the annual budget with the outturns of the preceding fiscal year and with forecasts of the main budget aggregates for the following year, is included. Appropriations are also compared with the outturns of budgetary execution.

**Accounting basis**

Despite the IMF's recent upbeat assessments of Sri Lanka, concerns continue to be expressed about the current system of cash accounting, which makes it difficult to track arrears. Further, concerns are also raised about large deviations and overruns from budget figures in previous years.[24] Sri Lanka's accounting standards however are reasonable proxy to international accounting standards. The Ministry of Finance subscribes to the International Public Sector Accounting Standards (IPSAS).

**Procurement and employment**

It is unclear whether regulations governing procurement and employment are effectively standardised. Several high-level government committees, including the Committee on Public Enterprises (COPE), exist to oversee and investigate malpractice within the public sector, but it is hard to assess how effective these bodies are. Certainly Sri Lanka's private sector has called for greater transparency in this area.[25] There are some concerns that the Cabinet-appointed tender boards are a source of malpractice/corruption. The Cabinet has the power to bypass normal proceedings when it chooses and award contracts to whomever it wishes.[26] There are proposals for legislation to streamline the procurement process.

Public sector administrative reform has thus far been very slow however. This said, the government has proved reluctant to make new recruits to the public sector. Recruitment has been virtually frozen. If such adjustment proceeds to plan, with adequate tax reform and expenditure restraint, the Sri Lankan government's fiscal position is expected to be sustainable over the medium-term.[27] Reform of the public sector really needs to begin with the creation of a database -- now underway -- of who is who. This will pave the way for all other reforms.

## Fiscal reporting

The CBSL now disseminates fiscal data on a monthly basis, though there is a time lag in the release of the data of almost two months. This includes data on central government aggregates on revenue, expenditure, taxes on income and various categories of non-tax revenue. This monthly release of data comes very close to meeting SDDS terms for coverage, periodicity and timeliness.

Section 10 of the FMR Act requires that a Mid Year Fiscal Position Report in respect of the fiscal performance during the first four months of the year be released to the public by the last day of June and thereafter laid before parliament. In this mid-year review of performance report, the finance minister is obliged to report to parliament by mid-year any deviation from the original public spending or revenue targets set out in the national budget. The reason for the deviation must be explained, together with the action to be taken to rectify it. The first Mid Year Fiscal Position Report was issued in June 2003, and it is available online through the MoF website.

Under the FMRA, the minister of finance is required to report three times each year to parliament on the government's budgetary management. This fiscal discipline supported by structural reforms has enabled the

government to implement certain bold but politically unpopular economic measures, which in the event proved beneficial.

## 4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY

●●● Enacted

### Data quality standards

While the new FMRA will go a long way in improving fiscal transparency, data quality and monitoring, the Act has a clause that permits departure from the stipulations of the legislation with the approval of parliament. As such, it remains to be seen how effective the legislation will be in holding future governments to account.

The only way to check data quality in aggregates in central government budgets is to reconcile figures with appropriate CBSL figures. Concerns about the methodology used to compile data for central government budgetary aggregates persist, partly because details the relevant methodologies are difficult to obtain.

### Independent scrutiny of fiscal information

**Independent Audit**

The Auditor General is the highest auditing authority, with jurisdiction over central and subnational governments, and other public bodies. The Auditor General applies standard procedures in auditing all government ministries and departments, and can also appoint other external auditors to help carry out audits. There has been some concern that the reports of the Auditor General should be published in a more timely fashion.[28] Such delays are typically the result of a lack of resources assigned to the Auditor General's department. The lack of funds also mean that the Auditor General is unable to retain well-qualified staff.

Though the Auditor General is fairly independent, the executive controls the divisions under him/her. There are a number of problems. The Auditor General's Department (AGD) is not effective. It does not have independent sources of funding -- it depends on Treasury allocation, which can be politically manipulated. The legal standing of the Auditor General's functions and duties is not clear. The Auditor General's powers are restricted to ministries, public corporations, and other government institutions. Private enterprises in which the state has equity shares are out of the remit of the AGD. The current government, together with the World Bank and the Asian Development Bank are looking to address some of these concerns however. The Attorney General's Department is currently preparing a new Audit Act, which should go some way in addressing some of these concerns. Multilateral donor agencies have signalled that they are prepared to provide grants for the strengthening and expansion of the AGD.

In March 2002, an external auditor, Ernst & Young New Zealand, was employed to audit the CBSL accounts. The CBSL has acted on some key recommendations of the initial, informal report and the same company was retained to audit 2002 and 2003 figures.[29] There is a five-year agreement (renewed annually) with Ernst & Young New Zealand.

**National Statistics Agency**

Sri Lanka's Department of Census and Statistics provides a range of demographic and socio-economic statistics, as well as verifying fiscal data. It releases estimates on national economy accounts annually to the public in the National Accounts of Sri Lanka publication. These can be purchased, or viewed online.

## INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to Sri Lanka between 13 and 18 November 2003:

### Ministry of Finance

**14 November 2003**

| | | |
|---|---|---|
| Rose Cooray | Director General | Director General of Department of Fiscal Policy |

### Central Bank of Sri Lanka

**14 November 2003**

| | | |
|---|---|---|
| W.A. Wijewardena | Deputy Governor | |
| P.W.R.B.A.U. Herat | Additional Director | Economic Research Department |

## ADDITIONAL INTERVIEWS

**13 November 2003**

| | | |
|---|---|---|
| Jeremy Carter | Senior Resident Representative | International Monetary Fund |

**14 November 2003**

| | | |
|---|---|---|
| J.C. Weliamuna | Executive Director | Transparency International Sri Lanka Chapter |

**18 November 2003**

| | | |
|---|---|---|
| Cresenta Fernando | Economist | World Bank, Colombo |
| Julitta Rasiah | Financial Management Specialist | World Bank, Colombo |
| Deva Rodrigo | Vice Chairman | Ceylon Chamber of Commerce |
| Gayathri Gunaruwan | Consultant Economist | Ceylon Chamber of Commerce |

## NOTES

[1] Fiscal Management (Responsibility) Act, No. 3 of 2003, Article 3
[2] *Budget Speech*, March 2002, p.8 available at http://www.eureka.lk/fpea/budget2002.htm
[3] *Sri Lanka: 2002 Article IV Consultation and Final Review Under the Stand-by Arrangement- Staff Report*, IMF Country Report No. 02/199, September 2002, Box 1, p.12
[4] *Sri Lanka: 2002 Article IV Consultation and Final Review Under the Stand-by Arrangement- Staff Report*, IMF Country Report No. 02/199, September 2002, p. 9; Sri Lanka's leading chamber of commerce, amongst other private sector organisations, has commended the government's policies, saying that private sector expectations were largely met - see http://www.chamber.lk/ai.htm.
[5] http://www.perc.gov.lk/privatisation_proc.html
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[7] Interviews in Colombo, November 13-18, 2003
[8] *Sri Lanka: Selected Issues and Statistical Appendix*, IMF Country Report 02/208, September 2002, p.45
[9] *Sri Lanka: Selected Issues and Statistical Appendix*, IMF Country Report 02/208, September 2002, p.49
[10] Interviews with officials in Sri Lanka, November 13-18, 2003
[11] *Annual Report 2002, CBSL*
[12] *Sri Lanka: 2002 Article IV Consultation and Final Review Under the Stand-by Arrangement- Staff Report*, IMF Country Report No. 02/199, September 2002, p.8
[13] *Strategies for Growth Leveraging the Private Sector,* Ceylon Chamber of Commerce, http://www.chamber.lk/sfgltps.htm
[14] See http://www.eureka.lk/fpea/publication1.htm
[15] *Strategies for Growth Leveraging the Private Sector*, Ceylon Chamber of Commerce, http://www.chamber.lk/sfgltps.htm
[16] Interviews in Colombo, November 13-18, 2003
[17] Interviews with CBSL officials, 11 & 12 November 2002.
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[19] *Media Conference Paper*, CBSL, http://www.centralbanklanka.org/Media_Note_280602.pdf
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[21] Sri Lanka—Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding. Colombo, Sri Lanka, March 28, 2003
[22] *Annual Report 2002, CBSL*
[23] http://www.eureka.lk/fpea
[24] *Sri Lanka: 2002 Article IV Consultation and Final Review Under the Stand-by Arrangement- Staff Report*, IMF Country Report No. 02/199, September 2002, Box 1, p.12
[25] *Strategies for Growth Leveraging the Private Sector*, Ceylon Chamber of Commerce, http://www.chamber.lk/sfgltps.htm
[26] Interviews in Colombo, November 13-18, 2003
[27] *Sri Lanka: Selected Issues and Statistical Appendix*, IMF Country Report 02/208, September 2002, p.3
[28] *Sri Lanka: 2002 Article IV Consultation and Final Review Under the Stand-by Arrangement- Staff Report*, IMF Country Report No. 02/199, September 2002, Box 1, p.12
[29] *Sri Lanka: 2002 Article IV Consultation and Final Review Under the Stand-by Arrangement- Staff Report*, IMF Country Report No. 02/199, September 2002, p.44

# OXFORD ANALYTICA

## TAIWAN

## FISCAL TRANSPARENCY

**Country Report 2003**

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# TAIWAN (REPUBLIC OF CHINA)

## COMPLIANCE RATINGS

| *Fiscal transparency* | *2003* | *2002* | *2001* |
|---|---|---|---|
| Clarity of roles | ●●● | ●● | ●●● |
| Availability of information | ●●● | ●●● | ●●● |
| Budget preparation | ●●● | ●●● | ●●● |
| Accountability | ●●● | ●●● | ●●●● |
| **Score** | 3.00 | 2.75 | 3.25 |

## OUTLOOK & COMMENTARY

The government's guidelines for fiscal administration clearly recognise the need for further reform in most areas of fiscal management, as well as indicating a willingness to undertake the necessary measures. In particular, the tax system and treasury management are singled out as areas promising potential efficiency gains. In addition, the government intends to more systematically survey its landed assets and to improve the return they generate through leasing, sale, and improved management.

The Taiwanese system of government, combined with the current political constellation, creates considerable potential for inertia and incomplete implementation. In spite of measures to combat it, corruption in public procurement and among officials will continue to pose some problems.

# EXECUTIVE SUMMARY

## 3.00 Enacted

Taiwan continues to make steady progress towards higher standards of fiscal transparency. The government has effectively implemented the IMF's Special Data Dissemination Standard (SDDS). Advance release calendars are published and fiscal data largely meet international standards in terms of coverage, periodicity, and timeliness.

Fiscal transparency has suffered somewhat from legal wrangling between the government and the opposition-controlled Legislative Yuan (parliament). Particular spending projects have been assigned to special *ad hoc* entities before they have received legislative approval and been properly incorporated in the budgetary process. Special attention should be paid to ensuring that all government spending and revenues are brought under the budget and executed and reported on in accordance with standard rules.

The sustainability of government finances remains an area of concern. Taiwan has in recent years seen a continued rapid increase in government indebtedness. The overall scale of government debt is in dispute. However, progress is being made in identifying and addressing sources of fiscal risks. The authorities are further committed to a programme designed to restabilise the fiscal situation over the coming 5-10 years.

The government of President Chen Shui-bian is committed to ambitious reforms in various areas of fiscal administration. However, the political situation continues to cast some doubt over the ultimate prospects of many of these measures. At the same time, their implementation is likely to suffer as a result of still fairly common corruption in public service.

Taiwan's overall score increases to 3.00 from 2.75 last year.

## 1. Clarity of Roles, Responsibilities, and Objectives

●●● Enacted

**The government sector should be distinguished from the rest of the public sector and from the rest of the economy, and policy and management roles within the public sector should be clear and publicly disclosed.**

**Structure, functions, and responsibilities of government**

The Constitution of the Republic of China, adopted in 1946 and amended in 1994, sets out the structure and functions of government.[1] The government is divided into five branches (yuans): the Executive, Legislative, Judicial, Control, and Examination Yuans. The Executive Yuan (cabinet) has three arms: ten ministries and commissions; 19 subordinate administrative organs of the state; and the Executive Yuan Council, the supreme policy-making body of the government.[2]

Taiwan consists of 16 counties (*hsien*), five municipalities (*shih*), and two special municipalities (*chuah-shih*) – Taipei and Kaohsiung. The government is correspondingly divided into central and local levels with the powers of both tiers clearly defined in the constitution. The central government has the power to "legislate and execute" in matters of national significance, including central government finance and national taxes, the demarcation of provincial and country taxes, state-operated enterprises, state banks, and the currency system.[3] General policy and management roles within the government sector are set out in the Organic Law of the Executive Yuan, which was adopted in 1948 and revised with subsequent changes in the government structure.[4]

**Co-ordination and management of budgetary activities**

The management of budgetary and extra-budgetary activities is entrusted to the Directorate-General of Budget, Accounting and Statistics (DGBAS), a government agency subordinated directly to the Executive Yuan. The DGBAS is responsible for budgeting, budget implementation and control, planning and appropriations, managing the reserve fund, supplementary budget appropriations, evaluation, government accounting, compilation of government balance sheets, statistical reporting, and the computerisation of the budget process.[5]

While the DGBAS is responsible for expenditures, the National Treasury, a department of the Ministry of Finance (MoF), oversees the revenue side of the budget.[6] The major functions of the MoF include the implementation of fiscal, tax, and customs policies, and the supervision of the insurance, banking, and securities businesses. These functions are institutionally separate, performed by distinct sub-divisions of the MoF, namely the Departments of National Treasury, Taxation, Customs Administration, and Insurance; the Bureau of Monetary Affairs; and the Securities and Futures Commission.[7] Banks meeting certain qualifications can act as substitute treasuries for municipal and country (or city) governments.[8]

The spending ministries are granted a certain amount of autonomy due to the so-called foundational budgets of individual departments, which are not earmarked for particular purposes. In addition, the government at times introduces "special budgets" which require formal authorisation by the Legislative Yuan. Examples include responses to the 1999 earthquake and the 2003 SARS outbreak. In some instances, spending commitments are carried out by non-profit special funds, including the Agricultural Stabilisation Fund, the Highway Fund, the Stock Market Stabilisation Fund, and the Nuclear Waste Disposal Fund.[9] Information on these funds is scarcer than on

budgetary activities, although the government is working to improve it. Although the Budget Law forbids the government to "obtain or use monies not accounted for in the budget," some analysts argue that government entities do raise money outside of the budget framework.[10] This is often attributable to the peculiarities of budgetary politics in Taiwan. The government often announces expenditure project running over several years. This is followed by parliamentary lobbying which frequently results with budgets passed inclusive of the original commitment.[11]

Although legislation exists to harmonise the regulations governing special funds and in spite of attempts to reduce their numbers, new ones are still being created. Examples include the Bureau of Taiwan High Speed Rail, the Government Certification Agency, the Bureau of Immigration, the Investment Commission, and the Commission of National Corporations, and the Bureau of Mines. The opposition claims that such entities are to receive NT$22.7 billion (US0.67 billion) next year. The government argues that the informal status of the agencies is due to delays in passing the necessary legislation due to opposition obstruction.[12]

Starting in 2001, all transfers to local governments were reconfigured as ordinary subsidies. Each subnational government unit is allocated a quota determined by financial capability, population, and land area. Under the new system, individual sub-national government are granted the freedom to use the funds according to their needs. A special regulatory framework exists to govern the implementation of the system.[13] Local governments can contract loans and issue bonds. However, borrowing cannot exceed 15% of the total revenue in any given year and the accumulated debt has to remain below 45% of annual outlays.[14]

In spite of considerable improvement, the division of roles and responsibilities between different levels of government, as well as between different agencies involved in the budgetary process, remains opaque at times due to overlap and infighting. Some commentators suggest that double counting between central and subnational governments is relatively common and may even occur between different central government ministries which all keep their separate budgets. While the problem is known, institutional inertia has frustrated reform efforts. The current system feeds an established tradition of avoiding responsibility by blaming other agencies for problems.[15]

## Relations between government and public sector agencies

The Executive Yuan comprises all government agencies that discharge fiscal and monetary policy functions, namely the DGBAS, the MoF, and the Central Bank of China (CBC). Certain policy areas are shared between different agencies. The Bureau of Monetary Affairs (BOMA) of the MoF is in charge of the financial system, while the CBC formulates monetary and foreign exchange policy, but the two, in conjunction with the Central Deposit Insurance Corporation, share responsibility for banking supervision. According to our interlocutors, such institutional overlaps and fragmentation do not pose a problem for the coordination of fiscal and budgetary activities.[16] However, by pooling and fragmenting departmental responsibility, they do potentially limit the transparency and accountability of economic policy in Taiwan.

