

# Guide to Transparency in Public Finances

## *Looking Beyond the Core Budget*

- *Extra-budgetary Funds*
- *Tax Expenditures*
- *Quasi-fiscal Activities*
- *Contingent Liabilities*
- *Future Liabilities*

# 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 this guide – 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 it.

This companion guide goes beyond the eight key budget reports covered in the original guides to examine other areas of public finance that are less well understood and especially vulnerable to efforts to shield them from public scrutiny. These areas include:

- ➔ Extra-budgetary Funds
- ➔ Tax Expenditures
- ➔ Quasi-fiscal Activities
- ➔ Contingent Liabilities
- ➔ Future Liabilities

## The sections on each topic cover 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 its 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 companion guide is 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](http://www.internationalbudget.org).

# Chapter 1

# Extra-budgetary Funds

Extra-budgetary funds and operations make sense in some cases, for example, when they ensure more effective management of government pension schemes or when they are designed to save and invest revenues from exhaustible natural resources for future generations. However, in other cases they reflect the government's interest in keeping certain budget items away from public scrutiny. While generally speaking, civil society organizations (CSOs) should campaign to minimize the use of these funds, they also should assess: a) the validity of the rationale for off-budget arrangements, and b) the adequacy of the governance arrangements put in place to manage extra-budgetary funds, and the degree to which they guarantee sufficient transparency and accountability.

## A. What are extra-budgetary funds, and why are they of interest?

The term extra-budgetary funds generally refers to public resources and government transactions that are not included in the annual budget or are not subject to the same general level of reporting, regulation, or audit as other public finance items. Extra-budgetary funds include a wide variety of arrangements, but traditionally they have included pension or social security funds, funds held by state-owned enterprises, and other discretionary or secret funds. More recently they have also included arrangements for public resources from natural resource extraction, foreign aid, debt cancellation, proceeds from privatization operations, and public-private partnerships.

These funds, when combined, can amount to a sizable share of government activities. On average, extra-budgetary funds account for nearly 40 percent of central government expenditure in transitional

and developing countries. The majority of these funds are social security funds, which constitute an average of 26 percent of government expenditures in these countries (Allen and Radev 2006).

A distinction can be made between those extra-budgetary funds that are established by and operate within budgetary and other laws and regulations of a country, and off-budget transactions that are undertaken outside these laws and regulations and so should be considered irregular transactions. For example, a Pension Fund Act may legally establish a fund with specific guidelines that do not require it to follow the government's general financial regulations but do require it to be publicly reported on in the same way as other government expenditures or to be subject to the same level of audit as the use of other public funds. In contrast, a secret fund that is kept off budget, ignoring the government's financial regulations, reporting, and audit requirements, can give rise to illegal or irregular transactions.

That is not to say that public funds cannot be managed efficiently and effectively through extra-budgetary funds; in some instances, this happens. However, depending on the specific case, extra-budgetary funds may not be subject to some or all of the following arrangements that provide adequate oversight:

- parliamentary approval of the government's budget;
- compliance with approved financial regulations;
- being accounted for through the government's accounting systems;
- being reported on through in-year or year-end financial reports; and
- statutory audit by the supreme audit institution.

Transactions outside the budget are unlikely to be subject to the same kind of financial discipline as are budget operations (for example, state-owned enterprises may have their own financial regulations and appoint their own auditors), partly because they are financially independent and partly because they are not explicitly compared with other public expenditures. This may result in an increased level of fraud, irregularity, or the use of such funds for unauthorized purposes. In addition, the use of extra-budgetary funds means the reported level of government expenditure may be understated. It also is more difficult to compare the finances of two governments if they have different levels of extra-budgetary funds.

In some countries the audit of extra-budgetary funds may not be undertaken as promptly as that for other public sector bodies. For example, in Ghana the results of the audit of central government ministries are reported to parliament within six months of the end of the fiscal year. In contrast the Auditor General's report on the public accounts of Ghana's public boards, corporations, and other statutory institutions for the year ending 31 December 2005 was not presented to parliament until September 2008. Even then, the audit report was not complete as some of the entities had not submitted their

audited accounts. Similarly in Uganda, in mid-2007 the audited accounts for 19 of 49 autonomous government agencies were two or more years in arrears.

