

Guide to Transparency in Public Finances

Looking Beyond the Core Budget

3. Quasi-fiscal Activities



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Introduction

For more than a decade, civil society organizations around the world, as well as international financial institutions, have been pushing for governments to provide the public with more comprehensive budget information. The International Budget Partnership's (IBP) Open Budget Survey examines the accessibility in countries around the world of eight key budget reports that governments should publish in order to enable civil society, oversight institutions, and members of the public to participate effectively in budget processes and hold governments accountable for how they use public money. In two companion guides to the briefs listed below — the *Guide to Transparency in Government Budget Reports: Why Are Budget Reports Important, and What Should They Include?* and the *Guide to Transparency in Government Budget Reports: How Civil Society Can Use Budget Reports for Research and Advocacy* — the IBP describes the importance of each key budget report, the information that it should contain, and how civil society organizations can use them.

This is one of five briefs that goes beyond the eight key budget reports covered in the guides to examine other areas of public finance that are less well understood and especially vulnerable to efforts to shield them from public scrutiny. The other briefs are:

- ➔ Extra-budgetary Funds
- ➔ Tax Expenditures
- ➔ Contingent Liabilities
- ➔ Future Liabilities

All of the briefs examine the following questions:

- ➔ What are these issues or activities, and why are they of interest?
- ➔ What information should the government include in budget documents and other reports on these issues in order to provide a comprehensive picture of the government's fiscal position and increase the public's understanding of how their money is being utilized?
- ➔ How can civil society groups use information contained in these documents to achieve their research and advocacy goals?
- ➔ Where can further information, country examples, and “model reports” be found?

The briefs are based on existing guidance and practices related to these areas of public finance gathered from various sources. In some cases, concrete examples are scarce, as these are new and complex areas of public budgeting.

The IBP will continue to build on this material and identify further public finance issues and activities that are typically shielded from public scrutiny but may have a major bearing on a country's public finances. Any additional briefs will be added to the IBP's website at: www.internationalbudget.org.

Quasi-Fiscal Activities

Like tax expenditures, quasi-fiscal activities represent “hidden expenditures,” are often invisible, and tend to benefit narrow groups. Every effort should be made to eliminate them, but at the very least they should be reported on transparently, and their fiscal impact measured.

A. What are quasi-fiscal activities, and why are they of interest?

Quasi-fiscal activities are any activities undertaken by state-owned banks and enterprises, and sometimes by private sector companies at the direction of the government, where the prices charged are less than usual or less than the “market rate.” Examples include subsidized bank loans provided by the central bank or other government-owned banks, and noncommercial public services provided by state-owned enterprises. A typical example would be state-owned enterprises providing fuel, electricity, or water at below market prices, thus providing an implicit price subsidy. If not clearly included in the government’s financial reports, quasi-fiscal activities are a particular type of extra-budgetary transaction.

Quasi-fiscal activities are usually undertaken at a loss or below the usual rate of profit. Thus they could, in principle, be replaced by specific taxes, subsidies, or other direct expenditures that would have the same net effect on the price at which these services are offered but bring them onto the budget books.

In recent years there has been an increased emphasis on governments having a balanced budget and low levels of debt. Such prescriptions may increase incentives for governments to use quasi-fiscal activities that mask the true cost of their policies and thus make their fiscal position look better than it really is.

The International Monetary Fund has provided the following outline of different types of quasi-fiscal activities, to which some examples are added to clarify how they might work (IMF 2007: p. 80).

Operations related to the financial system

- ➔ Subsidized lending, where state-owned banks provide subsidized loans to state enterprises or the private sector
- ➔ Under-remunerated reserve requirements, where banks are required to hold reserves on which they gain a reduced profit from that which they could earn by investing the funds

- Credit ceilings, where banks are subject to a limit on the amount of credit which they are allowed to issue

Operations related to the exchange and trade systems

- Multiple currency exchange rates, where the central bank may use a series of different exchange rates for different transactions, for example, by giving a state-owned enterprise a better rate
- Import deposits, where companies may be required to pay a deposit to the central bank to cover the cost they will eventually pay on imports
- Exchange rate guarantees, where the central bank may provide government contractors with guarantees on the exchange rate they will be required to pay on imports
- Nontariff barriers, where imports of certain goods that compete with products produced in the country may be banned or restricted

Operations related to the commercial enterprise sector

- Charging less than commercial prices, where state-owned enterprises may provide, for example, electricity at a subsidized price to some or all consumers
- Provision of noncommercial services (e.g., social services), where state-owned companies may provide some services at less than full cost; for example, universities may not charge the full cost of tuition
- Pricing for budget revenue purposes, where state-owned enterprises may be in a monopoly position and so may be able to charge prices above what a competitive market might establish to raise revenue for the government
- Paying above commercial prices to suppliers, where local suppliers may be paid above the market rate as a form of protection for their industry

What constitutes a quasi-fiscal activity, and what does not, are complicated issues. The identification of quasi-fiscal activities assumes that a clear distinction can be made between the transactions of state-owned enterprises (including banks) that are undertaken on a commercial basis, and those whose goal is to provide a public service rather than to earn a profit. Determining whether something is a quasi-fiscal activity also assumes that there is a general commercial rate of profit and so transactions that do not achieve this rate may be identified. In addition, although the government may direct a state-owned enterprise to provide a loan at a certain rate of interest or to provide services at a certain price, the market price or the price at which the state-owned enterprise would have provided its services without the government direction may not be so easy to determine, especially if the state-owned enterprise is operating as an effective monopoly.