Taiwan has 36 state-operated enterprises and 97 non-profit public sector institutions whose budgets are included in the central government budget.[17] They last year contributed over 17% of government revenues.[18]

## Government involvement in the private sector

The government is actively involved in dealing with a still fairly serious non-performing loans crisis. Newly established asset management companies are in the process of securitising bad assets with some US$7 billion transformed during the first half of 2003. The Resolution Trust Company deals with bad loan in local financial institutions, but its work has been hampered by a lack of money caused by opposition in the legislature.[19]

Taiwan still suffers from a problem of overlapping regulatory responsibilities in a number of areas. This frequently results in pre-emptive actions, inconsistency, and inefficiency. In some instances, decisions taken by a central regulator are contradicted by decision and interpretations of local government agencies.[20]

The government of Chen Shui-bian has been encouraging private and local involvement in public infrastructure projects through partnership and matching funds. Most such arrangements have been made under the revised Law for Promotion of Private Participation in Infrastructure Projects.[21]

The government is generally in favour of reducing its presence in the economy through privatisation, although the process has been hampered by employee opposition. More problematically, the government has shown itself willing to meddle in the affairs of partially privatised companies, for example China Steel in which it holds a 47% stake.[22]

The National Property Bureau (NPB) is pursuing a strategy of surveying and registering government property, especially land. The ultimate objective is to improve the efficiency of administration and the revenue-generating potential of national assets. In addition to outright sale, greater amounts of land not used by public entities are to be leased. The NPB is required each year to compile a ledger of national property and to submit it to the Executive Yuan.[23]

## There should be a clear legal and administrative framework for fiscal management.

### Legal framework for budgetary activities

The budgetary activities of the central and local governments are regulated by the Budget Law of 1998 which stipulates a five-stage budgetary process. First, the Executive Yuan draws up annual programmes and plans the budget; second, government departments prepare operational plans for the fiscal year; third, budget expenditure estimates and appropriations are approved; fourth, the DGBAS prepares the general budget proposal; finally, the Legislative Yuan adopts the proposal, and the president promulgates it. The implementation of the budget is carried out in accordance with the budget law, accounting law, a provisional statute on budget execution, and budget execution guidelines published by the DGBAS. The budgetary procedures for central and local governments were reformed in 2001-2002.[24]

Following recent changes, government departments are given somewhat greater flexibility in combining and reallocating their budgetary resources in response to unexpected changes in their needs. Depending on the size of the funds, permission from the Executive and the Legislative Yuan may be required. Although there are officially no completely discretionary funds available to ministries, rumours about “slush funds” abound.[25]

### Legal framework for taxation

The Law Governing the Allocation of Government Revenues and Expenditures divides taxes, duties, and fees into national and subnational (metropolitan, country, and city) ones. National revenues include income tax, estate tax, customs duties, business and commodity tax, and securities transactions tax. Metropolitan taxes include the land, house, vehicle, and deed taxes. A previously share category of monopoly revenues has been eliminated following Taiwan’s WTO entry.[26] There are two National Tax Administration departments, in Taipei and Kaohsiung, organised as administrative bureaux under the MoF. The website of the MoF provides tax laws, regulations, and reports in English and Chinese.

Some analysts have expressed concern over the lack of equal treatment of taxpayers. Larger firms often appear to pay less in tax than smaller ones. The informal sector is large and, for example, the consumption tax is routinely avoided. Many taxpayers feel little moral obligation to pay given the lack of accountability for government expenditure. Some observers feel that discretionary areas of the tax code have worsened in recent years and will probably prove hard to eradicate.[27]

Various measures are used to promote economic development and encourage export. Special tax exemptions are granted to "newly emerging, important, and strategic industries" and rebates issued for exports. The government has repeatedly adjusted tariff rates on daily necessities and industrial raw materials for the purposes of price stabilisation and accelerating industrial development. However, the target average effective rate is now set at a level comparable to industrialised countries.[28]

The MoF guidelines for the Finance Administration envisage a reform of the still elaborate tax system for the purpose of promoting economic development, as well as to enhance the efficiency of collection and to improve services to taxpayers.[29]

## Ethical standards for public servants

The rights and obligations of civil servants and the standards to which they are accountable are laid out in the Civil Servants Act and the Code of Conduct of Civil Servants.

Many observers note that corruption remains fairly common in Taiwan and is perpetuated by a deeply entrenched culture of complacency and a tradition of kickbacks. There have been a number of recent high-profile cases involving civil servants. However, the problem appears to affect primarily the local level.[30]

While the extent of corruption among public servants is notoriously difficult to measure, candidates in national elections often personally spend 5-10 times their projected salary on their campaigns, indicating that public office entails a range of unofficial benefits.[31] Given the local cultural tradition, there is often a thin line between political lobbying and outright corruption. On the other hand, however, foreign companies operating in the country have in many cases been able to remain completely unaffected by corruption.[32]

Another major problem in dealings with Taiwanese officials is the high degree of regulation in various areas of the economy. This has led to at times conflicting directions in different agencies and, even more frequently, to different interpretations of rules. The democratisation of Taiwan has added a new dimension of legislative interference. This results in inconsistent actions and even sudden reversals of decisions. The lack of standard operating procedures for dealing with large projects is a major problem.[33]

## 2. PUBLIC AVAILABILITY OF INFORMATION

●●● Enacted

**The public should be provided with full information on the past, current, and projected fiscal activity of government.**

**Central government operations**

The MoF began publishing online economic and financial data according to the IMF's Special Data Dissemination Standard (SDDS) in late 2002. Taiwan is not a member of the IMF and cannot therefore publish its data on the Dissemination Standards Bulletin Board. However, it largely complies with the SDDS requirements for coverage, timeliness, and periodicity.

Monthly data published on the MoF website cover general government operations, central government operations, and central government debt.[34] Data on central government operations cover revenue and grants, expenditure and net lending, the balance, and financing broken down into net borrowing and use of cash balances, further broken down into use of foreign exchange cash balances.[35] The MoF also publishes its comprehensive *Monthly Statistics of Finance* online, which covers major financial and economic indicators; revenues and expenditures of the National Treasury; and net tax revenues by item, district, and commodity. These data are summarised in the *Yearbook of Tax Statistics* and *Yearbook of Finance*, both of which are available on the website of the MoF for the previous fiscal year.[36]

The actual budget is not published online and is only available in Chinese, although plans exist to make key elements available in English. It follows a basic three-year framework with the definitive outcome for the preceding year and the estimates for the current and coming fiscal years.[37]

Expenditures are broken down into current and capital account appropriations. Our interlocutors claimed that expenditures from the current account were transparent, while capital account spending (on public investment projects) lacked appropriate justification and proper cost-benefit analyses. Many government departments appear to have begun to use off-budget means to finance public investment projects, sometimes even raising capital outside the formal budget.[38] Such borrowings represent contingent liabilities of an unknown magnitude, limiting the ability of external observers to provide a proper assessment of the fiscal situation of the Taiwanese government sector. According to the Budget Act, governments may not exceed their budgetary allocations unless permitted by other laws. Any borrowing outside of the government budget with a maturity of more than one year is counted as public debt.[39]

All central government operations are accounted for in the budget documents with the exception of the classified budgets of the Ministry of Defence, the Ministry of Foreign Affairs, and the National Security Board. While there is a commitment to reducing the amount of classified information, security considerations are unlikely to permit complete transparency in these areas. Similarly, there is a shortage of information on the extra-budgetary activities of government departments. A recent parliamentary dispute erupted over the government's decision to exclude NT$33.4 billion (US$ 0.98 billion) in subsidies for national infrastructure construction and the agricultural fund. The opposition refused consider the budget bill unless it is amended.[40]

**Public sector operations**

Data on general government, or public sector, operations are also published on the website of the MoF. General government operations include the central and local governments, and consolidated data are disseminated on revenue, expenditure, and balance. The data are recorded on a cash basis. Consolidated data on central and general government operations provide an indication of the fiscal position of the government and public sectors respectively.[41]

## A commitment should be made to the timely publication of fiscal information.

**Debt reporting**

Monthly statistics on central government debt are disseminated on the website of the MoF. The data are broken down into domestic and foreign debt. Data on total debt are classified according to instrument, residency, maturity, and debt guaranteed by the central government. [42]

Many analysts view the debt estimates as incomplete and potentially significantly too low, by as much as a third.[43]

**Advance release calendars**

An advance release calendar, which gives at least one month ahead notice of the precise release dates for central government operations, debt, and general government operations, is disseminated on the MoF website.[44]

## 3. Open Budget Preparation, Execution, and Reporting

●●● Enacted

### Fiscal policy objectives, macroeconomic framework, and risks

**Fiscal policy objectives**

Fiscal objectives are set by the DGBAS and the Council for Economic Planning and Development and stated clearly in the budget documentation. This information is available on the DGBAS website.[45] The introduction of new policies is announced in the budget.

More extensive ministry-level information is provided by the individual line ministries and made available on the web, although not always in English.

**Macroeconomic framework**

Economic forecasts are prepared by the Council for Economic Planning and Development and included in the budget package.

The quantitative macroeconomic framework, within which the budget is prepared, are based on a Keynesian model, reinforced with certain adaptations to take into account the nature of Taiwan's economy. The main parameters used by the model are government expenditure and revenue, consumption, currency markets, labour markets, and price information. The government believes that the effectiveness of this model compares well with those of other countries. Independent experts are often hired to review the model, provide advice, and allow the predictions to be adjusted in light of changes in the economy. All information regarding models, predictions, and assumptions is available on the DGBAS website.[46]

The DGBAS is responsible for forecasting budget-related trends such as expenditure and revenue growth. The CEPD provides forecasts of economic growth and other key macroeconomic variables. The National Treasury Office of the MoF projects trends in tax revenues. During budget preparation, the DGBAS collates all relevant materials from different government agencies so as to produce a unified budget estimate.

The task of assessing fiscal forecasts, and the macroeconomic assumptions on which these are based, is entrusted to a committee of 25 people, led by the head of the DGBAS. This committee consists of experts from different organisations, such as the CBC, the MoF, the Ministry of Economic Affairs, and Academia Sinica. Independent experts are also invited to join the committee, which meets regularly to discuss budgetary matters, economic trends, and relevant economic issues. DGBAS officials emphasised that these independent scholars played an important role in reviewing budgetary, accounting, and statistical data in committee meetings.[47]

**Fiscal risks**

No comprehensive assessment of fiscal risks is included in the budget documentation, although some risks, such as pension obligations, are covered.

The main risks at the moment are posed by non-performing loans and contingent liabilities stemming from the off-budget borrowing of government departments, medical insurance, and the pension debt. The government has made substantial efforts to resolve the first problem, while there seems to be no significant development on the second. Since the medical insurance and pension systems were created as self-financing entities, their borrowing is not included in public debt.[48]

Non-performing loans in September 2003 accounted for 5.1% of all outstanding debts in the country. The share of potentially non-performing "loans under supervision" was another 2.2%. This aggregate figure was expected to fall to 5.5% by the end of the year. As of 2003, the relevant statistics comply with international best practice.[49] However, several recent scandals in state-owned financial institutions pose a threat of a financial sector crisis. The problems of First Financial Holding Company, the Chung Shing Commercial Bank, the Bank of Overseas Chines, and the Kuo Hwa Life Insurance have prompted the government to consider a financial sector reform.[50]

A potential source of fiscal risk is the National Financial Stabilisation Fund was created in 1996 and legally formalised in 2000. It has total assets of NT$500 billion (US$14.7 billion) of which NT$86 billion (US$2.6 billion) have been used to date. Funds are accrued by loans from banks and government funds, e.g. pension funds. The Fund is managed by a committee which decides on possible market interventions. After heavy initial losses, the fund has tended to break even. However, the taxpayers are likely to bear the ultimate responsibility for it, should the positive trend be reversed.[51]

The central government has increased its scrutiny of potential public sector fiscal risks. For instance, a deal was struck with local governments in August to jointly manage teacher retirements. One area where progress could be made with risk assessment are exogenous shocks which typically involve earthquakes or energy shocks due to the island's heavy dependency on imported fuel. Another recent risk has been the SARS epidemic. Similarly, changes in relations with the People's Republic tend to have economic repercussions.[52]

**Fiscal sustainability**

No information is provided on fiscal sustainability in the budget documentation. The sustainability of Taiwan's fiscal position has become a source of concern in recent years, following a dramatic increase in the public debt-to-GDP ratio from 4.9% in 1990 to 32% at the end of 2003. Some estimates suggest that this figure could be as high as 40% if contingent liabilities related to health care and pension funds are included.[53]

The Alliance of Fairness and Justice recently claimed that the government's forecast ofNT$4.24 trillion next year – some 41% of GDP – is incorrect. The government has used this projection as a basis for arguing that further borrowing is possible before the 48% ceiling permitted by law is met. The Alliance's own estimate would put the debt-to-GDP ratio at 91%. The hidden debt is said to come from trusts and short-term bonds, which under Taiwan's public bon law do not have to be counted as debt. The alliance further claims that only 51% of government spending has been financed out of tax revenue since 2001.[54]

While the official figures are not alarming in international comparison, the growing debt-to-GDP ratio, coupled with Taiwan's continuing non-performing loan problem, put a strain on the ability of the government to use fiscal policy as a counter-cyclical measure or embark on the structural reforms of the pension and health care systems, which would be necessary to restore the fiscal situation to full health. Nonetheless, the markets seem quite able to absorb the government debt, even if the recent relatively rapid increase were to continue further, without putting pressure on interest rates in the near term.[55] Taiwan's high AA- country rating and relative maturity in terms of transparency, as compared to other Asian economies, still offer considerable potential for the development of the national bond market.[56]

The 1995 Public Service Pension Fund Act has created a pool now valued at NT$220 billion (US$6.47 billion) to deal with government pensions. Regular meetings are held to ensure that no unforeseen contingencies arise. Subnational governments are fully responsible for their pension commitments.[57]

The shrinking tax base poses a potential problem. Taxes currently account for 14% of GDP, but the government would like to increase the level to 18%. The government has set up a task force to address the issue is considering a corporate tax increase as part of an effort to eliminate the government's budget deficit over the next 5-10 years.[58]

## Budget presentation

### Data reporting

Having implemented the requirements of the SDDS, Taiwan largely complies with international standards on the presentation of budgetary data. Budget data for the central government and public sector are reported on a net basis, distinguishing revenue, expenditure, and balance for both sectors, as well as financing for the central government. The expenditures of the central government are broken down into current and capital account spending, specified according to administrative branch. The methodology of data reporting, such as definitions and classifications, are disseminated by the DGBAS in *The Central Government Agency Budget Implementation Guidelines*.

Taiwan has a fairly elaborate system of tax expenditures, although most of them have been gradually declining over time. The Executive Yuan in July issued indications on the "Establishment and Substantiations of the Tax Expenditure Policy Evaluation Mechanism" which have been incorporated in the Fiscal Reform Plan. The "Guidelines for Tax Expenditure Policy Evaluation Operations" were approved by the Executive Yuan in July 2003.[59]

## Budget execution and monitoring

Monitoring the execution of the budget is a responsibility of the DGBAS. Procedures for the execution of approved government expenditure are specified in the Central Government Budget Execution Provisional Statute and the Budget Execution Guidelines for Central Government Agencies and Subordinate Agencies. These two laws cover a stage-by-stage budget execution plan, restricting the transfer of funds for undesignated purposes, the establishment of a reserve fund, and the evaluation of budget execution performance.[60]

### Accounting basis

Budgetary data for general and central government operations are recorded on a cash basis. Government accounting has a clear legal basis in Taiwan. Receipts and payments are channelled through the cashier process of the National Treasury according to a budget allocation plan. Information on payments and receipts are regularly compiled to show the status of the execution of the budget, which is then submitted to the relevant agencies for reference. At the end of the year, DGBAS prepares a general accounting report with detailed information on revenue, expenditures, balance, and changes.[61]

**Procurement and employment**

Employment regulations are set out in the Labour Standards Law and Employment Services Act. The government has made efforts in recent years to standardise employment regulations by bringing a large number of service industries previously exempt from these provisions under the remit of the Labour Standards Law. The Council of Labour Affairs is responsible for matters pertaining to employment regulations and adjudication disputes.

Procurement regulations are set out in the Government Procurement Law, which was passed in 1998 following a spate of corruption scandals. This law seeks to guarantee the fairness and efficiency of government procurement and has stringent penal provisions on bids that break the rules of competition. Since joining the WTO in 2001, Taiwan has embraced the Government Procurement Agreement. Partly as a result, access to information about government projects has increased markedly, even as problems with excluding foreign firms and lack of transparency remain to be fully addressed.[62] However, formal endorsement by Taiwan of the Agreement has been delayed by a dispute with Beijing. Many foreign investors believe that it is a move designed to grant key projects to domestic companies, since the GPA would require equal access by foreign companies.[63]

While the new administration of Chen Shui-bian has done a great deal to disentangle the intricate ties that link the Kuomintang-led political elite to economic interests in Taiwan, the country still faces a long-term battle to eliminate corruption. Transparency International ranks Taiwan 30th on a list of 133 countries with a score of 5.7 on the 10-point Corruption Perception Index. However, the Ministry of Justice has been pursuing an anti-corruption policy over the past three years and statistics are pointing to a clear decline in especially local corruption which has hitherto been particularly endemic.[64] A recent example is the Taipei Mass Rapid Transit System which took nearly two decades to complete and is the most expensive system of its kind due to graft.[65] Another scandal involves the Taiwan city government in a merger of Fubon Financial Holdings Co and TaipeiBank.[66]

The government tendering process continues in many cases to be rigged by "special standards" that deviate from international best practice and force companies to take on various contingent liabilities. This process frequently shuts out foreign companies, while Taiwanese companies in some cases manage to avoid their legal obligations by declaring bankruptcy at the end of the project.[67]

Even though outright corruption is gradually being brought under more effective control, public procurement continues to be complicated by the extreme complexity of the administrative process. Decision-making is often highly decentralised and especially foreign bidders, already disadvantages by linguistic and cultural factors, find the system difficult to deal with. Foreign companies are often asked to reveal a comprehensive plan at the beginning of the process and in many instances this is then leaked by officials to local companies who can then undercut the foreign bid. However, foreign companies setting up joint ventures with Taiwanese companies have tended to be quite successful in public procurement.[68] Charges of government interference and unfair treatment by European investors recently prompted Prime Minister Yu Shyi-kun to promise that Europeans would be given priority in some of the ten major projects included in the government's NT$500 billion (US$14.71 billion) public construction budget.[69]

## Fiscal reporting

Since 2001, the DGBAS has compiled semi-annual central government balance sheets on top of the annual balance sheets it has to produce. These balance sheets are submitted to the National Audit Office for cross-examination, and the reports are submitted to the Legislative Yuan for approval. At the end of the fiscal year, DGBAS also prepares a budget settlement report to show the achievements of the budget and trends in public finance and macro-economic development, and to create a performance benchmark for next year's budget.[70] The statistical information available

on the budget is generally deemed to be consistent, thorough, and reliable, although some disputes with independent analysts arise as a result of definitional issues.[71]

## 4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY

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### Data quality standards

The clearest guarantee of the quality of fiscal data supplied by Taiwan is the country's compliance with SDDS for coverage, periodicity, and timeliness.[72] The budget data reflect recent revenue and expenditure trends, underlying macroeconomic developments, and well-defined policy commitments. This also applies to data supplied in the *Yearbook of Finance* and *Yearbook of Tax Statistics*, Taiwan's two key fiscal publications. Most fiscal data is published in both English and Chinese.