#### **A few examples of extra-budgetary funds include:**

➔ **Funds with their own income streams** – Extra-budgetary funds may refer to pension, social security, or other funds that have their own separate sources of income in addition to or in place of those provided through the government budget. In these cases, expenditures from the fund are financed by income from earmarked taxes or contributions, although in some cases a subsidy may also be provided through the budget. An example is a road fund that is funded from vehicle license fees. All vehicles are required to have an annual license and the fees are paid into a separate road fund. This fund is then used to finance the building and maintenance of roads. This arrangement may protect the fund and ensure that it is spent on the designated activities. However, it may also reduce the level of public scrutiny over the use of the fund. In recent years the number of insurance-type arrangements that provide funding for such expenditures as pensions or health services have increased. For example, in Nigeria the pensions of former civil servants, rather than being funded directly from the current budget each year, are based on contributions made to a pension fund by existing civil servants, which are invested and used to fund future pension payments. Similarly in Ghana, rather than funding health services directly from the budget, citizens or their employers make contributions to the National Health Insurance Scheme. In each case special extra-budgetary funds have been established. Government payments into these funds may be subject to budgetary approval, but the overall level of receipts of and payments by the funds, the management of the funds, the financial regulations they follow, and the reporting and audit arrangements are separate from the normal government arrangements. This does not necessarily mean that such arrangements are more prone to abuse than those of the government budget, but it does mean that they deserve particular attention to ensure that such extra-budgetary activities are managed in a transparent and accountable manner.

➔ **Natural resource funds** – Countries with ample natural resources – oil or diamonds, for example – may establish extra-budgetary funds to try to smooth the volatility of resource revenues (dramatic changes in prices for resources can make this revenue source unpredictable) or to invest the funds for future generations, given their exhaustible nature. The Government Pension Fund of Norway and the Foreign Holdings of the Saudi Arabian Monetary Agency are two examples of such arrangements. They both rely on oil revenues, and they are among the largest in the world, with holdings of around \$500 billion. While the motivation and operation of such funds can be meritorious, depending on their governance arrangements, they can easily turn into slush funds for corrupt governments, particularly if they are subject to less oversight than the rest of the government's budget. The Sovereign Wealth Fund Institute ([www.swfinstitute.org](http://www.swfinstitute.org)) compiles rankings of these funds based on the amount of information that they publish and on their governance arrangements. Norway's fund scores a full 10 out of 10, while Saudi Arabia's a mere 2.

➔ **Funds established to manage donor aid** – In many aid-dependent countries, projects financed by foreign aid are often channelled outside government systems and, therefore, can be considered extra-budgetary funds. According to a recent survey, more than half of official development assistance does not flow through country systems, meaning that detailed information on the use of these resources is not captured in budget documents (OECD 2008), or does not follow normal budgetary procedures. For example, in Ghana funds from debt relief proceeds were kept in a separate account and disbursed by the Ministry of Finance & Economic Planning, without the approval of parliament (IDASA 2005).

## **B. What information should the government include in budget documents and other reports on extra-budgetary funds?**

For government budgets and financial reports to be comprehensive and accurate presentations of total public revenues and expenditures, the use of extra-budgetary funds should be minimized. The creation of special or extra-budgetary funds should be restricted to exceptional cases and authorised by specific legislation, with governance arrangements that guarantee adequate levels of transparency and accountability. Wherever such funds exist, as argued in the International Monetary Fund's (IMF) Manual on Fiscal Transparency, their activities should be identified in the annual budget, or an annex to the budget, along with a statement of the purpose or policy rationale (IMF 2007), which should be periodically reviewed.

How much unreported off-budget spending is too much? According to the benchmarks adopted by the Public Expenditure and Financial Accountability (PEFA) initiative, which developed a set of indicators to assess the quality of public financial management systems, unreported extra-budgetary expenditure (other than donor-funded projects) should be kept below 1 percent of total expenditure for a country to attain the best score on the relevant PEFA indicator. The worst score corresponds to a situation where this spending constitutes more than 10 percent of total expenditure. For donor-funded projects, the PEFA benchmarks indicate that complete income and expenditure information should be available in the government's fiscal reports for 90 percent of the value of donor-funded projects, and that proportion should never fall below 50 percent.

