

ECONOMIC POLICY DESIGN AND ANALYSIS

EARMARKED FUNDS AND FISCAL SPACE

FRITZ A. GOCKEL (POLICY ANALYST)

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Getting The Best Out Of Fiscal Policy

- Fiscal Transparency Issues
 - Budget As Total Fiscal Transaction
 - General Principles of Fiscal Transparency
 - **Earmarked Tax/Funds**
 - **Quasi-Fiscal Activities**
 - Lessons From Ghana
 - Recommendations

Budget As Total Fiscal Transaction

- The way in which the term "budget" is defined is crucial. In some countries, the term is restricted to the estimates related to *annual appropriations* of funds by the legislature
- This concept, however, may capture only a small proportion of total fiscal transactions.
- Various kinds of operations may be set up outside the annual appropriations process, and are thus referred to as extra-budgetary, and are distinct from the general fund of government.

Best Practice Issues About Budgets

- **General Principles of
Fiscal Transparency**

General Principles of Fiscal Transparency

- **Clarity of Roles and Responsibilities** —is concerned with specifying the structure and functions of government, responsibilities within government, and relations between government and the rest of the economy.
- **Public Availability of Information** —emphasizes the importance of publishing comprehensive fiscal information at clearly specified times.
- **Open Budget Preparation, Execution, and Reporting** — covers the type of information that is made available about the budget process.
- **Assurances of Integrity** —deals with the quality of fiscal data and the need for independent scrutiny of fiscal information

Basic Requirements of Fiscal Transparency

- **Clarity of Roles and Responsibilities**

- The structure and functions of government should be clearly specified. *An institutional table should be published showing the structure of government and the rest of the public sector*
- Relations between the government and non-government public sector agencies (i.e., the central bank, public financial institutions, and non-financial public enterprises) should be based on clear arrangements to *avoid quasi fiscal activities*
- *The annual reports of public financial institutions and non-financial public enterprises should indicate the noncommercial services that the government requires them to provide*
- *Privatization of government assets should be open to independent audit.*

Public Availability of Information (1)

- Budget documentation, final accounts, and other fiscal reports for the public should cover all budgetary and extra-budgetary activities of the central government, and the consolidated fiscal position of the central government should be provided. *Detailed statements should be provided for all extra-budgetary funds.*
- Statements describing the nature and fiscal significance of central government contingent liabilities and tax expenditures, and of quasi-fiscal activities, should be part of the budget documentation.
- *Such statements should indicate the public policy purpose of each provision, its duration, and the intended beneficiaries. Where possible, major provisions should be quantified.*

Public Availability of Information

(2)

- The central government should publish full information on the level and composition of its debt and financial assets.
- Where subnational levels of government are significant, their combined fiscal position and the consolidated fiscal position of the general government should be published.
- *Sub-national levels of governments should also report publicly on their extra-budgetary activities, debt and financial assets, contingent liabilities, and tax expenditures, and on the quasi-fiscal activities of public financial institutions and nonfinancial public enterprises under their control.*
- The publication of fiscal information should be a legal obligation of government

Open Budget Preparation, Execution, and Reporting (1)

- The annual budget should be prepared and **presented** within a comprehensive and consistent quantitative macroeconomic framework, and the main assumptions underlying the budget should be provided. *This information should be provided in a background paper that is part of the budget documentation.*
- Budget data should be reported on a gross basis, **distinguishing revenue, expenditure, and financing, with expenditure classified by economic, functional, and administrative category.**
- There should be a comprehensive, integrated accounting system which provides a reliable basis for assessing payment arrears. *Cash accounting reports should be supplemented by accounts-based reports of bills due for payment to assess arrears.*

Open Budget Preparation, Execution, and Reporting (2)

- A mid-year report on budget developments should be presented to the legislature *within three months of the mid-year*. More frequent (at least quarterly) reports should also be published. *Details of central government debt and financial assets should be published annually, within six months of the end of the fiscal year.*
- Final accounts should be presented to the legislature within a year of the end of the fiscal year. *The coverage of final accounts, and the timing of their presentation, should be specified in the budget law*

Assurances of Integrity (1)

- Budget data should reflect recent revenue and expenditure trends, **underlying macroeconomic developments, and well-defined policy commitments**. *Summary information on revenue forecasts and expenditure estimates should be provided in a background paper that is part of the budget documentation, and detailed supporting information should be available for independent scrutiny.*
- The annual budget and final accounts should indicate the accounting basis (e.g., cash or accrual) and standards used in the compilation and presentation of budget data.
- Specific assurances should be provided as **to the quality of fiscal data**. **In particular, it should be indicated whether data in fiscal reports are internally consistent and have been reconciled with relevant data from other sources.**