### Independent scrutiny of fiscal information

**Independent Audit**

Fiscal audit in Taiwan is governed by the Law of 1998 Law of Audit.[73] Taiwan has a tripartite system of auditors which operate under the auspices of the Control Yuan. The National Audit office in is charge of auditing central government finances and those of related institutions. There are four provincial/city-level audit divisions responsible for auditing provincial and municipal governments. 15 county and city-level offices are responsible for local audits. Public enterprises with a majority government stake are also subject to audit.[74] The main types of audit at the moment are document, on-site, random, and entrusted audits. The Law on Audit specified measures available to ensure compliance with auditors' recommendations, including disciplinary action by the Control Yuan.[75]

The main official responsible for government audit in Taiwan is the Auditor General who is appointed by the president and approved by the Legislative Yuan for a six-year period. His independence is constitutionally enshrined.[76] The Constitution requires the Auditor General to complete the audit of the central government's financial statements within three months of their submission by Executive Yuan.[77] The results of the audits for the central government, regional governments, government enterprises, special funds, and other entities are published on the Ministry of Audit website.[78]

Some analysts have expressed scepticism over the effectiveness of the control function performed by the Control Yuan. Many of its investigations appear random or even politically motivated. Moreover, the NAO's work is said to be adversely affected by under-funding and under-staffing. [79]

The government has in recent years sought to improve mid-term budget implementation auditing and inspection. A monthly progress report is prepared to identify any delay and their causes, and to propose improvements.[80]

**National Statistics Agency**

Statistical functions are performed by the DGBAS, whose independence from other government departments is ensured by its direct subordination to the Executive Yuan. This does not, however, ensure its independence from the cabinet. While fiscal information is generally held to be reliable in Taiwan, other data, such as capital flows between

the mainland and Taiwan, continue to be monitored closely by the Taiwanese authorities. Our interlocutors claimed that the sensitive nature of Taiwan's bilateral ties with the mainland did not have any serious repercussions for budgetary data.[81] The National Budget, Accounting, and Statistics Network (eBAS) has created a nationwide system for handling statistical work.[82]

The improved quality and scope of statistical data have led to their increasing use in economic modelling and forecasting by the DGBAS. Further reform efforts in this area are ongoing.[83] The DGBAS publishes a *Monthly Bulletin of Statistics* and a *Statistical Yearbook*.[84]

## INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals in Taiwan between 16 October and 18 November 2003:

### Directorate-General of Budget, Accounting and Statistics, Taipei

**16 November 2003**

| | | |
|---|---|---|
| Li Guo-xing | Inspector | Division 1 |
| Huang Yao-sheng | Researcher | Division 1 |
| Zhuang Zhi-feng | Researcher | Division 2 |
| Cai Hong-kun | Specialist | Division 3 |
| Huang Yong-chuan | Deputy Executive Director | Accounting Centre |
| Huang Cheng-chang | Editor | Accounting Centre |

### Ministry of Finance, Taipei

**28 October 2003**

| | | |
|---|---|---|
| Patrick Y.P. Cheng | Deputy Director-General | Department of National Treasury |
| Shelly H.S. Chen | Director | Department of National Treasury |
| Huang Hsi Chin | Section Chief | Department of National Treasury |

**7 November 2003**

| | | |
|---|---|---|
| Wen-Siung Lee | Director | Bureau of Monetary Affairs |
| Bi-jen Yang | Assistant Director | Bureau of Monetary Affairs |
| Yu-peng Tseng | Section Chief | Division of Internal Banking, Bureau of Monetary Affairs |
| David Yang | Deputy Section Chief | Division of Internal Banking, Bureau of Monetary Affairs |

### Central Bank of China, Taipei

**13 November 2003**

| | | |
|---|---|---|
| Sue-yar Yue | Senior Specialist | Economic Research Department |
| Various unnamed representatives | | |

## ADDITIONAL INTERVIEWS

**18 October 2003**

| | | |
|---|---|---|
| Richard W. Hartzell | Freelance journalist and legal advocate | |

**21 October 2003**

| | | |
|---|---|---|
| Jyh-bang Jou | Professor | College of Social Science, National Taiwan University |

**22 October 2003**

| | | |
|---|---|---|
| Thomas H. McGowan | Attorney at Law | Russin & Vecchi International Legal Counsellors |
| Peter Kurz | CEO | Insight Pacific |

**29 October 2003**

| | | |
|---|---|---|
| Guy Wittich | CEO | European Chamber of Commerce |

**31 October 2003**

| | | |
|---|---|---|
| Andrea S. Lee | Deputy Director | Division of International Affairs, Securities and Futures Commission |

**3 November 2003**

| | | |
|---|---|---|
| Wu Chung-Shu | Research Fellow | Institute of Economics, Academia Sinica |
| | Member | CBC Board of Supervisors |

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# OXFORD ANALYTICA

## THAILAND

## FISCAL TRANSPARENCY

**Country Report 2003**

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# THAILAND

## COMPLIANCE RATINGS

| *Fiscal transparency* | *2003* | *2002* | *2001* |
|---|---|---|---|
| Clarity of roles | ●●● | ●●● | ●●● |
| Availability of information | ●●● | ●● | ●●● |
| Budget preparation | ●●● | ●● | ●● |
| Accountability | ●● | ●● | ●● |
| **Score** | **2.75** | **2.25** | **2.50** |

## OUTLOOK & COMMENTARY

Thailand has made significant progress in overhauling its fiscal transparency practices to remedy the shortcomings exposed by the 1997-98 Asian financial crisis. In many areas, the country has moved to reform the government's organisation and functions in agreement with principles established in pending legislation, in an attempt to address the weaknesses found in the fiscal governance framework.

However, despite the achievements attained so far, the lack of statutory force and/or legal delineation remains a latent drawback. In this context, it is essential for parliament to approve reforms in order to allay concerns over the lack of legal guarantees and accountability of a budget reform programme that is already in progress.

# EXECUTIVE SUMMARY

## 2.75 Enacted

Thailand has remained committed to improving fiscal transparency. In the last twelve months, several steps were taken to consolidate fiscal discipline and to strengthen the allocative and operational efficiency of fiscal policy. In many areas, the government has not waited for laws to be enacted and, where possible, has moved to reform the organisation and functions in agreement with the principles of the pending legislation.

The 'hurdle' approach to budget reform, although successful in transferring more responsibility for budget allocation and accountability, fell short of expediting overall results. In this context, Prime Minister Thaksin Shinawatra asked the Bureau of the Budget (BOB) to implement a new fiscal framework that would focus more on planning, costing, and financial/performance reporting. Pending amendments are expected to divide the BOB into an operational agency and a Budget Policy Committee, which would establish a link between government policy and budget programmes. Nevertheless, statutory enforcement of these reforms is needed to increase fiscal transparency.

Despite substantial achievements, concern remains about the lack of transparency at the Thai Asset Management Corporation (TAMC). In addition, further efforts should be made in order to disclose the amounts and future fiscal requirements from off-budget obligations, and the potential fiscal impact of contingent liabilities and quasi-fiscal activities.

Thailand observes the IMF's Special Data Dissemination Standard (SDDS) requirements for fiscal data. However, legislation that clearly delineates the responsibilities of agencies involved in statistical procedures would be a significant improvement to strengthen accountability and overall transparency.

Thailand's overall score has improved from 2.25 in 2002 to 2.75

## 1. Clarity of Roles, Responsibilities, and Objectives

●●● Enacted

**The government sector should be distinguished from the rest of the public sector and from the rest of the economy, and policy and management roles within the public sector should be clear and publicly disclosed.**

**Structure, functions, and responsibilities of government**

The 1997 Constitution of the Kingdom of Thailand clearly defines the roles of the executive, legislative and judicial branches of the central government. The relationship between different government levels with regard to fiscal policy, transfers and borrowings, and distribution of tax powers is set out and distinguished from the rest of the economy. The government sector comprises the central government, local governments, the Social Security Fund and the Retirement Mutual Fund. These categories are reflected in the compilation and distribution of Thailand's fiscal data, which are compiled in broad compliance with the IMF's Manual on Government Financial Statistics (GFSM 1986).

The Constitution stipulates the devolution of administrative powers to local administrative organisations (LAOs, comprising municipalities, provincial administrations, and *tambon* [village] administrations). The Devolution Plan and Sequence Act of 1999 further stipulates that subsidies, tax and duty, and other revenues will be allocated to LAOs according to a progressive scale, rising from 22% of net government revenues in fiscal year 2003 to 35% in 2006.[1] Under the devolution plan, responsibility for infrastructure, health, education, housing, and welfare will be progressively transferred to local authorities.

Thailand's fiscal decentralisation programme has been criticised by the IMF and other international institutions. Critics have argued that many LAOs are too small for efficient and effective operations. The fact that devolution of revenues precedes the devolution of functions, and the limited information that has been disseminated among the relevant agencies, has raised concern. In addition, the lack of clarity in expenditure assignments could interrupt the delivering of essential services, while local governments still lack the administrative capacity to meet their responsibilities.[2] However, government officials reported awareness of these potential problems and stressed that the devolution process during this year did not lead to substantial problems, partly because many capacity-building teams were in place to assist most LAOs.[3]

Thailand is comprehensively changing the structure of its central government. After a tumultuous process, the Thai Parliament approved two core civil service reform bills in late September 2002: the Bureaucratic Restructuring Bill and the Civil Service Administrative Reform Bill. The timing of the bills was mostly designed to facilitate passage of the 2003 budget under a new administrative structure. In practice, reforms are expected to take five years to complete at a procedural level. The first phase of reform involves creating five new ministries, and the enforcement of new administrative regulations.

**Coordination and management of budgetary activities**

Mechanisms for the coordination and management of budgetary and extrabudgetary activities are well established. The principal fiscal institutions are the Ministry of Finance (MoF), including its Fiscal Policy Office (FPO), the

Bureau of the Budget (BOB), and the National Economic and Social Development Board (NESDB). Additional government departments are responsible for specific fiscal tasks.

The overall organisational structure of the MoF, including the FPO, the Comptroller General's Department and the Customs Department is well defined.[4] The FPO is an instrumental government agency charged with financial and economic policy formulation. It has departmental status, with the authority to make recommendations on and oversee the implementation of fiscal, financial, government borrowings, capital markets, and other macroeconomic policies.

The BOB is responsible for improving budget allocation and delegating fiscal administrative authority to ministries and departments, so as to ensure flexible and effective public administration. The BOB, which focuses on strategic policy setting rather than on detailed operational control, seeks to streamline the budget process in order to reduce duplication of tasks.

The NESDB is a planning authority, responsible for formulating the five-year plans, the annual development plans and appraising development projects.[5]

**Relations between government and public sector agencies**

The relationship between monetary and fiscal operations is clearly defined in the 1942 Bank of Thailand Act, which allows for an independent central bank. As part of Thailand's reforms, a new Bank of Thailand Act, expected to reinforce the central bank's independence, is pending parliamentary approval. The Bank of Thailand (BoT) acts as the government's fiscal agent and is permitted to grant it loans to finance public expenditure, provided the loan does not exceed 20% of total expenditure. However, in practice such loans rarely occur. The BoT is also responsible for the dissemination of a wide variety of data on the public sector. Despite the fact that Prime Minister Thaksin Shinawatra has occasionally indulged in rhetoric that raised doubts about the autonomy of independent agencies, the independent status of the BoT has remained intact.[6]

**Government involvement in the private sector**

The Thai government is progressively withdrawing from public ownership and economic intervention. However, the government still intervenes periodically for political motives.

Thailand has many public institutions, including in the financial sector -- such as the Financial Institution Development Fund (FIDF), the Government Savings Bank, the Export-Import Bank (EX-IM Bank), the Thai Asset Management Corporation (TAMC), the Industrial Finance Corporation of Thailand, and the Bank for Agriculture and Agricultural Co-operatives. Non-financial public institutions include the Government Lottery Office and Thailand Tobacco, the government's tobacco monopoly. The MoF also has substantial equity stakes in a range of non-financial agencies, where it acts as the custodian of government equity. Included here are Thai Airways International, the Electricity Generating Authority of Thailand and the second Bangkok International Airport.

Each ministry has responsibility for reporting the activities of its agencies and, in the case of the agencies of the MoF, most enterprises have their own websites or operate media offices. Only the Krung Thai Bank, the EX-IM Bank, the Government Housing Bank, and the Government Savings Bank readily make information available in English. Although annual reports are available for all these agencies, they are usually only in Thai. The MoF and BoT have intervened in the management of state-owned institutions.

Fourteen state-owned enterprises (SOEs), with combined assets of 2.5 trillion baht (59.2 billion US dollars), were due to be sold by 2003 under an IMF privatisation plan. Regulatory delays and unfavourable trading conditions have

further postponed privatisation, but the government remains committed to the process. The MoF is planning the IPOs or share offers for certain corporations in banking, transportation, utilities and telecommunications -- with about six IPOs likely to be held in 2004.[7] However, privatisation efforts may still have only mixed success owing to the limited selection of issues, as well as misgivings over high debt levels and the accountability of management.

Commercial financial institutions are largely self-regulated, but the Commercial Bank/Finance Act (approved in 1999) substantially diminished this latitude by specifying the operational scope of banks and finance firms. The BoT Act outlines the central bank's jurisdiction over commercial banks, in order to set guidelines for loan portfolios and monitor implementation.

The Thai Asset Management Corporation (TAMC) was established in mid-2001 and will eventually acquire about half of the total distressed assets in the banking system (around 21% of GDP), mostly from state banks. The aim of the TAMC is to catalyse corporate debt workouts, restructure banks, and recover assets. However, a substantial share of distressed assets remains outside of the TAMC. In this context, alternative solutions have yet to be found for these assets. Although the TAMC has set itself aggressive goals and plans to restructure 75% of transferred loans, it has been severely criticised for failing to provide sufficient information.[8]

## There should be a clear legal and administrative framework for fiscal management.

**Legal framework for budgetary activities**

Annual budgets are administered under the 1959 Budget Procedures Act, which authorises the BOB to set spending priorities and allocate funds to public agencies. Previously, these priorities were set by the Prime Minister's Office (which then directly administered the BOB) on the basis of funding plans submitted by each ministry and state enterprise. This highly centralised system proved too costly: poorly established incentives led agencies to attempt to preserve historical levels of spending, rather than using resources effectively. Reforms aimed at amending the budget process have been underway for several years.

Under the 'Thai hurdle' approach to budget reform, the BOB agreed in 1999 to transfer budget details to spending agencies, giving them more responsibility for budget allocation, coupled with greater accountability for results. This transfer of budgetary power was made conditional on the agencies crossing seven budget-management 'hurdles'. Initially, six of the best-managed agencies started the process, after signing a quasi-contract between the agency and the BOB.[9]

However, overall progress under the hurdles plan was very slow. As a result, the prime minister asked the BOB to use a new budget process for fiscal year 2003, which focused more on planning, costing, and financial and performance reporting. One of the main features was an expedited move towards performance-based budgeting, essentially requiring all spending agencies to meet the second hurdle of output costing. Four government ministries (MoF, and the Ministries of Industry, Commerce, and Justice) are assessing the new system, which involves *Public Service Agreements* signed by the minister, and *Service Delivery Agreements* between the minister and the department heads.[10]

The 1959 Budget Procedure Act mandates that the government must set a budget once every twelve months, operating in a fiscal year that runs from 1 October to 30 September. A special budget debate must be tabled in parliament before the end of July in each year and both houses of parliament must approve the resulting Budget Act before the end of September.

A budget reform bill, which will amend the 1959 Budget Procedure Act, is pending and aimed at strengthening the allocative efficiency of government via an accountability system based on quasi-contracts. As with other pending

reform laws in Thailand, the government has not waited for the laws to be enacted before moving towards reforms in accord with the principles of the pending legislation. The draft of the reform bill divides the BOB into an operational agency and a Budget Policy Committee (BPC). The BPC aims to establish a link between government policy and budget programmes, so the BPC would enter into the Public Service Agreements with each portfolio minister. If the enacted legislation does not include the BPC, the cabinet will assume its Public Service Agreements responsibilities.[11]

**Legal framework for taxation**

The Revenue Department, the Excise Department, the Customs Department and the Board of Investment (BoI) administer taxes. The two most important tax codes are the revenue code and the investment decrees of the BoI. Copies of the revenue code are available through the BoI and Revenue Department. Summaries are available on the respective websites and via the Thailand Investor Service Centre.[12] BoI tax incentives can be accessed at the agency's website and in published material, while excise codes are documented on the Ministry of Commerce website. Taxpayers who have been treated unfairly can sue the director-general of the Revenue Department in an administrative court.