Furthermore, the rules and procedures that govern the establishment, operations, and management of extra-budgetary funds should be open to public scrutiny, along with their audited financial statements covering all inflows and outflows and, if relevant, the allocation of and return on assets. The financial reports for such funds should not simply report net income against expenditure but should also report the total income and the total expenditure of each fund at a minimum. Income and expenditure should generally be presented according to the standard classification or code of accounts used in other budget documents produced by the government.

South Africa does a fairly good job of accounting for extra-budgetary funds. The executive's budget and supporting documentation present extensive information on extra-budgetary funds, including both a narrative discussion and quantitative estimates of such funds. The bulk of extra-budgetary funds in South Africa are composed of social security funds, such as the Road Accident Fund, the Unemployment Insurance Fund, and the Compensation Funds. The money for these items is not included in the budget, but information on their payments and receipts is included in the accompanying document, the Budget Review. The Office of the Auditor General of South Africa publicizes its reports of audits of all extra-budgetary funds. The reports include all charges against the Revenue Fund, including extra-budgetary funds.

In contrast, in Ghana the executive's budget and supporting documentation present some information, but they lack important details. Year-end reports do not present the actual outcome for extra-budgetary funds, and the Auditor General does not release to the public reports of the audits of extra-budgetary funds.

India also provides a reasonably good example of openness with regard to extra-budgetary funds. Information highlighting key extra-budgetary funds is presented with the annual budget, though some details are excluded. In addition, the Comptroller and Auditor General release the audit reports of all extra-budgetary funds except those on secret items of expenditure. These are generally not released to the public. However, with the passage of the Right to Information Law, even this information can be requested. Extra-budgetary funds include the National Small Savings Fund; the Steel Development Fund, which is an industry-wide loan scheme that operates on commercial principles; and the Prime Minister's Relief Fund, which finances disaster relief from public donations.

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

In general terms, the significant size of extra-budgetary funds suggests a role for civil society organizations in monitoring these funds and advocating for greater openness in their management. In some cases, extra-budgetary funds do serve legitimate purposes, so CSOs should also assess: a) the validity of the rationale for an off-budget arrangement on a case-by-case basis, and b) the adequacy of the governance arrangements put in place for the extra-budgetary funds, and the extent to which they guarantee adequate levels of transparency and accountability.

To the extent that information on extra-budgetary funds is not publicly available, civil society organizations should advocate for its publication in line with international best practice. The use of all public money should be subject to the same high level of public scrutiny, comply with uniformly strict rules and procedures, and be audited to the same standards. Audit reports for all public funds, entities, or transactions should be made public promptly. Where necessary, civil society groups should advocate for such standards to be applied uniformly to both budgetary expenditure and what may be considered to be extra-budgetary funds.

In some cases, it might be useful for civil society groups to undertake some comparative research to see how extra-budgetary funds in their country fare when compared to similar funds in other countries or to international standards. For example, the "Santiago Principles" were developed as a voluntary code of conduct for sovereign wealth funds, covering accountability, transparency, and governance. In those 20 or so countries with significant sovereign wealth funds (often funded from natural resource revenues) civil society organizations should ensure that this code of conduct is adopted. The Public Finance Monitoring Center in Azerbaijan, for example, undertook a study of sovereign wealth funds across their region and internationally to develop a series of recommendations to improve the transparency and management of these funds.

More generally, civil society budget groups can use the information provided on extra-budgetary funds in the same way as they use other information on government finances.

One example of a successful campaign against opaque extra-budgetary financing of expenditure comes from Mexico. As part of the process of political liberalization in the mid-1990s, civil society leaders demanded information on what was called the president's "Secret Fund." How much money was there in this fund? How was it used? Did it include the president's salary, and if so, how much was it? While there was initially no clear response to the information request, it served to highlight important issues for which groups could use budget analysis to answer, if they had access to the necessary data. The Mexican civil society budget group, Fundar, was formed in part to seek answers to these questions, and its analysis of the fund contributed to the fund's dissolution.