Assurances of Integrity (2)

- *A background paper should be included with the budget documentation which analyses the difference between budget forecasts of the main macroeconomic and fiscal aggregates and the outturn for recent years.*
- *There should be rigorous reconciliation of fiscal and monetary data, and where reconciliation processes are weak, this should be drawn to public attention (e.g., in audit reports) in a timely manner.*
- A national audit body or equivalent organization, which is independent of the executive, should provide timely reports for the legislature and public on the financial integrity of government accounts. *Such a body should be set up under law. There should be mechanisms to help ensure that remedial action is taken in response to adverse findings in external audit reports.*

Extra-Budgetary Transactions

Budget As
Total Fiscal
Transaction
REVISTED

Extra-Budgetary Funds

- **Earmarked taxes**

- Taxes raised and allocated to specific expenditure programs, often through an extra-budgetary fund

- **Extra-budgetary funds**

- refers to sets of government transactions that are not included in the annual budget presentation. These may not be subject to the same level of scrutiny or accounting standards as the annual budget.
- A wide variety of extra-budgetary arrangements are used, including funds set up under separate legislation, commodity funds that use proceeds of commodity aid, and earmarking specific kinds of revenue for specific purposes

Earmarked Funds

- It is not uncommon for government agencies to be allowed to use revenue from fees and charges directly for expenditure (e.g., hospital fees and charges that are used by the health administration without first being transferred to the general fund of government).
- Some countries have set up extra-budgetary funds and channel *earmarked taxes* to them.
- **The channelling of earmarked taxes to extra-budgetary funds is common where there is a strong link between taxes and benefits, emphasis on which may result in earmarked taxes being more easily accepted than regular taxes e.g. NHIS Levy in Ghana**

Implications Of Extra-Budgetary Funds(1)

- Although there may be valid reasons for setting up some funds outside the budget, and for earmarking, excessive use of such arrangements can diminish transparency (as well as reduce fiscal policy control and flexibility).
- It is therefore important that the activities of extra-budgetary funds are subject to the same discipline as budget appropriations.
- Moreover, there should be rules and regulations regarding the accountability of extra-budgetary fund management, and the accounting and auditing of extra-budgetary funds.

Implications Of Extra-Budgetary Funds (2)

- Often there are transfers from the budget to extra-budgetary funds, and there is risk to the budget if fund revenue is lower or expenditure is higher than expected
- Activities undertaken through **extra-budgetary funds should be less influenced by the short-term considerations that affect the budget, and may even be governed by separate legislation.** Social security has these characteristics

Implications Of Extra-Budgetary Funds(3)

- The more general point is that all fiscal activities should be subject to review and priority setting as part of the budget process.
- **All fiscal activities should also be open to scrutiny by the legislature and the public.**
- This requirement should apply even to extra-budgetary funds that are independently managed and under separate legislative authority.
- Otherwise, such funds could be subject to abuse

Implications Of Extra-Budgetary Funds(4)

- Earmarked taxes and netting operations should be clearly shown and accounted for, just as in other areas of administration.
- If, for instance, a tax department is authorized to use a share of the revenue it collects from audits for staff bonuses or certain administrative expenditure, then the rules on the use of these funds should be clearly specified and normal accounting regulations should apply.

Quasi-Fiscal Activity

- **Definition:**

- Activities, under the direction of government, of central banks, public financial institutions, and non-financial public enterprises, that are fiscal in character.
- That is, in principle, they can be duplicated by specific fiscal measures, such as taxes, subsidies or other direct expenditures, even though precise quantification can in some cases be very difficult.
- Examples include subsidized bank credit and non-commercial public services provided by an enterprise

Types of Quasi-Fiscal Activity (1)

- *Operations related to the financial system*
 - **Subsidized lending**
 - **Administered lending rates**
 - **Preferential rediscounting practices**
 - **Poorly secured and sub-par loans**
 - **Loan guarantees**
 - **Under-remunerated reserve requirements**
 - **Credit ceilings**
 - **Rescue operations**

Types of Quasi-Fiscal Activity (2)

- *Operations related to the exchange system*
 - **Multiple exchange rates**
 - **Import deposits**
 - **Deposits on foreign asset purchases**
 - **Exchange rate guarantees**
 - **Subsidized exchange risk insurance**

Types of Quasi-Fiscal Activity (3)

- *Operations related to the commercial enterprise sector*
 - **Charging less than commercial prices**
 - **Provision of non-commercial services (e.g., social services)**
 - **Pricing for budget revenue purposes**
 - **Paying above commercial prices to suppliers**