**Ethical standards for public servants**

While there is no specific code of conduct for revenue officials, all public officers are bound by a code of conduct and are subject to National Counter-Corruption Commission (NCCC) scrutiny. Members of the public can secure information on individual cases through the 1998 Official Information Act, and can request an ombudsman if they believe they have been wronged. Among other things, the code requires that all public officials issue receipts by hand, and secure a written acknowledgement from the recipient. Seventeen Supreme Administrative Judges have been officially appointed and an Ethics Promotion Centre has been established. Despite commitments to more open government, patronage links between business and political leaders remain endemic, and regulatory reforms have failed to establish a culture of corporate transparency.

## 2. PUBLIC AVAILABILITY OF INFORMATION

●●● Enacted

**The public should be provided with full information on the past, current and projected fiscal activity of government.**

**Central government operations**

After the 1997-98 financial crisis, the IMF helped Thailand improve its government financial disclosure, since a lack of transparency had contributed to the collapse of the baht. Thailand has faced increasing off-budget obligations since the crisis, some of a legal nature (such as state-guaranteed debt), others reflecting policy commitments (such as non-guaranteed obligations of state-owned enterprises). Statements on the nature and scale of contingent liabilities, tax-expenditures and quasi-fiscal activities are not readily available. The proliferation of off-budget initiatives that could compromise budget transparency and create more contingent liabilities threatens Thailand's transparency record. Guarantees to state enterprises will be limited by a reform of the Public Debt Law, and privatisation of enterprises.[13]

In mid-2002, Thailand's gross liabilities were estimated to be 22% of GDP, mostly connected with the costs of financial sector restructuring. FIDF's off-balance liabilities (estimated at 19% of GDP) have arisen from the issuance of guaranteed loans against various losses. Additional contingent liabilities are linked to the government's quasi-fiscal activities, including spending programmes funded outside of the budgetary framework.[14]

Thailand reports data on its fiscal activity as part of its commitment to the IMF's Special Data Dissemination Standard (SDDS). Data are disseminated on central government operations on a monthly basis, with a lag of one month from the end of the reference month or quarter. Data are preliminary and subject to revision for five weeks after release. An advance release calendar is available from the MoF website.[15] Data are also available in English from the IMF website, and in English and Thai from two MoF websites.[16] They include a preliminary budget balance, and details on revenue, expenditure, and public debt -- including actual outturns compared to budget estimates, and compared to the preceding fiscal year.

**Public sector operations**

The FPO issues quarterly and annual data for general government and non-financial public corporations, in compliance with SDDS, on its website.[17] The MoF includes revenue from state enterprises on its website.[18]

Since coming to office in early 2001, the Thaksin government has implemented a number of stimulus programmes separately from its main budget. These include the Village Fund, Debt Suspension for Farmers, and Universal Health Care. The eventual costs of these programmes are in some cases uncertain, but have been non-recurrent and therefore manageable. By February 2002, 70.4 billion baht (1.4% of GDP) had been disbursed under the Village Fund. The total cost of the Debt Suspension for Farmers is estimated at around 20 billion baht (0.4% of GDP). Losses are compensated by the budget over a three-year period, with 8 billion baht allocated thus far. The total cost of government fiscal initiatives over 2001-2003 is estimated at 245 billion baht (4.8% of GDP).[19]

These programmes have been marred by suggestions of a lack of transparency and even deliberate concealment of government intentions. Independent economists have charged that taxpayers were misled over the true cost and

anticipated benefits of the extrabudgetary programmes. Nevertheless, these have been popular among the population.[20] Information on specific programmes is only available on an immediate basis from individual ministries or state enterprises. In practice, it is difficult to secure a full breakdown of expenditures owing to overlapping responsibilities and a tradition of secrecy in the civil service. The annexe to the fiscal year 2003 budget lists appropriations for 19 state enterprises and 18 funds and revolving funds.[21]

## A commitment should be made to the timely publication of fiscal information.

**Debt reporting**

Thailand releases information on the level and composition of debt as part of its commitment to the SDDS. The Public Debt Management Office (PDMO), a state-run enterprise under the MoF, manages debt. The BoT is responsible for debt information releases. Data are disseminated on the central government's total gross outstanding debt, both external and internal. The debt is broken down by maturity, with domestic debt also listed according to the type of debt holder. The data details outstanding debt borrowed directly by the government to finance the restructuring of the financial sector. The PDMO releases all the public debt data monthly via its website and data is also released on a MoF website.[22]

According to the IMF, coverage of debt statistics is broad, with headline debt covering not only the direct liabilities of the central government but also the debt of non-financial public enterprises and the on-balance sheet liabilities of the Financial Institutions Development Fund (FIDF).[23] However, some commentators and rating agencies have argued that, despite their broad coverage, headline debt statistics underestimate the full extent of government indebtedness since they exclude a large stock of contingent liabilities.[24]

Information on sub-national debt is available, although often not current, and not always available in English. The fiscal position of the regions (North, Northeast and South) is disclosed on the BoT website. Local government data are calculated on the basis of actual transactions of the Bangkok Metropolitan Administration, which accounts for approximately 40% of total local government transactions. The remaining local government data are based on estimates derived from historical trends.

**Advance release calendars**

In accordance with its commitment to the SDDS, Thailand produces advance release calendars for all the fiscal information it discloses. The calendar gives the precise release dates, and is posted on the IMF Dissemination Standards Bulletin Board and the FPO website.

## 3. Open Budget Preparation, Execution and Reporting

●●● Enacted

### Fiscal policy objectives, macroeconomic framework, and risks

**Fiscal policy objectives**

The current budgetary process operates on a twelve-month cycle, but the reform process includes measures to adopt longer-term budget planning which will complement the five-year national development plans prepared by the National Economic and Social Development Board (NESDB). The annual budget framework sets out the government's broad political objectives, but lacks detail on specific fiscal programmes and the coherence derived from being embedded in a longer-term fiscal time frame. Extensive and ill-documented off-budget activities make it difficult to quickly gain an overall picture of fiscal activity.[25]

As part of the government's reforms, the BOB is developing a Medium Term Expenditure Framework (MTEF). The MTEF will be a four-year rolling budget based on key economic assumptions and fiscal targets. A statement of medium-term outcome targets for all government levels will complement the MTEF framework.[26]

**Macroeconomic framework**

The FPO operates as a government think-tank, and is responsible for making fiscal policy recommendations. It also engages in revenue forecasting, using a consensus of NESDB, BoT and FPO data, and in budget formulation, in which it collaborates with the various tax agencies, the NESDB and the BoT. Each tax collection agency develops its own revenue projections, and the FPO consolidates and presents these as an annual fiscal report.

**Fiscal risks**

The annual budget documentation identifies quantitative risks, but these are usually outlined in general terms. Cost uncertainties are not factored into expenditure commitments, and the government does not disseminate the underlying calculus or a range of alternate fiscal scenarios. Instead, the normal response to deviations from forecasts is reactionary and *ad hoc*, with overruns in one area covered by shifting expenditure from another. The release of fiscal forecasting information into the public domain typically occurs through regular FPO press conferences.

The plan to resolve the FIDF's losses has offered a transparent and viable solution to finance a great part of the government's current contingent liabilities.[27] The MoF and BoT have jointly agreed that the resolution of those losses must be clear and acceptable to all parties, with minimal impact on the government's fiscal position and a minimum burden on taxpayers. The solution must be transparent and in accordance with good governance. In order to set the fiscalisation in motion, the cabinet approved three Emergency Decrees on 21 June 2002, gaining parliamentary approval a week later. The burden of the principal repayment falls on the BoT.[28]

**Fiscal sustainability**

The NESDB prepares medium term-fiscal projections. Its macroeconomic figures are integrated into the medium-term fiscal sustainability projection of the MoF. Sensitivity analysis of the key figures is employed to analyse fiscal vulnerability.

Forecasts from the FPO, NESDB and private (largely foreign) investment and research houses are available on the Thailand Investor Service Centre website.[29] Simplified sensitivity analyses of the key figures, using a numeric model by the Fiscal Policy Research Institute (independent, but reporting to the MoF), can also be run via the Internet.[30]

## Budget presentation

Budget data are reported on a gross basis, classified by sector, programme and function. The public sector balance, including details of the activities of the non-government public sector, is included in the overall public sector accounts.

The budget programme can be obtained in Thai from the Revenue Department or from the NESDB, but not in English. The BOB website is the principal online source for information on the budget, and offers *Thailand's Budget in Brief* in English for all fiscal years from 1999 onward.[31]

## Budget execution and monitoring

The New Budget Information System (BIS) is being developed to support the new budget system. The BIS is aimed to expand budget coverage, collect financial and performance information, and make budgeting more efficient by automating many operations. The BIS will also make financial and performance reports readily available to managers to aid decision-making and performance monitoring. The first 'prototype' is now complete and ready for full development. The BIS at the BOB will be connected to the Government Financial Management Information System (GFMIS), in order to further facilitate the flow/organisation of critical financial and performance information.[32]

### Accounting basis

Uncertainties associated with the accounting methodology present a key difficulty in monitoring the execution of the budget in Thailand. Accounting systems are currently being overhauled to an accrual-based accounting system, and authorities are currently planning an extensive, 15-year reform of the accounting process, which is guided by KPMG.[33] Many state-owned enterprises have their own accounting standards, with their own empowering act setting down financial norms.

### Procurement and employment

All government agencies must adhere to the procurement regulations of the Prime Minister's Office. Procurement rules are currently being overhauled to improve the transparency of public contracts.[34] However, ingrained corruption has led to a tradition of deception and inconsistent selection of contractors. The parameters for public contracts are frequently changed to suit individual contractors. Since 1992, it has been obligatory for larger projects to be vetted by a panel of planners, but there is limited transparency in smaller projects.

Public sector employment regulations, by contrast, are standardised, and generally meet international standards. They are easily accessible in both Thai and English from the Labour Ministry, the Office of the Civil Service Commission and from the Board of Investment.

Wide reforms of the civil service were launched in 1998, with support from the World Bank. The reforms aim to improve the efficacy of policy implementation, promote public participation in national administration and improve

accountability. This programme may take as long as 15 years to come to fruition and progress has been slow, because a number of enabling laws must be overhauled.

## Fiscal reporting

The Revenue Department reports the state of public revenues on a monthly and quarterly basis, but there is no formal procedure for presenting a mid-year report on budget developments. Budget data are usually only presented to the legislature during the annual budget debate or during occasional censure (no-confidence) debates.

There is no established procedure for presenting the results of major budget programmes to the legislature. The prevalence of off-budget activities, contingent liabilities and quasi-fiscal operations by state financial institutions and other enterprises has profound implications for fiscal reporting in Thailand, and compounds the difficulty of reaching an accurate and up to date assessment of the government's fiscal position.

## 4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY

●● Intent declared

### Data quality standards

Thailand observes the SDDS data dimension requirements in all categories. The BoT compiles and publishes a broad range of economic and financial data, some of which are compiled in accordance with the 1942 BoT Act and its Royal Decree, while others are compiled for operational and policy requirements and subsequently published. However, the BoT is not obliged to release data on non-financial public sector operations and central government operations/debt; the central bank disseminates them as a service to the public.

Fiscal time series data reflect revenue and expenditure trends, but disaggregated figures and more updated information are not readily available. Insufficient available analysis complicates attempts to relate trends in the fiscal data with ongoing policy commitments.

The BoT's *Annual Economic Report* publishes detailed information on sources of central government revenue; central government budgetary expenditure broken down by economic classification and by function; non-financial state-owned enterprises' capital expenditure; and non-financial state enterprises' financing.

### Independent scrutiny of fiscal information

**Independent Audit**

The Comptroller General's Office plays a central role in internal monitoring of public expenditure. Under recent changes to the State Audit Act an internal audit committee, consisting of former officials, has been placed within each ministry. The Office of the Auditor-General is responsible for auditing the budgets and fiscal procedures of all public ministries and state enterprises. An independent agency, it has gained greater neutrality. The Auditor-General and the Comptroller General's Office publish audit statements on the Internet.[35]

Additional legislative oversight of the budget process presently occurs through the activities of a parliamentary commission, appointed by parliament and chaired by the minister of finance, but this does not provide an independent assessment of budget activity.

**National Statistics Agency**

The National Statistical Office (NSO)[36], in compliance with the Statistical Act of 1965, collaborates with and participates in the coordination of the work of statistical agencies in the assembling, compilation and analysis of data. It also makes recommendations or advises other statistical departments on plans, methodology, forms, questionnaires, as well as other documents such as handbooks and instructions to be used for statistical purposes.

In addition, data on national accounts is governed by the Revision of the Royal Decree of 1994, which assigns the responsibility for producing national accounts statistics to the NESDB. The NSO and the NESDB are subordinate to the Prime Minister's Office, and as such they lack statutory autonomy for providing independent assessments on data quality. However, commentators perceive both as highly independent with regard to statistical practices.[37]

## INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to Thailand between 8 and 9 December 2003 and a visit to Dubai (2003 Meeting of the Boards of Governors of the World Bank Group and the International Monetary Fund) on 23 September 2003:

### Ministry of Finance

**9 December 2003**

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| Pongpanu Svetarundra | Deputy Director-General | Fiscal Policy Office |
| Navajit Boonyarattaphun | Economist | Fiscal Policy Office |

### Bank of Thailand (BoT)

**23 September 2003**

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|---|---|---|
| Bandid Nijathaworn | Assistant Governor | Monetary Policy Group |
| Chantavarn Sucharitakul | Director, International Department | Monetary Policy Group |

**8 December 2003**

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| Atchana Waimquamdee | Senior Director, Domestic Economy Department | Monetary Policy Group |
| Yunyong Thaicharoen | Senior Economist, Domestic Economy Department | Monetary Policy Group |

## ADDITIONAL INTERVIEWS

### Bureau of the Budget

**9 December 2003**

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|---|---|
| Somnuk Pimolsatien | Adviser to the Budget Director |
| Jiraporn Meeleesawat | Director, Budget Strategy Centre |
| Dechapiwat Nasonghkla | Budget Analyst Level 8 |
| Nitinai Sirismatthakarn | Economic Adviser |
| Niphon Jongwichit | Budget Analyst Level 7 |
| Natjaree Anuntasilpa | Budget Analyst Level 7 |
| Thanapat Reungsri | Budget Analyst Level 5 |

## IN ADDITION, WE CORRESPONDED WITH:

| | | |
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| Ammar Siamwalla | Thai Development Research Institute (TDRI) | |
| Pornchai Nuchsuwan | Budget Director | Bureau of the Budget |

## NOTES

[1] *Thailand's Budget in Brief: Fiscal Year 2003*, Bureau of the Budget, pp. 84-5 at: www.bb.go.th
[2] Teresa Daban, "Fiscal decentralization in Thailand", in IMF, *Thailand: Selected Issues and Statistical Appendix*, Country Report No. 02/195.
[3] Interviews in Thailand, 8-9 December 2003.
[4] The organisation chart of the MoF is at: www2.mof.go.th/org_chart.htm
[5] A description of the NESDB, including its objectives and membership of its council, is at: www.nesdb.go.th/Role/Role_data/historyE_new.html
[6] Interviews in Thailand, 8-9 December 2003.
[7] *Business Day*, 12 December 2003.
[8] Interviews in Thailand, 9-11 October 2002. Interlocutors at the SEC were positive about prospects for increased transparency from TAMC reforms in the near future.
[9] Geoffrey Dixon, "Thailand's hurdle approach to budget reform", Worldbank, *PREMnotes*, no 73, August 2002
[10] Interviews in Thailand, 8-9 December 2003.
[11] Pornchai Nuchsuwan, Budget Director, BOB, personal communication, 30 September 2003; interviews in Thailand, 8-9 December 2003.
[12] For the BOI overview of the revenue code including corporate income tax, value added tax and specific business tax, and personal income tax, see: www.boi.go.th/english/business/taxation.html (also available in Chinese, German, French and Japanese); the Revenue Department has similar information, for example on personal income tax at: www.rd.go.th/publish/6000.0.html
For other legal issues for investors, see: www.boi.go.th/english/business/legal_issues.html -- for the Thailand Investor Service Centre and its links to taxation laws, see: www.thailandoutlook.com/top_menu/weblink/laws.asp
[13] Some of Thailand's contingent liabilities include: deposit guarantees; obligations of the FIDF; liabilities of extra-budgetary funds; net worth of the BoT; non-guaranteed obligations, arrears and deferred maintenance of state-owned enterprises (including concession agreements of public utilities, arrears of the State Railways to the PTT and deferred railway track rehabilitation). In addition, there are future possible commitments and obligations of sub-national governments and the pay-as-you-go pension system.
[14] Lorenzo Giorgianni, "An assessment of Thailand's fiscal vulnerability", in IMF, *Thailand: Selected Issues and Statistical Appendix*, Country Report No. 02/195, September 2002.
www.imf.org/external/pubs/cat/longres.cfm?sk=16056.0
[15] http://dw.mof.go.th/foc/gfs/database/release_carlendar.xls
[16] See the IMF website at: http://dsbb.imf.org/Applications/web/sddsctycatbaselist/?strcode=THA&strcat=CGO00 and the FPO Public Finance data pages (in English) at: http://dw.mof.go.th/foc/gfs/index.html The Thailand Investor Service Centre has links to the MoF data (only updated to May 2003, after which the FPO Public Finance Data pages take over) at: www.thailandoutlook.com/main_sector/government/govern_fiscal.asp Detailed revenue data, for example, is available from the MoF at: http://203.150.52.175/foc/program/income_gov/programeng/
[17] http://dw.mof.go.th/foc/gfs/index.html
[18] http://203.150.52.175/foc/program/state_Enterprise/programeng
[19] Interviews in Thailand, 9-11 October 2002 and Lorenzo Giorgianni, "An assessment of Thailand's fiscal vulnerability", in IMF, *Thailand: Selected Issues and Statistical Appendix*, Country Report No. 02/195, p. 40.
[20] Interviews in Thailand, 9-11 October 2002.
[21] *Thailand's Budget in Brief: FY 2003*, pp. 134-5.
[22] The PDMO website is at: www.pdmo.mof.go.th and is almost entirely in Thai; the MoF website has data in English and Thai at http://203.150.52.175/foc/program/debt/programeng
[23] Lorenzo Giorgianni, "An assessment of Thailand's fiscal vulnerability", in IMF, *Thailand: Selected Issues and Statistical Appendix*, Country Report No. 02/195, September 2002, p. 44.
[24] Interviews in Thailand, 9-11 October 2002.
[25] Interviews in Thailand, 24-27 September 2001.
[26] Pornchai Nuchsuwan, personal communication, 30 September 2003.
[27] Lorenzo Giorgianni, "An assessment of Thailand's fiscal vulnerability", in IMF, *Thailand: Selected Issues and Statistical Appendix*, Country Report No. 02/195, September 2002.