## D. Relevant materials, websites, and "model reports"

Allen, Richard and Dimitar Radev. *Managing and Controlling Extra-budgetary Funds*. IMF Working Paper WP/06/286. Washington, D.C.: International Monetary Fund. 2006.  
<http://www.imf.org/external/pubs/ft/wp/2006/wp06286.pdf>

Griffin, C. et al. *Lives in the Balance: Improving Accountability for Public Spending in Developing Countries* (esp. pp. 34-37). Washington, D.C.: Brookings Institution Press. 2010.

IDASA. *Budget Transparency and Participation: Nine African Case Studies*. Cape Town: IDASA. 2005.  
<http://www.idasa.org/media/uploads/outputs/files/Nine%20African%20Budget%20Transparency%20&%20Participation%20Case%20Studies.pdf>

International Monetary Fund. *Manual on Fiscal Transparency* (esp. pp. 50-53). Washington, D.C.: International Monetary Fund. 2007.  
<http://www.imf.org/external/np/pp/2007/eng/051507m.pdf>



International Working Group on Sovereign Wealth Funds. *Sovereign Wealth Funds: Generally Accepted Principles and Practices* (“Santiago Principles”). 2008.

<http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf>

Ministry of Finance, South Africa. “South Africa National Budget Review Document 2011.” 2005.

<http://www.treasury.gov.za/documents/national%20budget/2011/review/Budget%20Review.pdf>

Organisation of Economic Co-operation and Development. *2008 Survey on Monitoring the Paris Declaration*. Paris: OECD. 2008.

<http://www.oecd.org/dataoecd/58/41/41202121.pdf>

PFMC Azerbaijan Project on Sovereign Wealth Funds.

[http://www.pfmc.az/index.php?option=com\\_content&view=article&id=253:sovereign-wealth-funds&catid=39:swf&Itemid=64](http://www.pfmc.az/index.php?option=com_content&view=article&id=253:sovereign-wealth-funds&catid=39:swf&Itemid=64)

## Chapter 2

# Tax Expenditures

Tax expenditures are part of any government’s toolbox, and in some cases they can be an effective way to provide incentives to citizens and firms. However, their impact on the budget tends to be much less visible than that of normal expenditures, and they receive little systematic scrutiny. They also can disproportionately benefit specific interest groups, who will lobby to maintain them. As tax expenditures can be very large compared to normal government spending, it is important for civil society organizations to monitor them, assess their impact, and push governments to publish detailed information and carry out periodic reviews.

### A. What are tax expenditures, and why are they of interest?

Tax expenditures are usually defined as a government’s estimated revenue loss that results from giving tax concessions or preferences to a particular class of taxpayer or activity. The revenue loss, or “expenditure,” is calculated as the difference between whatever tax would have been paid under a defined benchmark tax law (which identifies what tax structure should normally apply to taxpayers) and the lower amount that was actually paid after the tax break. Tax expenditures are used instead of direct spending to deliver a government subsidy to a class of taxpayer or encourage a desired activity. They can take many forms, including tax exemptions; tax deductions; tax offsets (or credits); and concessional tax rates or timing rules, such as accelerated depreciation of capital assets, that either reduce or defer a taxpayer’s tax liability. A typical example is a deduction on income tax that is allowed for interest paid on home mortgages, which is designed to encourage home ownership.

The tax expenditure concept recognizes the similarity between direct government spending and “spending” through the tax system. Consider two scenarios:

- ➔ a government collects \$100 in tax from a taxpayer and then pays a direct subsidy of \$100 to that same taxpayer (a direct government expenditure); or

- ➔ a government decides to reduce the tax liability by \$100 for the same taxpayer (a tax expenditure).

In both scenarios, the direct monetary effect on the taxpayer is the same. The delivery of the tax expenditure, however, may be treated very differently by the government in its budget reporting and analysis. In fact, typically tax expenditures undergo less scrutiny than direct spending. Unlike many spending programs, tax expenditures are not usually subject to a direct appropriations vote in the legislature every year and thus are less likely to undergo periodic review.

A tax expenditure policy can be applied to any type of tax law. That is, a personal income tax, corporation tax, commodity tax (such as tariffs and excises), sales tax (or Value Added Tax [VAT]), property tax, wealth tax, or inheritance tax may all contain tax expenditures. In some cases, the total value of the revenue impact of tax expenditures can reach as high as 10 percent of GDP (OECD 2010).