Examples of quasi-fiscal activities and how they are treated in budgets include Azerbaijan, where fuel subsidies provided by the national oil company, SOCAR, were eventually put on budget by recognizing the amount of the subsidy in the budget and granting SOCAR tax credits for the same amount. Likewise, in Ghana there are indirect expenditures made to independent power producers that provide power to the Electricity Corporation of Ghana, a public corporation. The Electricity Corporation pays the power producers a higher rate for the electricity they provide than is charged for the users of this electricity. The costs of providing such energy subsidies to ratepayers are not reported in the government's budget (Chivaluk and York 2006).

B. What information should the government include in budget documents and other reports on quasi-fiscal activities?

The IMF Manual on Fiscal Transparency (IMF 2007) provides a series of indications regarding how governments should cover quasi-fiscal activities in their budget documents. To start with, budget documentation should include statements on the purpose, duration, and intended beneficiaries of each quasi-fiscal activity, based on information provided by those agencies that undertake these activities, whether state-owned enterprises or the central bank. In turn, public corporations should include in their reports specific information on, for example, noncommercial services that the government requires them to provide or lending to other government-owned agencies, while central banks should report on any nonmonetary policy activities that they conduct on behalf of the government.

South Africa provides a good example of openness with regard to quasi-fiscal activities. All quasi-fiscal activities are included either in the main budget or in the budgets of the relevant extra-budgetary agencies. In India, in contrast, a number of government companies and institutions also perform quasi-fiscal activities. For example, oil companies charge less than the market price to consumers, and the Reserve Bank of India intervenes in currency markets. Yet, even the total amount of these activities is not mentioned in budget documents.

In Mexico, although the most important subsidy programs are publicly reported on, there are some quasi-fiscal activities for which insufficient details are provided for an informed discussion. Information is lacking about the subsidies that are provided to agriculture production, as well as that on certain trust funds. In Angola vast sums of money are spent outside of the official budget process through Sonangol, the state-owned oil company. Sonangol engages in quasi-fiscal activities on the government's behalf, including providing fuel subsidies and contributing to the servicing of the national debt. The company has begun to record some payments through the integrated financial monitoring system, but reporting remains far from comprehensive, and there is no external control over the expenditure decisions themselves.

C. How can civil society use this information for research and advocacy?

Civil society budget groups may be able to use information on quasi-fiscal activities in a variety of ways as part of their research and advocacy. If the government is proposing to cut, or not increase, the allocation of resources to expenditures that address poverty, this could be compared to the subsidies to private companies or relatively wealthy individuals through quasi-fiscal activities. For example, the budget group could contrast cuts in social spending with the amount of below-market rate loans provided to private companies from government-owned banks, or the amount of revenues lost from providing private individuals or companies with government land at less than the usual cost.

If there are significant quasi-fiscal activities that are not reported, this could have an impact by reducing, and thus understating, the reported level of government expenditure. As a result, the proportion of spending on pro-poor activities could be inflated relative to other governments with a lower level of quasi-fiscal activities, giving the false appearance of a greater effort to address poverty. In these cases, the recognition of quasi-fiscal activities could help in making arguments that the government should increase such expenditure to match the share of pro-poor spending in overall government expenditure to that found in other countries. Before undertaking such work, however, civil society should bear in mind that estimating the costs of quasi-fiscal activities is not a simple or cost-free exercise. In addition, some quasi-fiscal activities, such as subsidies to basic food prices or fuel subsidies, may in fact be pro-poor.

D. Relevant material, websites, and “model reports”

Chivaluk, M. and R. York. *Implications of Quasi-Fiscal Activities in Ghana*. IMF Working Paper WP/06/24. Washington, D.C.: International Monetary Fund. 2006.

<http://www.imf.org/external/pubs/ft/wp/2006/wp0624.pdf>

International Monetary Fund. *Manual on Fiscal Transparency* (esp. pp. 67-70). Washington, D.C.: International Monetary Fund. 2007.

<http://www.imf.org/external/np/pp/2007/eng/051507m.pdf>

Revenue Watch Angola Transparency Snapshot.

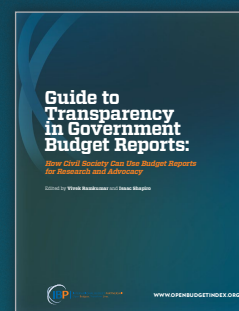
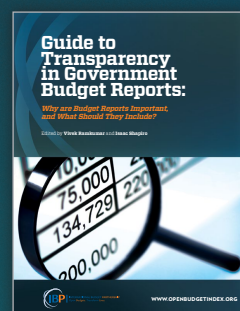
<http://www.revenuwatch.org/our-work/countries/angola/transparency-snapshot>

The Open Budget Initiative

This guide is part of a series that looks at public finance topics in terms of transparency and accountability. The Open Budget Initiative may produce additional guides around other important related topics in the future.

1. Extra-budgetary Funds
2. Tax Expenditures
3. Quasi-fiscal Activities
4. Contingent Liabilities
5. Future Liabilities

This series is a companion to two earlier **Open Budget Initiative** guides on public budget transparency — one for governments and one for civil society organizations.



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