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[31] www.bb.go.th/budget/inbrvee/main.asp The rest of the site is in Thai.
[32] Pornchai Nuchsuwan, personal communication, 30 September 2003.
[33] Interviews in Thailand, 9-11 October 2002.
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[37] Interviews in Thailand, 8-9 December 2003.

# OXFORD ANALYTICA

## TURKEY

## FISCAL TRANSPARENCY

**Country Report 2003**

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# TURKEY

## COMPLIANCE RATINGS

| *Fiscal transparency* | *2003* | *2002* |
|---|---|---|
| Clarity of roles | ●●● | ●●● |
| Availability of information | ●●● | ●● |
| Budget preparation | ●●● | ●● |
| Accountability | ●●● | ●● |
| **Score** | 3.00 | 2.25 |

## OUTLOOK & COMMENTARY

The Public Financial Management and Financial Control (PFMC) Law will overhaul the entire system of budget preparation, execution, reporting and auditing. It should take effect at the beginning of 2004, and be fully implemented by 2005. It includes the introduction of a new accrual-based accounting system; medium-term budgeting (three year period); and performance-based budgeting. Under the law the Court of Accounts will become the single, supreme audit body, and its scope of audit will increase. Additionally, the government's internal audit system is being overhauled. These reforms will only take effect following the passage of the PFMC law. A new budget classification system that is in line with international standards (GFS 2001) has been introduced, and was used in the preparation of the 2003 budget. All these factors represent significant improvements for fiscal transparency.

Legislation on the second phase of direct tax reform, improving state enterprise governance, and the improvement of the public sector personnel system, including establishing an ethical code of conduct for civil servants, is still waiting to be passed.

# EXECUTIVE SUMMARY

## 3.00 Enacted

This past year has seen significant progress made towards enacting a number of IMF mandated reforms, that will have a considerable impact on fiscal transparency. The legislation that looks to be passed by the end 2003 addresses problems outlined last year such as the exclusion of a large proportion of public revenue and expenditure from the budget by means of separate funds, state enterprises, banks, and loan guarantees, and the inadequately documented budget. There is still a level of uncertainty as a result of previous economic crises; however it was these economic crises that sparked the efforts to increase transparency and to address a number of structural deficiencies.

The Public Financial Management and Financial Control (PFMC) Law -- a landmark development, approved in early December 2003 -- will address many deficiencies in the fiscal system.[1] The aim is to harmonise the financial management and control system with international best practise. The law overhauls the entire system of budget preparation, execution, reporting and auditing. It should take effect at the beginning of 2004, and be fully implemented by 2005. It includes numerous innovations such as the introduction of: a new budget classification system that is in line with international standards (GFS 2001); a new accrual-based accounting system; medium-term budgeting (three year period); and performance-based budgeting. The law formalises the reporting process. The Court of Accounts will become the single, supreme audit body, and its scope of audit will increase. Additionally, the government's internal audit system is being overhauled. Once enacted, the law will have far-reaching positive effects on fiscal transparency. The new budget classification system was used in the preparation of the 2003 budget; however most reforms will start to take effect only now that the PFMC Law has been passed.

Additional bills are currently being prepared on public administration reform, which should improve transparency and efficiency in the provision of public services and will involve considerable decentralisation. The Banking Regulation and Supervision Agency's effectiveness has been strengthened and amendments have been made -- though are yet to be passed -- to the Court of Accounts Law.

There have been delays in the enactment of certain proposed reforms, including: the passage of the second phase of direct tax reform; the passage of legislation improving state enterprise governance; and the improvement of the public sector personnel system, including establishing an ethical code of conduct for civil servants.[2]

Turkey's overall score has improved from 2.25 in 2002 to 3.00.

## 1. Clarity of Roles, Responsibilities, and Objectives

●●● Enacted

**The government sector should be distinguished from the rest of the public sector and from the rest of the economy, and policy and management roles within the public sector should be clear and publicly disclosed.**

**Structure, functions, and responsibilities of government**

The structure and functions of government are specified in a large body of legislation. The responsibilities of different levels of government and of the executive branch, the legislative branch and the judiciary are reasonably well defined.

The duties, authorities and structure of local government organisations and their shares of tax revenues are set out in various laws. Responsibility for expenditure at the local level is less clear. Provinces have limited autonomy and report to the Ministry of the Interior. Municipalities have strong elected mayors and weak councils.

**Coordination and management of budgetary activities**

Mechanisms for the management of budgetary and extra-budgetary activities are governed by various laws, including the Public Accounting Law of 1927, the Court of Accounts Law of 1967, the Public Procurements Law and the annual budgets; by periodic regulations issued by the MoF; and by time-honoured practice.[3]

There is a Basic Law of Public Administration -- currently before parliament -- which will better define the respective responsibilities of local and central government. This is expected to be followed by further legislative amendments concerning local governments, including its revenues. The new accounting and classification systems are already being extended. However, in practice, local government finances are still widely considered an area that lacks transparency.

The setting, implementation and ongoing scrutiny of central government finances is shared between a range of institutions each operating according to its own law and regulations, and typically reporting to a different government minister:

- The Ministry of Finance (MoF) is responsible for budget preparation, budget execution, accounting and reporting, and revenue collection. It has separate departments for budgeting and fiscal control, for public accounting and for revenues.

- The State Planning Organisation prepares five-year plans, which are intended to give longer-term direction.[4] It draws up annual programmes and the public investment programme, which feed into the budget each year. It also serves as secretariat to the High Planning Council, a statutory sub-committee of the Council of Ministers with an important role in the overall policy-formulation process.

- The Undersecretariat for the Treasury is responsible for cash management and the public payments system.[5] It manages the public debt and provides loan guarantees. It oversees the operations of state enterprises and extra-budgetary funds and is responsible for relations with international financial institutions.

Some commentators argued that the MoF and the Treasury should be merged.[6] A more likely solution to the administrative complications is to re-clarify the responsibilities of these institutions and of the State Planning Organisation, while placing them all under a single Economy Ministry, in order to improve coordination. However, there is much disagreement with regard to the merits of merging the MoF and the Treasury. Many do feel there are too many institutions involved in fiscal management, all under different ministries. Some commentators stated that there is no need for a separate Treasury and that it could easily be merged with the MoF, leaving outside only a separate debt management unit. The Treasury currently performs a wide range of miscellaneous roles that should be performed elsewhere. Many also argue that the State Planning Organisation is not necessary, saying that a department for planning investments would suffice. Commentators tended to agree that it would be beneficial to have a single person in charge of economic affairs.[7] Meanwhile, the formation in November 2002 of the first single-party government in eleven years has improved coordination and facilitated the speedier progress of transparency efforts.

Mechanisms for coordinating and managing revenues and expenditures that fall outside the scope of the main budget process are varied and often unclear, a situation replicated at the local government level.

**Relations between government and public sector agencies**

Article 65 of the 1982 Constitution of the Republic of Turkey stipulates the monitoring of state enterprises by parliament under the auspices of the state enterprise committee.[8] Nevertheless, state commercial banks and non-financial public enterprises (NFPEs) have operated under the aegis of various government ministers.

Since 2001, two of the remaining three major state banks (Ziraat Bank and Halkbank) have been placed under a single autonomous management, and have been heavily streamlined. They are no longer obliged to lend at below market rates to farmers, agricultural or housing cooperatives or small businesses. Precedents have been set since 2002 for the inclusion of a separate appropriation in the budget to cover the cost if and when the banks are asked to perform such tasks. The third major state bank, Vakifbank, is scheduled for early privatisation. However, there has been no progress made in this respect over the past year, or in the privatisation of other public banks in general. The state also owns a foreign trade bank, T. Eximbank, and the Turkish Development Bank (TKB).

The use of NFPEs for quasi-fiscal or political purposes has been reduced. State enterprises processing tobacco, sugar and grain are no longer obliged to buy up crops at prices set by the government, unless they are reimbursed through the budget. NFPEs are pricing their goods and services increasingly on a commercial basis, and some have cut staff and services, indicating a reduction in hidden social spending by these businesses. In spite of this trend, the extent to which NFPE decision-making is influenced by non-commercial considerations remains difficult to monitor.

The delayed legislation on the governance of state economic enterprises (SEEs) is due to be passed by parliament by end-2003, although it may take longer. This legislation is expected, *inter alia*, to clarify goals and financial targets, set new accountability standards and address accounting, reporting and auditing arrangements. At present, SEEs are responsible to a committee in parliament but there is no procedure for them to provide data in advance. Some government officials feel the legislation to be over-ambitious in its goal to reform the entire SEE system.[9]

Further legislation is pledged to unify the three main social security institutions and to separate health from pensions, measures which should improve transparency.

Important amendments made to the Central Bank Law in 2001 enhance the Central Bank of Turkey's independence and clarify its relationship with the government (including distribution of profit). According to the amendments, the Bank is no longer allowed to finance the government. It may support the Savings Deposit Insurance Fund (responsible for troubled banks) provided monetary policy is not affected.

**Government involvement in the private sector**

Public equity ownership in the private sector is low. If the state holds a majority of the capital in a company, then the company is subject to the Public Procurement Law. Most privatisations are carried out in line with the Privatisation Act, although this has not prevented allegations of lack of transparency.

The state may participate in the capital of some commercial banks to strengthen the banking system. Rules and criteria for all these banking operations are specified in legislation. The criteria according to which the Banking Regulation and Supervisory Agency (BRSA) decides to re-sell troubled banks or assets thereof to the private sector are less clear.

Rules on state aid are laid down by law and decree, but are liable to frequent change. The Treasury has provided guarantees for private sector investors carrying out infrastructure and energy projects under Build-Operate-Transfer (BOT) and Build-Operate contracts. For example, pledges of the state electricity company to purchase electricity from private power plants have been backed by Treasury guarantees. A figure for net lending as a result of Treasury guarantees is now included in the budget. The Treasury has been working to recoup amounts it is owed by the original debtors. In this context, the Treasury is now very reluctant to issue new guarantees.[10]

## There should be a clear legal and administrative framework for fiscal management

**Legal framework for budgetary activities**

The constitution states that the expenditures of the state and of public entities other than state economic enterprises are to be made through the annual budgets.[11] Adherence to this prescription has improved in the last three years. The number of extra-budgetary funds, set up by various laws and decrees, has been reduced from 13 in 1999 to four (Defence Industry Support Fund, Social Aid and Solidarity Fund, and the Privatisation Fund and Promotion Fund). Meanwhile, opportunities for using Treasury guarantees to enable public agencies to raise credit with which to make extra-budgetary expenditures have been curtailed by the 2002 Public Financing and Debt Management Law.

This Law centralises all public borrowing and restricts annual borrowing to the amount needed to cover the envisaged budget deficit. Maximum limits must be fixed for Treasury guarantees and loans each year in the annual budget. The Law consequently prevents the Treasury from unilaterally issuing 'non-cash' bonds to pay off the arrears of public entities, or to bail out troubled state and private banks as occurred in 2000-2001. The powers of the Treasury to seek redress from public entities that fail to pay their guaranteed debts have also been strengthened.

In spite of these changes, it appears that the Treasury may issue bonds as part of the current Imar Bank bail-out, without inclusion in the budget or authorisation by parliament. Any such bonds will be issued as a loan to the Savings Deposit Insurance Fund. Decisions will be taken by the Council of Ministers under the July 2003 enabling legislation. Treasury officials say bonds cannot be issued *gratis* -- for example to state banks in return for duty losses -- ruling out quasi-fiscal activities.[12]

Special budget agencies will be subject to the same arrangements as mainstream budget agencies under the new budget classification system. Managers of budget agencies will be given greater responsibility (and accountability) for spending decisions. Revolving funds will be eliminated by 2007.

A separate law is expected to establish the elimination of special accounts. Under this law, special account revenues would have to be written over directly in the budget. This process is likely to start in January 2005.

Supplementary budgets have been common in Turkey. However, owing partly to the improvements mentioned above, the amounts and distribution of budget expenditure have come closer to the original appropriations since 2000. The government used to be able to switch spending between allocations without obtaining permission from parliament, provided there was no increase in the overall total expenditures, but as of 2003 this is not allowed.

Earmarking revenues for specific expenditures currently persists (a legacy of the fund system). Much earmarking has been eliminated over the past year, such as the appropriations of the Special Consumption Tax. The Advance Payments Account used to allow expenditures to be made against the following year's allocation -- for example it used to fund higher-than-envisaged social security institution deficits. However changes in the regulation of the Public Accounting Law in June 2003 removed this practice. Now the work of this account is to be within the same year's budget allocations.

Procedures for municipal spending are set out in the relevant legislation. Nevertheless, much public expenditure has come to be diverted through municipal companies (known as 'municipal economic enterprises') subject only to private company law.

**Legal framework for taxation**

Taxes are charged in line with detailed laws, and taxpayers' rights are protected. Tax allowances, rebates, exceptions and incentives also have a specific legal basis.

The constitution states that taxes can only be imposed by law, although tax laws may empower governments to alter the amounts or rates of taxes within limits.[13] In practice, the government can adjust tax rates, duties, fund levies and other rules pertaining to their implementation within the fairly broad parameters determined in legislation.

Tax legislation is generally clear and the adoption of a direct tax reform in April 2003 simplified its complexity. The tax administration and the private sector provide information, interpretations and taxpayer services. However, tax legislation has changed frequently. Moreover, numerous tax amnesty laws have been approved in the past. Expectations of further amnesties may discourage the payment of taxes on time. Arrears have also been blamed on weak enforcement, despite the introduction of tax identification numbers, which have been required for a wide range of transactions since 2001. User charges made by annexed budget agencies (universities and some general directorates providing infrastructure and other services) and special budget agencies are generally set out clearly, although here too frequent changes and government interventions have also occurred.

Clear rules do not exist for setting the fees, commissions, and donations charged by revolving funds and public sector foundations. The Public Financial Management and Financial Control Bill will ban the foundations from collecting any such revenues, and make the revolving funds subject to full budget procedures.

Levels of social security premiums are set clearly on the basis of the relevant legislation. However, non-payment and delayed payment of premiums is a major problem. There have been frequent amnesties for those in arrears.

The handling of state land allocations and the diverse rents and prices charged for it are a source of complaint and sleaze allegations, notwithstanding the applicability of public procurements legislation.

Rules for municipal revenues are set out in law. The municipalities are financed partly through clearly prescribed shares of central government revenues and property tax. The public sector Provinces Bank (Iller Bankasi) controls the flow of budget allocations to municipalities and is sometimes accused of political favouritism.

There have been improvements over the last year in taxation. Parliament on January 16, 2003 approved legislation designed to reschedule tax claims, pardon tax offences and terminate tax disputes. IMF tutelage, coupled with the

continuing need for revenues, is obliging the government to overhaul the tax system.[14] This should help debt sustainability and macroeconomic stability. A Direct Tax Reform was passed in April 2003 which simplified the corporate tax regime and unified the income tax regime. Preparation of the second phase of direct tax reform which will improve tax administration and free trade zones, is facing delay however. It is hoped this will be passed by the end of the year. Under the PFMC Law, tax expenditure has now been introduced into the budget. Financial earnings must be declared. [15]

**Ethical standards for public servants**

The government has pledged to the IMF that it will legislate a code of ethical conduct for civil servants and public administrators by the end of 2003.[16] At present, various laws such as the Law on Government Officials and the Tax Procedure Law as well as laws governing individual government agencies, include stipulations concerning the conduct of public officials. Also, legislation on public administration reform is being prepared by the government to create a more favorable legal and institutional environment for the efficient, transparent and participatory provision of public services.

## 2. PUBLIC AVAILABILITY OF INFORMATION

●●● Enacted

**The public should be provided with full information on the past, current, and projected fiscal activity of government.**

**Central government operations**

The annual budget bill submitted to parliament covers: (a) tax, non-tax and special revenues, the expenditure of general budget agencies and the revenues and expenditures of annexed budget agencies and budgetary funds, and (b) transfers for interest payments, special budget agencies (including social security institutions), revolving funds, extra-budgetary funds, and local government. An annual economic report and an accompanying budget memorandum are submitted to parliament together with the budget bill. Starting in 2002, this documentation has also included the accounts and outlook of extra-budgetary funds, social security organisations (including arrears), revolving funds, financial and non-financial state enterprises, local authorities and contingent liabilities of the Treasury.[17]

Currently, the Treasury publishes quarterly information on contingent liabilities and also publishes bi-annually information on payments made by the Treasury in its capacity as a guarantor of debt and on the amounts owed to the Treasury by origional debtors (municipalities, state enterprises, funds, banks). As of 2003, the net payments of the Treasury arising from loan guarantees have been included in the budget.