There are particular characteristics of tax expenditures that may make them a more attractive policy tool than direct spending.

- ➔ If the government wants to provide a benefit to a large target population without separately assessing each applicant, a tax concession may offer the least cost path both for the government to administer and for taxpayers to comply with.
- ➔ Enacting a tax expenditure may prevent churning of tax revenue collection and public spending, enabling the government to efficiently deliver benefits by avoiding the administrative cost of collecting tax from a taxpayer only to return it to the same taxpayer in the form of a government payment.
- ➔ The tax system might be the best means of advertising the availability of government assistance, especially when there is a large target group of taxpayers required to submit tax returns. By asking taxpayers to consider whether they fit the requirements for the government assistance as part of mandatory tax filing, a government might ensure that assistance reaches the target group.

On the other hand, there are several reasons why tax expenditures may be less effective as a policy tool than another mechanism, such as direct spending or a regulation.

- ➔ It is more difficult to subject tax expenditures to legislative control, as often tax expenditures are a permanent part of a law that, unless specified in the law itself, does not require regular legislative review. Compare this to direct spending programs, which are budgeted for and, therefore, scrutinized in every budget cycle. As part of the tax code and not a specific spending program, tax expenditures do not fall under the responsibility of any particular functional agency that the legislature oversees. And, without a “sunset clause” to end the tax expenditure, it may remain in law after its usefulness as a policy tool has come to an end.

- ➔ Tax expenditures may generate unfair distributional outcomes between taxpayers, as in the case when only individuals who can afford tax advice are likely to learn about and access the concessions.
- ➔ Tax expenditures may create interest groups to defend and perpetuate them, especially when such expenditures are narrowly defined and targeted, which can lead to significant lobbying of politicians and more generally an environment not conducive to well-informed policy choices.

**Tax expenditures vary with respect to how they affect the fundamental elements of a tax.**

**What is subject to tax?** A tax expenditure might exempt or only partially subject some parts of the tax base (e.g., individual or corporate income or the value of a purchase of a taxed good or service) to tax. In Ghana, for example, the tariff code provides an exemption for energy saving compact fluorescent and LED lamps to promote energy savings and reduce power consumption.

**Who must pay the tax?** A tax rule might exclude particular taxpayers from taxation or might give favourable tax treatment to all taxpayers who possess certain characteristics, such as their age or family status. In a number of countries, for example, income tax law provides that the primary income earner of a household is allowed a deduction when the income earner’s husband or wife has limited income.

**What is the tax rate?** The rate of tax may vary for particular categories of taxpayers or transactions. For instance, small business income or income comprising capital gains might be taxed at a lower rate than otherwise would apply, as in the case of South Africa.

## B. What information should the government include in budget documents and other reports on tax expenditures?

The International Monetary Fund (2007) and the OECD (Organization for Economic Co-operation and Development) (2002, 2010) recommend that a government should estimate and report the revenue impact of at least key tax expenditures. A World Bank paper (Li Swift 2006) recommends the same. Tax expenditure reporting serves three important functions. First, it enhances the government’s fiscal management by exposing all forms of government spending, both direct spending and indirect spending through the tax code, to the same level of scrutiny in the budget process. This facilitates informed decision making, as well as public understanding and advocacy. Second, reporting enables analysis that can help determine the best tools for government to use to achieve its policy goals (e.g., through public ownership of resources, regulation, direct spending, taxation, or tax expenditures). Tax expenditure analysis is no different from public policy analysis more generally, as it entails consideration of the best means of achieving a government’s objectives. Third, tax expenditure reporting promotes

analysis of tax policy principles, making tax expenditure advocacy one avenue by which civil society organizations can advance claims about the fairness and effectiveness of the tax system.