Ghana's Experience With Transparency Issues(1)

- **Ghana meets the standards of the fiscal transparency code in several areas. In particular:**
 - **(i) the responsibilities of the different branches of government are clearly defined;**
 - (ii) a transparent and fairly comprehensive legal and administrative framework for budget preparation and execution has been put in place;
 - **(iii) the annual budget is based on a comprehensive and consistent quantitative macroeconomic framework;**

Ghana's Experience With Transparency Issues(2)

- **(iv) the budget statement discusses the main assumptions underlying the budget and provides an overview of the implementation of fiscal policies for the previous year and the objectives for the current year; and**
 - (v) budget data are presented on a gross basis, classified by institution and economic and functional category.

Ghana's Experience With Budget Coverage (1)

- **Ghana's budget documents cover most central government fiscal activities.**
- The annual budget statement provides comprehensive coverage of economic and financial performance and new fiscal policies.
- **Budgets contain summary tables of macroeconomic performance and forecasts and main fiscal aggregates as well as matrix-form tables of discretionary expenditures funded by domestic general revenues (the so-called "Government of Ghana" funds) and foreign donor funds, respectively, broken down by organizational and economic classifications**

Ghana's Experience With Budget Coverage (2)

- The summary table intends to capture all expenditures financed by Government of Ghana funds, donor resources and internally generated funds.
- **Ghana's Budget distinguishes such statutory payments as debt service, transfers to households, subsidies for utility companies and Tema Oil Refinery and transfers earmarked for the statutory funds (i.e., DACF, GETF, the Road Fund, and the Petroleum Related Fund) from discretionary payments, including VAT refunds and arrears clearance**

Ghana's Experience With Budget Coverage (3)

- **The Appropriation Bill contains a detailed breakdown of discretionary expenditure. More detailed “Annual Estimates” of expenditure by spending agencies, that amount to several *volumes* each in many cases, include activities financed from the domestic and foreign sources and, as far as possible, from the internally generated funds of spending agencies.**
- A “Review of Economic Performance,” presented in the second half of the year, assesses economic developments and provides aggregated fiscal data for the first six months.
- **Defense expenditures are identified and reported in the same format as the other expenditure heads**

BUT..... (1)

- **In spite of the progress, the transparency of fiscal activities still falls short of the standards in a number of important areas.** The most significant shortcomings are:
 - (i) the coverage of the general and central government in the budget documents and, in particular, the fiscal reports remains incomplete;
 - (ii) a significant amount of budget spending is conducted through transfers to statutory funds, the spending of which is not consolidated with that of central government and sometimes poorly reported;
 - (iii) internal and external audits are ineffective, resulting in weak oversight and a major backlog of audit reports; and
 - (iv) laws and regulations are implemented in a manner that hampers private sector activity

BUT..... (2)

- **Operations of the local government are outside the scope of the budget documents.**
 - The Local Government Act requires district assemblies to produce annual budgets, regular expenditure reports, and audited annual accounts
 - None of these documents are prepared in a comprehensive and timely way and made available to the public.
 - **However, aggregate transfers to the DACF—which in turn are allocated to Metropolitan, Municipal and District Assemblies (MMDAs) mainly for infrastructure development—are subject to parliamentary approval and publicly documented.**
 - Spending by local units of Ministries, Departments and Agencies (MDAs)—which is part of discretionary expenditure as reported in the budget documents—appears to account for most of the overall operational expenditure at the local assembly level.

BUT..... (3)

- **Most mineral revenues are fully reflected in the budget and accounts, but sustainability issues are not explicitly addressed in the budget.**
 - **Mining revenues other than the earmarked 20 percent of royalties and the property taxes levied by the District Assemblies go to the central government.**
 - **They are fully fungible with the other resources in the Consolidated Fund and spent through the standard appropriation process. Including personal income (PAYE) taxes, these mining revenues have accounted for around 10 percent of GoG revenue in recent years.**
 - The sector's contribution to GoG revenue is expected to remain broadly unchanged in the coming years but, given the mature nature of most mining operations in Ghana, it is expected to diminish over the medium to long term
 - There are no policies in place to set aside part of the GoG mining revenues for the benefit of future generations. Fiscal risks arising from mineral revenue volatility are not explicitly considered in the budget documents.

Conclusion

- Sufficient Progress has been made in Ghana on Fiscal Transparency and Budget Coverage
- There are Challenges to ensure more efficacy in the Budgetary process and implementation as a tool of development policy

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