There are four existing extra-budgetary funds. Data for those are published every year in the annual programme, but there are no plans to publish the accounts more frequently. Treasury officials say it would be possible, but there are no plans to do so.[18]

Under the 2002 Public Financing and Debt Management Law, funds coming from foreign grants and credits have to be included in the budget as revenues.[19] There is hitherto no attempt to quantify tax expenditures, but this will now become obligatory under the PFMC Law.

The budget documentation includes comparisons with the projection for the preceding year and the outturns for earlier years. Information on budget performance in past years is also available from the MoF's General Directorate of Public Accounts, although the changing scope of the budget makes some comparisons difficult.

Budget forecasts are not available, although a broad scenario has been set out in the latest IMF standby agreement. A rolling three-year budget system similar to that in most OECD countries is now to be introduced following the passage of the PFMC Law.[20] The presentation of mid-year reports are also mandated in the PFMC Law. Mid-years reports are due to begin from mid-2005.

The General Directorate of Public Accounts provides monthly performance data on the 20th of the following month. This includes a detailed breakdown of budget revenue and expenditures, although the classification of expenditures could be more functional.

Performance-based budgeting has been piloted in six government agencies, and will now be introduced formally following the passage of the PFMC Law It will be introduced in all government departments and agencies in the

2005 budget. It will require government departments and agencies to publish accountability reports every year, which will then be evaluated by the Court of Accounts.[21]

Economic analysts find it difficult to keep abreast of the performance of the social security institutions, state enterprises and local government. IMF standby accords in force since 1999 have in principle established targets for the 'consolidated government sector' -- which includes the social security institutions, the larger extra-budgetary funds and state enterprises as well as the budget. However, information has not been provided about the performance of these aggregates, apart from occasional comments contained in letters of intent to the IMF and in the occasional statements of Turkish and IMF officials to the effect that targets have been met. The introduction of the new budget classification system and accrual-based accounting system, which will apply across the board, should address these problems. Extra-budgetary funds will be subject to the same rules as the rest of the budget, and will be included in the budget put forward by parliament. The new budget classification system -- introduced this year -- creates a consolidated, comprehensive budget and clarifies its composition.[22] The PFMC Law in general creates a unified concept of central government and "collects the various floating agencies and institutions".[23]

Some commentators have had difficulty predicting the deficit and the primary surplus targets given that a large portion of budget disbursements are given in December, a month in which non-interest expenditures are very large. The sector would like more communication from the MoF on this matter. The introduction of the accrual-based accounting may iron out this problem. Commentators also feel they would benefit from systematic written comments -- perhaps monthly reports -- explaining budget data throughout the year similar to those produced by the Central Bank of Turkey (CBT) on inflation prospects. However, commentators did remark that the MoF communicates very well in general and is very responsive.[24]

## A commitment should be made to the timely publication of fiscal information.

**Debt reporting**

There is comprehensive and timely publication of debt figures. The Treasury makes available data/information on its borrowing activities and publishes regular monthly data on borrowing and debt servicing, the level and composition of domestic debt, the level of Treasury-guaranteed foreign debts and on central government foreign debt. It also publishes quarterly data on foreign debt of all public and private sector institutions, including breakdowns by maturity, currency composition, type of instrument, lender and borrower.

The 2002 Public Financing and Debt Management Law has increased the transparency of debt-management decisions. The Treasury is required to submit to parliament a quarterly report on debt management. This report also reviews debt sustainability. Debt management in general is perceived as transparent. As of 2003, the net payments of the Treasury arising from loan guarantees have been included in the budget.

**Advance release calendars**

Turkey subscribes to the IMF Special Data Dissemination Standard (SDDS) and is therefore committed to releasing data on fiscal performance and public debt in a timely manner and in accordance with advance release calendars. There is currently a lack of up-to-date data on local government, state economic enterprises, social security institutions and extra-budgetary funds. Commentators noted the need for projections for the social security institutions.[25]

Turkey has now passed a Freedom of Information Act. This act defines "the rights of citizens to request information and the obligation of public organisations to provide information".[26] However, concepts such as "state secrets" and

"banking secrets" are not clearly defined giving rise to the possibility that government officials may interpret such concepts rather arbitrarily, limiting effective implementation.

## 3. Open Budget Preparation, Execution, and Reporting

●●● Enacted

### Fiscal policy objectives, macroeconomic framework, and risks

**Fiscal policy objectives**

The preparation of the budget begins with the publication of the prime minister's budget notice in the *Official Gazette* in June. Budget agencies then receive instructions from the MoF on preparing their budget proposals, which are then submitted to and negotiated with the General Directorate of Budget and Fiscal Control (under the MoF). Proposals related to investment spending, are submitted to and negotiated with the State Planning Organisation, which maintains a record of ongoing approved investment projects. Under the constitution, the government is responsible for submitting the budget bill to parliament 75 days before the end of the calendar year.[27] The budget is then debated in the Plan and Budget Committee and plenary sessions.

In recent years, a large number of factors have obstructed the use of the annual budget as an instrument to obtain fiscal policy objectives. These include the short horizons consequent on frequent changes of governments and ministers, high inflation and the urgency of the government's debt situation, as well as the limited scope of the budget, its overall lack of credibility and the scope for extra-budgetary expenditure and revenue. However, over the past year, the budget's credibility has improved somewhat according to commentators, and the new budget classification system has provided a more comprehensive and transparent budget.

First steps have been taken towards introducing an element of competition for funding allocations among public institutions. This is being piloted in six agencies ranging from road junctions to elderly health care. For the most part, however, the budget is still not based on overall policy objectives, and there is still no question of introducing new policies through the budget, or of stating the objectives to be achieved by major programmes. All this is expected to change when the PFMC law takes effect, starting with the 2005 budget.

The main change in the preparation of this year's budget is the introduction of the functional classification system (for both revenues and expenditure), as noted above, which is in line with international standards (GFS 2001). Tax rebates are now deducted from tax revenues rather than counted as expenditure. A project aimed at strengthening the budget preparation process is to commence at the beginning of 2004, and will last 18 months. Technical support for this is being provided by the Netherlands government. This will cover: preparing secondary legislation according to the new law; the preparation of audit goals to be used by internal auditors, controllers and experts; enriching the budget call and budget guide (for the budget preparation process); and training. Help will be given to spending agencies in their budget preparation.[28] In addition, there is a MEDA (EU-Mediterranean)-funded study for modernising the personnel regime.

As of 2005 the budget will deal only with general budget institutions and special budget institutions (together with the autonomous agencies these make up the central government). Autonomous agencies will submit their own budgets separately to parliament, while the MoF will be informed to allow consolidation of figures.[29] Annexed budget agencies will be eliminated. Local government and social security institutions will not have to submit budgets to parliament but they will have to use the new budget classification and accrual-based accounting systems. The same audit system will also apply.[30]

**Macroeconomic framework**

The MoF prepares the prime minister's budget speech. It includes a description of economic conditions and fiscal objectives, prepared by the State Planning Organisation and -- by law -- should be related to the goals stated in the five-year development plans.[31] In recent years, the IMF standby accords have also provided an overall macroeconomic scenario and fiscal targets (for up to three years in advance) against which budget agencies can prepare their budget proposals.

**Fiscal risks**

The budget is not accompanied by an assessment of the risks threatening the achievement of fiscal targets. However, under the 2002 Public Financing and Debt Management Law, the Treasury is required to submit to parliament a quarterly report on debt management, which provides details on, *inter alia*, contingent liabilities.

**Fiscal sustainability**

The fiscal rules governing budget preparation are not based on an ongoing assessment of medium to long-term fiscal sustainability. There is no specific public assessment of the medium and long-term significance of factors such as the condition of the social security institutions, the government's responsibility to support further interventions in the banking system if necessary, or the fiscal implications of guarantees provided for the import of gas and for the purchase of electricity from private generators.

Under the 2002 Public Financing and Debt Management Law, the Treasury is required to submit to parliament a quarterly report on debt management. This report provides details on debt sustainability and contingent liabilities.

## Budget presentation

The code structure of the budget is broken down into five different levels: programmes, sub-programmes, appropriation, type, project and line expenditure. It is not clear which policy areas are covered by the administrative units. Revolving and extra-budgetary funds under the current system not classified according to the same structure.[32] However, revolving funds will be eliminated by 2007, and extra-budgetary funds are to be brought under the new budget classification system. Under the new system, the cost of tax breaks will also be stated.[33]

The new budget classification in line with GFS 2001 standards was introduced on a pilot basis in 2002.[34] This was adopted formally in the 2003 budget, which thus incorporates the new functional classification system. This provides a clearer, more functional breakdown of the budget, and means that it is now comparable on an international level. Levels of social spending and their destinations will now be apparent, thereby significantly increasing transparency.

**Data reporting**

In practice, the most common measures of the fiscal position are the primary central government budget balance and the overall central government budget balance. These measures are readily available and updated monthly. The overall balance of the general government, which would provide a better measure of the fiscal position, cannot be ascertained accurately due to lack of adequate, timely accounts and/or use of incompatible accounting systems by some parts of the government. Again, this problem should be addressed by the introduction of the new budget classification system and accrual-based accounting system across the board. Commentators feel that the credibility of budgetary figures has increased in the last couple of years, and that budget targets, while ambitious, are far more

realistic than they used to be. The MoF has made good progress in reducing the deviation between original projections and budget performance.

## Budget execution and monitoring

The Public Financial Management and Financial Control Law, sets out a comprehensive framework for budget preparation, execution, accounting, reporting, and internal and external audit.[35] The Law consolidates into the central government budget, under a common classification, revolving and extra budgetary funds, annexed institutions, and all regulatory agencies, bringing the latter under parliament's oversight while preserving their financial and administrative autonomy. It also eliminates earmarking mechanisms. The law states that all public revenues and expenditures will be audited by the Court of Accounts, including those of the presidency and parliament. In line with international standards, there will be one external audit body; the Court of Accounts. Internal audits will be conducted within each government agency by sound internal audit bodies. The Court of Accounts will then assess the internal audit system rather than assessing all transactions as at present.[36]

According to the PFMC Law, all central government agencies, budget agencies, social security institutions and local government, will have to follow the same new budget classification system, and will have to use the same accrual-based accounting system (to be introduced in 2004). Autonomous budget agencies (regulatory agencies) will now submit their budgets separately to parliament thereby safeguarding their autonomy. Annexed budget agencies will cease to exist. These new arrangements are in line with international best practice.[37]

### Accounting basis

The MoF General Directorate of Public Accounts is responsible for public accounting.

The lack of a uniform accounting system has been an obstacle to fiscal discipline and transparent fiscal reporting. However, as noted above, a new comprehensive, integrated, accrual based accounting system will be introduced in 2004. A new computerised accounting system is already in place. The new accrual-based accounting system was introduced on a pilot basis in 2002. The new system is in line with International Accounting Standards (IAS) standards for public finance and the IMFAC public sector committee.[38] The new accounting system will apply to all general government and budget agencies, social security institutions and local government. The system will help with borrowing planning and public expenditure planning, and should improve the coordination of the two.[39] It will give clear visibility to the position of the state on a monthly basis.

The government can no longer write appropriations nor submit them to parliament, as of the 2003 budget. All appropriations must now go through parliament, which will improve fiscal discipline and transparency.[40]

Inflation accounting is to be introduced in 2004 (for tax-collection purposes) which will be an improvement on the revenue side.

### Procurement and employment

Major amendments to the legislation on public procurements were made in January and June 2002, bringing Turkey into line with the UNCITRAL standard. The new legislation came into force in January 2003, but amendments were made in July of this year, which somewhat watered down the law as it was perceived to be cumbersome in its original form. The amendments make various exceptions, but are not thought to reduce the effectiveness of the law significantly. The new system is expected to ensure open, competitive tendering throughout the public sector.

Procedures for employment in the public services are disclosed. Career structures vary from department to department.

**Control and auditing**

The MoF General Directorate of Budget and Fiscal Control has authority for releasing and auditing budget expenditures, in conjunction with the budget offices of budgetary agencies. There is a complex, centralised system for releasing allocations and approving payments. The Court of Accounts also has some powers of *ex-ante* control, approving payments orders and new posts and registering contracts and commitments.[41]

Under the PFMC Law, the MoF is now authorised to set standards for financial control and reporting for the general government.

Furthermore, as a result of the PFMC law, proper internal control structures for audit are to be set up within government. There will be a separation of the investigation and audit functions. Internal auditors are being introduced into spending agencies (until now internal audit has been carried out by internal financial inspectors and controllers). The system will become operational at the beginning of 2004.[42] This transfer of control from the MoF to the spending agencies means that effectively, the MoF will 'audit the auditors' rather than carrying out the audits directly. The new audit system will also apply to social security institutions and local government. Some of the powers of budget implementation will be devolved to the spending agencies. The MoF has a two year project with the European Commission to commence by early 2004 to train internal auditors and to introduce the internal audit system.

**Tax administration**

The General Directorate of Revenues under the MoF, which is responsible for tax administration, is currently being reorganised. Tax arrears, including the arrears of state enterprises, were reduced through a partial tax amnesty scheme in 2003, but still require careful monitoring. A high-level audit committee was established at the MoF in May 2002, the number of auditors has been increased and annual audit plans are drawn up.

## Fiscal reporting

Under the constitution, the government is obliged to presenting the final accounts not later than seven months after the end of the calendar year.[43] The government is not as yet legally obliged to present quarterly or half-yearly reports on the performance of the budget, or to update its projections on a regular basis. However, it plans to present a regular mid-year economic and fiscal update to parliament by 2005.

## 4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY

●●● Enacted

### Data quality standards

The State Planning Organisation produces the macroeconomic forecasts used in the budget. The methods, assumptions and data used for formulating these forecasts are not published or subject to independent scrutiny. However, Turkey meets the IMF's Special Data Dissemination Standard.[44]

At present however, Turkey's data on general government finances is not sufficiently comprehensive: responsibility for compiling and disseminating government statistics is not centralised and accounting standards differ across the agencies that compile fiscal data.[45] This should change with the introduction of the new budget classification system and accrual-based accounting system, which will apply to all general government and budget agencies, social security institutions and local government by 2004.

### Independent scrutiny of fiscal information

**Independent audit**

The integrity of government accounts is assessed by the Court of Accounts (Sayistay), an independent judicial body with constitutional status that reports to parliament. The Court of Accounts prepares and manages its own budget and has free access to all documents and information. Its members are elected by parliament and remain members until they retire at 65. Its president is elected by parliament for a seven-year term.

The Court of Accounts submits an annual statement on the conformity of the final accounts to parliament, within 75 days of the submission to parliament of the accounts themselves.[46] The Court of Accounts also draws up other reports on behalf of parliament and carries out investigations of its own choosing within its field of responsibility.

The remit of the Court of Accounts covers general and annexed budget agencies (including the Treasury), local administrations and municipalities, revolving funds and extra-budgetary funds. Under the PFMC Law, the Court of Accounts is to take on responsibilities for auditing the whole of general government, and its own accounts will become subject to external audit. Extra-budgetary funds and social security institutions will be brought under the control of the Court of Accounts under this law. Annexed budget agencies are also to be abolished and revolving funds are to be eliminated by 2007. Revolving funds and extra budgetary funds provided a means of escaping the control of the Court of Accounts.

Until now, the Court of Accounts has not conformed to international standards and its scope of audit has been quite limited -- it has not been able to audit autonomous agencies or parliament for example. Under the PFMC Law, all public agencies will be under the scope of audit of the Court of Accounts. The Court has had rather a low profile up to now, though this should begin to change with the Court's expanded role. Over the past year, work has been carried out in conjunction with the World Bank and the European Commission to improve the capacity and functional efficiency of the Court. This will help prepare it for its expanded role under the new Law.

Commentators have been critical of the practices of the Court of Accounts, especially in relation to its lack of regular reports, many of which often fail to scrutinise performance and value-for-money; lack of effective sanctions at its disposal; lack of coordination with internal control bodies of the general and central government; the time it takes to complete audits; its unaccountability to the public and the need for more resources and better trained and motivated staff. However, some commentators believed that the Court has been a useful tool for the critique of government practices.[47]

The changes that will come into effect as a result of the enactment of the PFMC Law should address many of the aforementioned criticisms. The Court will become a proper supreme audit body. At present the Court checks all accounts transactions, which is not efficient. Under the PFMC law, government agencies have their own sound internal audit inspectors, and the Court of Accounts will simply evaluate the activities and reports of the government agencies' auditors in an annual report in line with the new system of performance auditing. Additionally, an annual report will also be sent by the Court of Accounts underlining the most significant of all its budget findings. Both reports will be available to the public via the Court's website. The Court is aware of the need to produce more reports to parliament, and that it has been deficient in this in the past, and the new mandatory reporting requirements mentioned above should address this deficiency. In the past the Court's judicial function has tended to take precedence over the auditing function.

The Court is making considerable efforts to ensure that it has sufficient technical capacity for its expanded role. It feels it has sufficient IT capacity, and has addressed previous concerns over training. While it feels its current training arrangements are sufficient for the current methodology, it acknowledges that the expanded methodology requires expanded training. As a result a large portion of the Court's auditors have now been trained in the new 'Anglo-Saxon' based system. New auditors are given two years training. A twinning programme has also been arranged with the European Union to last 18 months, which again should increase the skills and capabilities of the staff. There is still an need to increase the capacity for external audit. This is a precondition for accession to the European Union.

A permanent public accounts committee is to be created by parliament in order to look into the Court of Account's reports.[48] The lack of such a committee until now, has been partly responsible for the insufficient number of reports produced by the Court for parliament. The committee could be headed by an opposition member of parliament. The creation of this committee is in the government programme, though no specific date has been set for this to take place.