**With the broader goals of the public and civil society organizations in mind, the following information should be included in a tax expenditure report.**

- ➔ **Definition of benchmark:** the benchmark against which each tax expenditure is assessed (the tax structure that would normally apply to taxpayers in the absence of the expenditure) should be clearly stated and defended within the tax expenditure report.
- ➔ **Credible measurement framework:** the method used for estimating individual tax expenditures should be clearly set out in the report. A significant factor affecting the usefulness of a tax expenditure statement is the accuracy with which the cost of a particular expenditure is determined, so the degree to which each tax expenditure estimate is reliable ought to be clearly indicated.
- ➔ **Detailed breakdown of aggregate tax expenditures:** At a minimum, the revenue impact or “cost” should be reported by government function (e.g., health, social security, environment, industry assistance); with time-series data over a period of, say, five years (noting any variations to the tax law or benchmark in that time); and by levels of government, if possible.
- ➔ **Additional information for each tax expenditure item, including:**
  - the estimated cost of the tax expenditure, with an indication of the reliability of the estimate, including the quality of the data upon which the estimate is based;
  - the source of the tax expenditure (e.g., tax law provision, administrative practice, or tax treaty);
  - the duration of the tax expenditure (is it subject to a “sunset clause,” or is it ongoing?);
  - the type of tax expenditure (e.g., an exemption, a refundable tax credit, or a deduction);
  - policy justification for each tax expenditure (the policy objective of the tax expenditure, and why it is the best means of achieving that objective);
  - the distributional impact of major tax expenditures, to the extent that data is available, including where relevant gender analysis; and
  - reference to the last government review for at least the most significant tax expenditures.

In India the Minister of Finance first presented the *Statement of Revenue Foregone*, which reports on various tax exemptions, in the 2006-07 Union Budget. The statement reveals some aspects of the distributional effects of tax expenditures but does not explicitly analyze them. It demonstrates that tax expenditures that give preferential treatment to the corporate sector are significantly greater than tax expenditures targeted at the nonprofit sector and individuals. In Chile, as in several other Latin American countries, there is a constitutional obligation to report tax expenditures. Every year the tax expenditure report is included in the *Budget of Public Finances*. This document presents the estimate made by the Chilean Tax Administration of the impact of tax expenditures relating to income tax and VAT, including projections of future impact. Its latest report showed that the value of revenue forgone through tax expenditures was equal to 4.27 percent of GDP.

## C. How can civil society use tax expenditure reports for research and advocacy?

In its *Guide to Tax Work for NGOs* (IBP 2006: p. 60), the IBP stated:

*Although a civil society group would not likely be in a position to estimate the revenue losses from tax expenditures, it may be able to compile a list of major tax expenditures. (This could require partnering with a tax lawyer or accountant.) By highlighting the existence of these subsidies, such a list could promote improved oversight and prompt discussions about the policy rationale for the provisions. It could also help pressure government to provide more information.*

More generally, a tax expenditure report can be used by civil society organizations in a number of different ways, including:

- ➔ exposing “hidden” public welfare to more robust scrutiny;
- ➔ identifying inconsistent spending and tax programs — i.e., government might be promoting inconsistent policy outcomes by adopting contradictory spending and tax measures;
- ➔ identifying areas where the tax system is not operating in accordance with legislative intention (e.g., the tax administration has insufficient resources to enforce the law, or it has allocated enforcement resources to other matters);
- ➔ assessing a government’s ongoing management of tax expenditures;
- ➔ identifying the best means of delivering a particular policy outcome (that is, direct spending may be a better alternative than a tax expenditure); and



- identifying aspects of the tax law that ought to be improved if the community’s aspirations for its tax system are to be carried into effect.

Of key importance to civil society groups, in addition to the overall impact on revenue, is how tax expenditures distribute costs and benefits across different segments of taxpayers. This should be addressed to the extent possible using available data. The results of such an analysis can contribute significantly to civil society budget advocacy that aims to increase social justice outcomes as a result of taxing and spending policies. A distributional analysis may identify significant gaps in the impact of the budget on different groups; for example:

- **Income/wealth analysis:** How do low-income individuals or individuals with little wealth benefit compared to high-income or wealthy individuals?
- **Gender analysis:** Is there a differential impact on women and men? For example, if only men work in the manufacturing industry in a particular country, a tax expenditure that reduces the tax burden on workers in manufacturing will benefit men more than women. An analysis of this expenditure may also identify policy reasons for the focus on manufacturing.
- **Minority analysis:** Is the expenditure effectively reaching its target beneficiaries? A regional tax investment credit may have the goal of benefiting a minority group that lives in a particular region. The tax expenditure analysis may be able to identify if the credit is, in fact, benefiting that group.

A recent report published by the Center on Budget and Policy Priorities in the United States (Marr and Highsmith 2011) presents an interesting analysis of tax expenditures in the U.S., highlighting how they represent a very substantial share of federal spending, while being both inefficient and inequitable, with the wealthiest households receiving the largest tax subsidies.

Note: this chapter on tax expenditures draws heavily on the background paper listed in Section D below and written by Mark Burton and Miranda Stewart of the University of Melbourne.

## D. Relevant materials, websites, and “model reports”

Burton, M. and M. Stewart. Promoting Budget Transparency Through Tax Expenditure Management. A Report on Country Experience for Civil Society Advocates, Legal Studies Research Paper No. 544. Melbourne Law School. Melbourne: University of Melbourne. 2011.  
[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1864324](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1864324)

Gobierno de Chile. *Informe de Finanzas Públicas*. 2008.  
[http://www.dipres.cl/572/articles-3689\\_ifp2008.pdf](http://www.dipres.cl/572/articles-3689_ifp2008.pdf)

Government of India. *Statement of Revenue Foregone*. 2010.  
<http://www.indiabudget.nic.in/ub2009-10/statrevfor.htm>

International Monetary Fund. *Manual on Fiscal Transparency* (esp. pp. 64-5). Washington, D.C.: International Monetary Fund. 2007.  
<http://www.imf.org/external/np/pp/2007/eng/051507m.pdf>

Levitis, J. et al. *Promoting State Budget Accountability Through Tax Expenditure Reporting*. Washington, D.C.: Center on Budget and Policy Priorities. 2009.  
<http://www.cbpp.org/files/4-9-09sfp.pdf>

Li Swift, Z. *Managing the Effects of Tax Expenditures on National Budget*. World Bank Policy Research Working Paper 3927. Washington, D.C.: World Bank. 2006.  
[http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2006/05/23/000016406\\_20060523092056/Rendered/PDF/wps3927.pdf](http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2006/05/23/000016406_20060523092056/Rendered/PDF/wps3927.pdf)

Marr, C. and B. Highsmith. *Reforming Tax Expenditures Can Reduce Deficits While Making the Tax Code More Efficient and Equitable*. Washington, D.C.: Center on Budget and Policy Priorities. 2011.  
<http://www.cbpp.org/files/4-15-11tax.pdf>

OECD. *Best Practices for Budget Transparency*. Paris: OECD. 2002.  
<http://www.oecd.org/dataoecd/33/13/1905258.pdf>

OECD. *Tax Expenditures in OECD Countries*. Paris: OECD. 2010.  
[http://www.oecd.org/document/37/0,3343,en\\_2649\\_34119\\_44961317\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/37/0,3343,en_2649_34119_44961317_1_1_1_1,00.html)

# Chapter 3

## 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 the costs related to the activities 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.revenuewatch.org/our-work/countries/angola/transparency-snapshot>

# Chapter 4 Contingent Liabilities

Government liabilities are a measure of fiscal risk. Contingent liabilities, whether explicit or implicit, can affect the government’s fiscal position and, therefore, its capacity to meet its spending obligations. Civil society organizations should ask governments to include information on the purpose and potential fiscal impact of contingent liabilities in budget reports, and they could carry out their own analysis of the rationale and potential impact of such liabilities on the allocation of scarce budget resources.

## A. What are contingent liabilities, and why are they of interest?

Government liabilities are amounts of money that a government owes, such as that for the repayment of sovereign debt and for payments owed to suppliers of goods and services. In this sense, comprehensive information on government liabilities is key to understanding and assessing the level of fiscal risk that a government faces and thus should be reported publicly. Contingent liabilities are amounts that the government may owe, but the amount, or indeed the existence, of the liability will depend on future (and uncertain) events. Government guarantees are a common form of contingent liabilities. The government may guarantee a loan, but it will only be liable to make the payment if the recipient of the loan defaults. So, when financial statements are produced, it is often not known whether the government will have to repay all or some of the loans that it has guaranteed.