Additionally, amendments to the Court of Accounts law -- for example, on quality assurance -- are due to be passed within the next six months. They will complement the PFMC law. One of the amendments is a commitment to better inform the public on the activities of the Court in order to improve its profile and transparency. It is to begin, under this amendment, to make press releases.[49]

Municipalities and local government administrations are audited by the Court annually at present. Increasing importance is being given to the audit of municipalities, given that they use huge public resources due to real estate revenues and funds from central government. Municipalities have been known to try to escape the audit of the Court by creating public companies (municipal economic enterprises). The new law will allow the Court to audit any transfer of public funds.

At present there are a number of bodies with audit functions in addition to the Court of Accounts. Under the PFMC law the Court is to take over all of these, thus improving coordination. The High Audit Board (YDK), attached to the Prime Ministry, reports to parliament on NFPEs and some funds. This board is to be absorbed by the Court of Accounts under the PFMC Law. State Economic Enterprises -- at present under the control of the High Audit Board -- will come under the control of the Court. Regulatory bodies will also come under the control of the Court, as will social security institutions and the four remaining extra-budgetary funds. There is also a State Audit Board (DDK)

attached to the presidency, which carries out *ad hoc* studies and investigations on any part of the public sector, except for the courts and the military, as and when requested by the president.

The central bank and some state enterprises including the state banks are already externally audited. The new law, also enables the Interior Minister, upon the request of concerned mayors or the Internal Audit Coordination Board, or where serious possible risks of fraud are detected, shall order the authorised audit personnel to inspect all financial management and control systems of local administrations for compliance with financial decisions and related legislation, and for thier performance.

**National Statistics Agency**

The national statistical agency (State Institute of Statistics) enjoys technical independence but in practice it does not seek to verify the quality of the fiscal data provided by the MoF and various agencies.

## INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to Turkey between 20 and 24 October 2003:

### Ministry of Finance

**21 October 2003**

| | | |
|---|---|---|
| Hasan Gul | General Director | General Directorate of Budget and Fiscal Control (BUMKO) |
| Ahmet Kesik | Deputy Director General | BUMKO |
| Abdulkadir Goktas | Head of Department | BUMKO |

### Central Bank of Turkey

**23 October 2003**

| | | |
|---|---|---|
| Fatih Ozatay | Vice Governor | |
| Yuksel Gormez | Specialist (Monetary Mechanisms) | Research Department |
| Erhan Yazgan | Assistant General Manager | Internal Audit Department |

### Treasury

**24 October 2003**

| | | |
|---|---|---|
| Ibrahim Canakci | Undersecretary | |
| Ercan Sendil | Assistant to Undersecretary | |
| Nilgun Pehlivan | Head of Department | General Directorate of Public Finance |

### Turkish Court of Accounts (Sayistay)

**22 October 2003**

| | |
|---|---|
| Erol Akbulut | Deputy Secretary General |
| Gulsun Canova | Principal Auditor |
| Feyzullah Okumus | Senior Auditor |
| Mehmet Bademli | Principal Auditor and Deputy Head of International Relations Department |

## ADDITIONAL INTERVIEWS

**20 October 2003**

| | | |
|---|---|---|
| Tugrul Belli | Secretary General | Turkish Bank |

| | | |
|---|---|---|
| Emre Tezmen | Director<br>Research and Institutional Sales | Turkish Bank |
| Belma Firat | Research Department Economist | Yapi Kredi Bankasi |
| Cenk Tarhan | Research Department Economist | Yapi Kredi Bankasi |

**24 October 2003**

| | | |
|---|---|---|
| James Parks | Lead Economist | World Bank |

## NOTES

[1] Once approved by parliament laws still have to be approved by the president, who has 15 days to study them, and can ask for parliament to reconsider them one more time. It is unlikely this will happen with the PFMC Law.
[2] Letter of Intent to the IMF, July 25, 2003. The latest timetable is: direct tax reform November 2003; state enterprise legislation December 2003; and personnel system early 2004. Some further minor delays are possible yet but all of these are still likely to happen by summer 2004.
[3] A wide range of other legislation might also be mentioned, including the Civil Servants Law, legislation on the foundation and operation of various funds, laws and decree-laws on state enterprises, the Privatisation Act, the Banks Act and a body of legislation concerning local government.
[4] The State Planning Organisation (www.dpt.gov.tr) operates under the Decree-Law on the Establishment and Duties of the State Planning Organisation (1994)
[5] Structures and duties of the Undersecretariat of the Treasury (www.hazine.gov.tr) are determined under Decree-Law No. 4059 of 1994. Law No. 4749 of 2002 regulates the public finance and the debt management duties of the Treasury.
[6] The MoF and the Treasury were separated in 1984, at which point a number of agency roles were transferred to the Treasury, in effect to beef it out).
[7] Interviews with officials, 20-24 October, 2003.
[8] http://www.mfa.gov.tr/grupc/ca/cag/I142.htm
[9] Interviews with officials, 20-24 October, 2003.
[10] The budget law [each year] specifies a limit for the amount of new guarantees. The Treasury also conducts more comprehensive due diligence before providing guarantees. The Treasury insists that an escrow account is opened to ensure repayment. A communiqué has been issued on this. This year the limit in the budget is $750m and so far the Treasury has issued guarantees for only around $250m of credits. Interviews with officials, 20-24 October, 2003
[11] Article 161.
[12] Interviews with officials, 20-24 October 2003.
[13] Article 73. See also Article 167 for taxes on foreign trade.
[14]Oxford Analytica Daily Brief, January 22, 2003.
[15] Interviews with officials, 20-24 October, 2003.
[16] Letter of Intent to the IMF, April 2002, Article 18.
[17] Memorandum of Economic Policies accompanying Letter of Intent to the IMF, May 2001, Article 19, and Letter of Intent to the IMF November, 2001, Article 23.
[18] Interviews with officials, 20-24 October, 2003.
[19] Interviews with officials, 3-7 November 2002.
[20] Interviews with officials, 20-24 October, 2003.
[21] Interviews with officials, 20-24 October, 2003.
[22] Some commentators questioned how consolidated the 'consolidated' budget really is. They also commented that the figures for the whole government appear very late, which they saw as a structural problem rather than an attempt to escape scrutiny. Interviews with officials, 20-24 October 2003.
[23] Interviews with officials, 20-24 October 2003.
[24] Interviews with officials, 20-24 October 2003.
[25] Interviews with officials, 20-24 October 2003.
[26] Letter of Intent to the IMF April, 2002, Article 18.
[27] Article 162.
[28] Interviews with officials, 20-24 October 2003.
[29] Separately, legislation on autonomous agencies is currently being prepared at the Prime Ministry. (It will deal with organisation and administrative matters; there are also likely to be clauses on budgeting, auditing and accountability).
[30] Interviews with officials, 20-24 October 2003.
[31] The current five-year plan, the eighth, is for 2001-2005. The plans and associated sub-committee reports constitute a national agenda. They are largely prepared through non-partisan consultations that draw on a wide range of expertise and serve as a national forum. However, the usefulness of the plans with respect to budget preparation is limited by the fact that they do not set out the fiscal costs of the policies recommended. Nor are the plans up-dated annually.

[32] IMF: Experimental Report on Observance of Standards and Codes: Turkey, June 27, 2000, 3.2.1.
[33] Interviews with officials, 20-24 October 2003.
[34] Interviews with officials, 3-7 November 2002.
[35] Letter of Intent to the IMF, July 2002, Article 10.
[36] Letter of Intent to the IMF, July 25, 2003.
[37] Interviews with officials, 20-24 October 2003.
[38] See 'Reform in the Government Accounting: From Cash to Accrual Basis,' prepared by the MoF General Directorate of Public Accounts.
[39] Interviews with officials, 20-24 October 2003.
[40] Interviews with officials, 20-24 October 2003.
[41] See Policy Paper on the Future Development of the Turkish Public Internal Financial Control Systems of July 3, 2002, pp.12-17.
[42] Interviews with officials, 20-24 October 2003.
[43] Article 164.
[44] See IMF Report on the Observance of Standards and Codes (Data Module) of March 2002.
[45] IMF Report on the Observance of Standards and Codes (Data Module), March 2002.
[46] Article 164.
[47] Interviews with officials, 3-7 November 2002.
[48] At present the Court's reports go to the Plan and Budget Committee which is a large committee which deals with the budget and has little time to spend on the Court's reports.
[49] Interviews with officials, 20-24 October, 2003.

# OXFORD ANALYTICA

## VENEZUELA

## FISCAL TRANSPARENCY

**Country Report 2003**

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# VENEZUELA

## COMPLIANCE RATINGS

| *Fiscal transparency* | *2003* | *2002* | *2001* |
|---|---|---|---|
| Clarity of roles | •• | •• | ••• |
| Availability of information | ••• | •• | •• |
| Budget preparation | •• | •• | •• |
| Accountability | •• | •• | •• |
| **Score** | **2.25** | **2.00** | **2.25** |

## OUTLOOK & COMMENTARY

The sway of political instability and economic recession will continue to determine progress in fiscal transparency. The lack of coordination between the government and political opposition has consolidated a framework whereby the Chavez administration implements *ad hoc* policies/legislation to secure both economic and political goals. This structure has proved contradictory on several occasions, diminishing the transparency with which the government carries out its legal functions and responsibilities.

Short-term improvements should be attained in data dissemination for the general government, while additional information on the non-financial public sector remains a medium-term objective. The main weakness will likely remain the lack of fiscal reporting for pension liabilities and quasi-fiscal operations from state-owned enterprises.

# EXECUTIVE SUMMARY

## 2.25 Intent declared

Venezuela has taken some measures to improve fiscal policy transparency in 2003, but the economic recession and rise in political tension have had many adverse effects. The discretionary use of resources from the Investment Fund for Macroeconomic Stabilisation (FIEM), the atypical methods of issuing/allocating government debt, and the selective enforcement of procurement regulations and foreign currency sales are hindering efforts to attain the legal requirements of transparency. Further, several state-owned enterprises have been created to operate in sectors where private firms have reduced their activities owing to government-imposed market restrictions.

As part of its commitment to the IMF's General Data Dissemination System (GDDS), Venezuela has achieved improvements in making available information on all government levels, some state-owned enterprises and debt. The Ministry of Finance's Office of Public Finance Statistics (OEFP) has been leading the overhaul of the country's computerised systems in order to expand the coverage on central government data to include the operations of social security institutions and non-financial public enterprises. With technical assistance from international organisations, data on regional and local governments is now ready for publication, and collating this information into the general government data will start by early 2004. Nevertheless, major improvements are still needed in reporting budget execution, contingent and pension liabilities, and the fiscal risks undertaken by state-owned enterprises and financial institutions.

Venezuela's overall score has improved from 2.00 in 2002 to 2.25.

## 1. Clarity of Roles, Responsibilities, and Objectives

●● Intent declared

**The government sector should be distinguished from the rest of the public sector and from the rest of the economy, and policy and management roles within the public sector should be clear and publicly disclosed.**

Venezuela is a decentralised republic, in which power is divided between the executive, the legislature (the National Assembly), and the judiciary. The executive and the National Assembly have continuously introduced new laws, reforms and decrees that have done little to consolidate the institutional framework envisaged in the constitution.[1] In this context, the increasingly politicised environment has led to considerable uncertainty in fiscal policy. The country has worked slowly to implement a comprehensive framework that governs fiscal relations between the national and sub-national levels of government. Progress in this area has been limited to the delineation of responsibilities over education and social security.

**Structure, functions, and responsibilities of government**

The constitution defines the relationship between the national and sub-national governments, and their respective jurisdiction over public and private sector economic activity. In 2003, the National Assembly approved additional laws governing budgetary planning and policy coordination at all levels of government[2], although legislation governing the financial process of states, and revenue transfers from the national government to states and municipalities for investment projects have yet to be approved. These laws aim to consolidate the framework for the decentralisation process, particularly requiring sub-national governments to follow planning principles similar to those of the federal government -- including multi-year planning and the development of operational plans to facilitate spending.

More importantly, the economic recession has given additional incentives for the government to embark on a stronger programme of economic guidance. In this context, several state-owned enterprises have been created to operate in those sectors where private investors have halted their activities owing to diverse market restrictions -- in particular, the controls on foreign exchange (introduced in February) and the lack of flexibility in labour regulations.[3] These quasi-fiscal activities have diminished the transparency with which the government carries out its legal functions and responsibilities.

**Coordination and management of budgetary activities**

The Organic Law on the Financial Administration of the Public Sector (LOAF, passed in 2000) establishes the general framework for financial management.[4] The LOAF constitutes a significant achievement in terms of fiscal management and transparency when compared to the previous fiscal regime. It establishes general principles for the budget process and the financial relationship between the federal government and the sub-national levels of government, decentralised agencies, and state-owned enterprises. The LOAF states that the Ministry of Finance (MoF) is responsible for the budget process, including the presentation of the budget bill and management of the budget execution.[5] The responsibility to issue regulations on budgetary matters and to execute the budget lies with the National Budget Office (ONAPRE) within the MoF.[6] The LOAF also establishes a unified treasury account and accounting system, the internal control system, and addresses aspects of macroeconomic coordination between the national government and the Central Bank of Venezuela (BCV).[7]

Commentators have stressed that the government is still implementing actions that contradict a number of principles set out in the LOAF, such as those concerning the need for transparency and macroeconomic stability. For example, the discretionary use of resources from the Investment Fund for Macroeconomic Stabilisation (FIEM) and the numerous reforms to its legal framework, the atypical methods of issuing/allocating government debt without auctions, and the selective enforcement of procurement regulations and foreign currency sales are perceived as contradicting the LOAF's requirements.[8]

After five amendments to the FIEM law (the last two made in January and April 2003), in October the National Assembly approved the preliminary articles of a law that transforms the FIEM into the new Macroeconomic Stabilisation Fund (FEM).[9] The FEM law aims to establish clear rules for disbursements, in order to allay concerns about the lack of clarity that previously characterised the FIEM.

**Relations between government and public sector agencies**

The relationship between the central government and other public sector agencies is clearly defined in the 1999 constitution. The BCV, the Office of the Comptroller General, the Office of the Prosecutor General, and the Office of the Defendant of the People are autonomous state entities.

However, several reforms to the BCV law and complementary regulations have clouded the central bank's actual autonomy. Since 2002, the government has been legally allowed to use profits earned by the BCV in the same fiscal year to meet cash shortages. This mechanism became more relevant after the introduction of a fixed exchange rate alongside foreign currency controls in February, since the new monetary regime could provide the government with additional revenues stemming from all foreign exchange transactions. Commentators have stressed that the monetary framework has been implemented with numerous *ad hoc* amendments, which are more in line with the government's political agenda rather than any economic rationale.[10]

Similarly, many legally independent regulatory agencies are in practice subject to considerable influence by the government. The Superintendence of Banks and Financial Institutions (SUDEBAN) is responsible for overseeing public and private financial institutions. However, several public banks are not subject to oversight by SUDEBAN, even though they perform important quasi-fiscal operations on behalf of the government. Special concern has been raised by the fact that many development banks, trust funds and state-owned enterprises generate considerable losses that are frequently financed with government bonds.[11]

**Government involvement in the private sector**

Articles 299-310 of the constitution set out the broad framework for government involvement in the private sector. The constitution reserves certain strategic sectors, such as the oil sector in particular, to government control. A number of other sectors deemed of national interest, such as tourism, are subject to state aid and protection. Since the end of 2002, the government has been increasingly involved in private sector activities: directly through the creation of state-owned enterprises that operate in sectors (such as manufactures and trade) where private firms have decreased activities owing to financial problems, and indirectly by selling bonds to commercial banks in order to finance public spending.[12] The fiscal risks involved in these operations have seldom been quantified.

The Oil Company of Venezuela (PDVSA) provides about 30% of the public revenues through taxes, transfers and profits and has a considerable role in the foreign exchange and financial markets. PDVSA has been used to fund a number of activities on behalf of the government and to carry out activities that weaken fiscal and monetary transparency in Venezuela. Commentators have long pointed out PDVSA's role in shaping monetary policy and foreign exchange objectives.[13]

## There should be a clear legal and administrative framework for fiscal management

Article 311 of the constitution establishes broad principles for fiscal management in Venezuela. These cover issues of transparency, responsibility, efficiency, and the need for balanced fiscal accounts. Based on these general principles, Venezuela has begun to enact a clear legal framework for budgetary activities, including the principles set out in the LOAF. However, progress has remained slow, and the Chavez administration has been unsuccessful in allocating spending and tax responsibilities at the sub-national level.

**Legal framework for budgetary activities**

Articles 311-313 of the constitution specify the legislature's role in the budget process. After the government submits the budget for legislative approval, the National Assembly may introduce changes to the bill, but these must be financed. The Assembly approves the debt plan issued by the government, but may not reduce revenues. If the executive fails to submit a budget bill or the National Assembly declines to approve it, the budget of the previous year is enacted. At the end of the fiscal year, the government must submit the public accounts statement to the National Assembly.

The Law on State Fiscal Management (*Ley de Hacienda Publica Estadal* -- LHPE), which sets out the fiscal process at the sub-national level, is yet to be approved by the National Assembly (the law was presented in March 2001). The LHPE would require multi-year planning with annual operative plans with clear targets and objectives, while also determining accounting and reporting guidelines. The proposed law prevents state and local governments from issuing or acquiring debt and introduces new measures to strengthen the capacity of sub-national governments to raise tax revenues. Commentators said that little progress had been achieved in the decentralisation programme in the last twelve months, which is corroborated by the fact that the MoF's Tax and Customs Administration Service (SENIAT) has re-established centralised tax collection mechanisms.[14]

**Legal framework for taxation**

The constitution specifies the principles that guide taxation. Law must specify all taxes, and exemptions must be determined at the same time. Taxes may not have expropriation effects and tax evasion is a criminal offence. The Organic Tributary Code (*Codigo Organico Tributario*) further develops the tax framework.[15] The code details the tax base, the tax subjects, the procedure to create taxes and to issue tax exemptions, and behavior that can lead to conviction and imprisonment. The code also establishes legal procedures for dispute settlement and resort to the court of appeals.

**Ethical standards for public servants**

The constitution and complementary legislation determine ethical standards for public servants. The Public Service Statute (*Ley Sobre el Estatuto de la Funcion Publica*) provides ethical standards required for public employees at all government levels, and includes hiring, promotion and contract termination procedures.[16]

## 2. PUBLIC AVAILABILITY OF INFORMATION

●●● Enacted

### The public should be provided with full information on the past, current, and projected fiscal activity of government.

**Central government operations**

The MoF publishes annual, quarterly, and monthly fiscal information on the activities of the central government on its website. Ahead of its submission to the National Assembly, the ONAPRE publishes the budget draft that includes forecast revenues, expenses, and financial requirements.[17] Nevertheless, commentators have stated that the MoF/ONAPRE have persistently underestimated the government's financial needs and overestimated oil and tax revenues.[18] Budget documents do not compare appropriations with effective budgetary execution, although year-end data are available on the ONAPRE website (from the 1999 fiscal year onwards).[19] Models and methodology used to estimate and forecast fiscal activity are not publicly available.

A number of forecasts for quasi-fiscal activities and contingent liabilities are available on the *Multi-annual Budget Framework for FY 2003-04* (published in July 2002).[20] However, most assumptions are regarded as outdated, given the discrepancies created by the oil strike at the beginning of this year and the generalised economic recession.[21]

The MoF publishes an *Annual Report* containing a detailed review of fiscal performance during the past fiscal year as well as reports from the ONAPRE and the Treasury Office.[22] In addition, the MoF makes available monthly/quarterly statistics for central government budgetary operations[23] and submits public accounts to the National Assembly at the end of each fiscal year.

**Public sector operations**

Full details of the fiscal activities of general government are not available, although the Office of Public Finance Statistics (OEFP, under the MoF) plans to incorporate most sub-national level information in early 2004.[24] The MoF releases data on the 'Narrowly Defined Public Sector' (*Sector Publico Restringido*), which includes quarterly updates on the fiscal performance of the central government, decentralised institutions and a number of non-financial state-owned enterprises.[25]

The MoF also publishes the consolidated narrowly defined public sector accounts, which include data for public financial institutions. The accounts provide details of quasi-fiscal operations by the BCV and transfers to public and private individuals. Quasi-fiscal operations undertaken by state-owned enterprises and public financial institutions are not disclosed.

### A commitment should be made to the timely publication of fiscal information.

The public finances chapter of the constitution and the LOAF both acknowledge the need for fiscal transparency. The LOAF contains requirements for the timely submission of fiscal information to the National Assembly. The government has improved the collection of information from state-owned enterprises and has improved the timeliness of data releases and publications.

**Debt reporting**

As part of Venezuela's commitment to the IMF's General Data Dissemination System (GDDS), the country publishes annual and quarterly domestic and foreign debt data. In addition, the MoF website posts a report by the minister of finance to the National Assembly on debt operations, prospects, and financial strategy. The MoF details its daily debt operations through press releases and weekly balance reports. However, commentators have expressed concern about the lack of clarity with which government bonds are distributed (without auctions) to a number of state-owned enterprises and social security agencies to finance their liabilities.[26]

**Advance release calendars**

The MoF's website includes an advance release calendar, and a description of reporting guidelines, definitions, and classifications.[27]

## 3. Open Budget Preparation, Execution, and Reporting

●● Intent declared

### Fiscal policy objectives, macroeconomic framework, and risks

Under the terms of the LOAF, Venezuela should adopt an open budget preparation framework. Budgets are expected to reflect the planning process and contain measurable objectives and resource allocations. The LOAF also requires the use of a multi-year primary fiscal balance framework for investment projects funded by debt issues. However, in practice Venezuela's budgetary process is far from meeting these requirements. The budget bill excludes the budgets of state-owned enterprises, which are separately reviewed and approved by the president and the Council of Ministers.

**Fiscal policy objectives**

The Ministry of Development Planning (MPD) publishes the *Annual Economic Plan*, which discloses fiscal policy objectives for the relevant fiscal year.[28] The *National Development Plan 2001-2007* forecasts fiscal performance for the entire presidential term, although it is not updated to reflect changing economic and fiscal conditions.[29] The government's main fiscal policy objectives are to recover the stability of fiscal aggregates and achieve a fiscal balance in the medium term. However, the poor performance of Venezuela's economy and the ongoing political crisis has led to a severe deterioration of the country's fiscal accounts.

**Macroeconomic framework**

A basic macroeconomic framework, which is prepared by the government and the BCV, is included in the budget bill. The framework is developed using a general equilibrium model that incorporates economic growth, oil prices, foreign exchange depreciation, and interest rates. The SENIAT estimates tax revenue used for revenue forecasting, but commentators stated that actual tax revenues have rarely met SENIAT estimates. In addition, there are doubts about the reliability of the macroeconomic assumptions with regard to oil production/revenues, which are expected to be much lower than the budgeted amount.[30]

**Fiscal risks**

The LOAF requires the budget to include all fiscal risks including contingency scenarios for oil revenues and contingent liabilities. However, the 2004 budget does not include a detailed description of fiscal risks or contingent liabilities. The *Multi-annual Budget Framework for FY 2003-04* has a broader analysis of fiscal risks, but these figures have not been updated since mid-2002 and the methodology employed is considered to be inadequate.[31]

**Fiscal sustainability**

The LOAF requires that the multi-year financial plan promote fiscal sustainability by incorporating fiscal primary balances by the end of the plan's term. The *Multi-annual Budget Framework for FY 2003-04* includes a detailed analysis of fiscal sustainability, but it should be updated in order to reflect true economic conditions.

## Budget presentation

Venezuela has made some progress in improving the presentation of the budget. The 2004 budget documentation does include more information than in previous years, but additional efforts are needed to incorporate all the data mandated by the LOAF. Fiscal transparency would be enhanced if an updated multi-annual framework could be incorporated into each fiscal year's budget.

**Data reporting**

The current budgetary framework mandates a wealth of budgetary information that includes detailed policy objectives, human resource needs, and budgetary execution of the previous five years. The government continues to make progress on data reporting, but many areas for improvement remain. New programmes, changes to the *National Development Plan*, and resources transferred to pension liabilities are not clearly explained or measured in terms of their fiscal impact. Budget data are classified by institution, policy function, and type of expenditure; information at programme level is not available.

## Budget execution and monitoring

The provision of information on the execution of the budget is particularly crucial in the case of Venezuela, because the lag in budgetary execution by the end of the fiscal year has typically been close to 20% of the overall budget. This has often led to considerable under-estimation of the budget deficit. Typically, the Venezuelan budget continues to be executed well into the following year. For example, the transfer of resources to sub-national governments as mandated by the 2002 budget law was still taking place in early 2003.

The ONAPRE and the Treasury Budget Office are in charge of budgetary execution and monitoring. Fiscal data is compiled through the Integrated System of Public Finance Management and Supervision (SIGECOF). However, up to date information on execution of the consolidated budget is not available; the ONAPRE reports changes to the budgeted disbursements throughout the year, but does not record the percentage of actual disbursements compared to total appropriations.[32] However, the MoF, the MPD and the Office of the Comptroller General are developing an *Integrated Management and Financial Information System* that will allow the real-time recording of expenditures and monitoring of budget execution in future.

The SENIAT is the sole tax administration agency in Venezuela.[33] It has legal, administrative, financial, and technical independence from the executive. However, the executive appoints the head of the SENIAT, and during the last three years there have been three presidential appointees. Since 2002, the government has reformed on several occasions the legal framework of the value added tax, income tax, and the tax on bank debits; the frequency of changes to the tax regime reflects the paucity of technical assessment when drafting tax laws.[34]

**Accounting basis**

Budgetary revenues and expenditures are recorded on a cash basis, which can lead to the underestimation of the annual budget deficit. Accounting records are kept by the National Treasury, and are derived from payment orders settled by the Treasury. The MoF provides only limited information on the procedures followed in compiling budgetary data, but a comprehensive online list of the accounting and audit practices for the public sector are available from the Comptroller General's website.[35]

**Procurement and employment**

Venezuela reformed its Law on Procurement (*Ley de Licitaciones*) in November 2001.[36] The current framework establishes a national registry of providers of goods and services to the government and guidelines for a transparent selection process that includes the use of electronic platforms. However, commentators asserted that many government agencies have used the provisions of Chapter II (Articles 87-89) of the law to override the selection process and assign contracts directly, which is increasingly perceived as a sign of corruption.[37]

## Fiscal reporting

The LOAF and the constitution mandate the MoF to produce the *Annual Report* for submission to the National Assembly. The report contains detailed information of fiscal performance during the relevant fiscal year. Similarly, the budget bill includes a report of execution of appropriations during the previous fiscal year together with new budget allocations.

## 4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY

●● Intent declared

### Data quality standards

As part of its commitment to the IMF's GDDS, the OEFP has been working to expand the coverage on central government data to include the operations of social security institutions and non-financial public enterprises. With technical assistance from international organisations, data on regional and local governments is now ready for publication, and collating this information into the general government data will start by early 2004.[38] In addition, the OEFP plans to incorporate the accounts of non-financial public enterprises to obtain the balance for the non-financial public sector by mid-2004.

Budget data are reported following clear accounting guidelines, and are subjected to independent internal and external auditing. The National Superintendence of Government Accounting and Audit crosschecks the balance sheets of public agencies and institutes. The reports produced by the Superintendence are more reliable than government data as they follow a modified accrual accounting methodology that incorporates changes in the budgetary lag, rather than the cash-based methodology followed by the MoF.

### Independent scrutiny of fiscal information

**Independent Audit**

Under the *Organic Law of the Comptroller General*, the Office of the Comptroller General is an autonomous entity responsible for monitoring fiscal operations, including the transparent use of public resources and the performance audit of public management. However, there is a perception that the comptroller's office is technically weak and lacks sufficient independence from the executive.[39] The 2002 reports on *Public Management and Fiscal Performance* are hitherto not available on its website. A selection committee that includes representatives of the state legislative bodies and from civil society elects state comptrollers in an open process.

**National Statistics Agency**

The OEFP is responsible for gathering and reporting fiscal data. The National Institute of Statistics (INE) is a devolved body of the MPD, and by law it has the authority and responsibility for planning and implementing the organisation and development of an integrated national accounting system.[40] However, the INE does not possess auditing functions to verify the government's financial statistics. Further, commentators said that since the beginning of this year, INE's data compilation (e.g. population, unemployment and national accounts) have been subject to technical interference to fulfil political interests.[41]

## INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to Venezuela between 27 and 30 October 2003:

### Ministry of Finance

**29 October 2003**

| | | |
|---|---|---|
| Elke Wecke | General Director | Government Finance Statistics |
| Nora Guarata | Adviser | Vice Minister Office |

### Central Bank of Venezuela (BCV)

**30 October 2003**

| | | |
|---|---|---|
| Jose Guerra | Manager | Economic Research Office |

## ADDITIONAL INTERVIEWS

**27 October 2003**

| | | |
|---|---|---|
| Luis Ernesto Andueza | Partner | Macleod Dixon Solicitors |
| Antonio Casas | Board Adviser | Tecnoconsult |

**28 October 2003**

| | | |
|---|---|---|
| Domingo Fontiveros | Chair | FEDECAMARAS |
| Haydee Cisneros de Salas | | Economy and Finance Committee |
| Carlos Hernandez Delfino | | |
| Tamara Herrera | | |
| Amparo Parejo de Hibirma | | |
| Ignacio Enrique Oberto | | |
| Carlos Mollinedo | Economist | World Bank |
| Maria Magdalena Colmenares | Senior Social Specialist | |
| Angel Cardenas | Consultant | |

**29 October 2003**

| | | |
|---|---|---|
| Richard Obuchi | Public Policy Centre | IESA |

**30 October 2003**

| | | |
|---|---|---|
| Mercedes De Freitas | Head | Mirador Democratico |
| Robert Bottome | Director | Veneconomia |

## NOTES

[1] Constitucion de la Republica Bolivariana de Venezuela (as amended, in Spanish only): www.gobiernoenlinea.ve/documentos/PG_CAREA_GENERAL/PG_FOLDER_NORMATIVA_LEGAL/CONSTITUCIONES/CONSTITUCIONBOLIVARIANA.PDF
[2] Law on Local Planning Councils (*Ley de los Consejos Locales de Planificación Publica*) and Law on Public Policy Coordination (*Ley de Coordinacion de Politicas Publicas*).
[3] Interviews in Venezuela, 27-30 October 2003.
[4] Organic Law of the Financial Administration of the Public Sector (LOAF): www.mf.gov.ve/mfen/acrobat/ley_ing.pdf
[5] Ministry of Finance (MoF): www.mf.gov.ve
[6] National Budget Office (*Oficina Nacional de Presupuesto*, ONAPRE -- previously OCEPRE): www.ocepre.gov.ve
[7] Central Bank of Venezuela: www.bcv.org.ve
[8] Interviews in Venezuela, 27-30 October 2003.
[9] *Ley que Crea el Fondo de Estabilizacion Macroeconomica* (FEM, in Spanish only): www.asambleanacional.gov.ve/ns2/leyes.asp?id=336
[10] Interviews in Venezuela, 27-30 October 2003.
[11] Interviews in Venezuela, 27-30 October 2003.
[12] Interviews in Venezuela, 27-30 October 2003. Commentators were particularly concerned about the use of monetary policy instruments (foreign currency controls) to implement fiscal policy. In this context, the controls have boosted the country's domestic monetary liquidity that -- in addition to depleted credit operations and increased non-performing loans -- have left private banks with the option of buying government debt to guarantee profits in future.
[13] Interviews in Venezuela, 18-20 November 2002.
[14] Interviews in Venezuela, 27-30 October 2003.
[15] The Organic Tributary Code (*Codigo Organico Tributario*, in Spanish only): www.seniat.gov.ve/pls/portal/docs/PAGE/SENIAT_CA/SENIAT/TRIBUTOS_INTERNOS/NORMATIVA/COT/COT.PDF
[16] Public Service Statute (*Ley Sobre el Estatuto de la Función Publica*, in Spanish only): www.venezuela.gov.ve/ns/Leyfuncionpublica.asp
[17] Budget Proposal for FY 2004 (*Proyecto de Ley de Presupuesto 2004*, in Spanish only): www.ocepre.gov.ve/informacion/Ley_2004/Ley2004.html
[18] Interviews in Venezuela, 27-30 October 2003.
[19] For example, see Budget Execution (*Asignacion y Ejecución Financiera del Presupuesto 2002*, in Spanish only): www.ocepre.gov.ve/documentos-publicaciones/Clasificacion%20E_S_PO_PCG/2002/Boletin3009.pdf
[20] *Marco Plurianual del Presupuesto, para los Ejercicios Fiscales 2003 – 2004*, (in Spanish only): www.ocepre.gov.ve/documentos-publicaciones/MarcoPlurianual/MPP%202003-2004.pdf
[21] Interviews in Venezuela, 27-30 October 2003. For example, the multi-annual framework forecasts 3.5-4.5% GDP growth for 2003, while domestic analysts currently anticipate a –12% contraction. In addition, the accuracy of information on oil production has diminished considerably, and thus the forecast oil revenues are deemed unreliable.
[22] *Memoria 2002 del Ministerio de Finanzas* (in Spanish only): www.mf.gov.ve/acrobat/MEMORIA%202002%20-completa-.pdf
[23] OEFP Central Government statistics: www.mf.gov.ve/mfen/estadisticas_con_est1.htm
[24] Interviews in Venezuela, 27-30 October 2003.
[25] OEFP Restricted Public Sector statistics: www.mf.gov.ve/mfen/estadisticas_con_est1.htm
[26] Interviews in Venezuela, 27-30 October 2003.
[27] www.mf.gov.ve/mfen/calendario.htm
[28] *Plan Operativo Anual Nacional* (POAN, in Spanish only): www.mpd.gov.ve/poan2003/poan2003.htm
[29] *Plan de Desarrollo Economico y Social de la Nacion 2001-2007* (in Spanish only): www.mpd.gov.ve/pdeysn/plan.htm
[30] Interviews in Venezuela, 27-30 October 2003. This is of particular concern given that about 30% of all government revenues come from the oil sector. If the budgeted target were not met, spending would have to be financed with additional debt.
[31] Interviews in Venezuela, 18-20 November 2002. The methodology used in annual or multi-annual budgeting was not available for consultation.

[32] *Ley de Presupuesto y Modificaciones 2003* (as amended on August 22, 2003, in Spanish only): www.ocepre.gov.ve/documentos-publicaciones/Acordado/2003/acordado.pdf
[33] National Integrated Tax Management Service (*Servicio Nacional Integrado de Administración Tributaria*-SENIAT): www.seniat.gov.ve
[34] Interviews in Venezuela, 27-30 October 2003.
[35] Accounting and audit practices (in Spanish only): www.cgr.gov.ve/no_publicaciones.html
[36] *Ley de Reforma Parcial a la Ley de Licitaciones* (in Spanish only): www.venezuela.gov.ve/ns/Leylicitaciones.asp
[37] Interviews in Venezuela, 27-30 October 2003.
[38] For example, the compilation of information on mayors' offices is being arranged under the *alcaldia digital* programme: www.alcaldiadigital.cnti.ve
[39] Interviews in Venezuela, 18-20 November 2002.
[40] INE: www.ine.gov.ve
[41] Interviews in Venezuela, 27-30 October 2003.