Contingent liabilities are also significant because a government may be considered to be the insurer of last resort, and so its implicit or assumed guarantees may be very wide. For example, in the wake of the latest global financial crisis, many governments guaranteed loans made by commercial banks in their country. In other instances, governments are expected to make significant payments to deal with the aftermath of such natural disasters as floods or earthquakes.

**The International Public Sector Accounting Standards (IPSAS) Board defines a contingent liability as:**

- ➔ A possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or
- ➔ A present obligation that arises from past events but is not recognized because:
  - (i) It is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; or
  - (ii) The amount of the obligation cannot be measured with sufficient reliability.

(IPSAS Board 2011: pp. 584-585)

The “past event” may be the provision of a government guarantee for a loan, and the “future event” could be the company defaulting on the loan, requiring the government pay the loan on behalf of the company. By the above definition, such liabilities are only required to be disclosed or recognized in the government’s accounts if it is likely that the government will have to repay the loan, or if the amount of the eventual payment can be estimated reasonably accurately.

The International Monetary Fund (IMF) Manual on Fiscal Transparency (2007: p. 59) includes the following examples of different types of government contingent liabilities (with added explanations). Explicit liabilities are specific obligations of the government established by a particular law or contract. Implicit liabilities involve a moral obligation or expected responsibility of the government that is not established by law or contract (see also Polickova 1998: p. 3).

---

**Explicit contingent liabilities**

- ➔ Guarantees on commercial bank deposits for cases in which the government has agreed to provide low-interest loans or short-term funds to support commercial banks in difficult economic or financial conditions
- ➔ State insurance programs the government sets up to protect local farmers, for example, against the impact of natural disasters on agricultural production
- ➔ Loan guarantees through which the central government backs loans made to other arms of government or public corporations

- ➔ Demand/revenue guarantees in public-private partnership contracts in which the government commits to a specified minimum level of income for a contractor in cases where future demand cannot be accurately predicted
- ➔ Statutory commitments in the form of such entitlements as pensions or social benefits, when the number of beneficiaries may not be known in advance

---

**Implicit contingent liabilities**

- ➔ Banking system bailouts, in which governments may consider it prudent to rescue their banking systems even though no formal guarantees have been provided, as was done in response to the latest financial crisis
- ➔ Coverage of liabilities of privatized entities in cases where the government may consider it necessary to compensate the new owners of privatized companies for unexpected liabilities, even if such support was not included in any formal contracts, to ensure the success of future privatization programs
- ➔ Environmental and disaster relief in cases in which the government might compensate the victims of exceptional environmental or other disasters, even without any legal or formal obligations
- ➔ Guarantees of debt obligations of subnational governments through which the central government may guarantee loans to subnational governments, even where there is no formal policy or other requirement to do so

For example, the Indian government provides a variety of guarantees for its own programs, state governments, other public sector institutions, cooperative societies, and banks. These may cover loans, including the associated interest, and the repayment of share capital and minimum dividends for investors in state entities. In addition, the central government sometimes provides performance guarantees for Indian companies operating in foreign countries, or guarantees to railways and electricity boards that public sector customers will pay their invoices on time.

In recent years the governments of some countries have greatly curtailed the level of loan guarantees they provide. Botswana’s state-owned enterprises are supposed to be run on a commercial basis and have been told that if they need loans, these will have to come from commercial banks. In Uganda the Non-Performing Assets Recovery Trust was established in 1994 to salvage bad loans from the Uganda Commercial Bank and the Uganda Development Bank, which were subsequently privatized.



## B. What information should the government include in budget documents and other reports on contingent liabilities?

The IMF (2007: pp. 77-79) recommends that information on contingent liabilities should be included in budget documents, describing their significance and nature. Such information should include the policy rationale behind the government's choice to provide a specific guarantee, their total amount, their intended beneficiaries, and the likelihood that the liability will in fact be incurred. Quantitative estimates of their potential fiscal impact should be published, as well.

In contrast to these guidelines, the South African government states that it “is not possible to determine the portion of these guarantees which will realise as liabilities to the National Government” (National Treasury 2009: p. 81). However, some other countries provide information on the value of outstanding loans as of the date of the financial statements, which represents the maximum liability the government could face. In Namibia only summary information is provided and then only in the annual report of the central bank. The Bank of Namibia's Annual Report for 2002, for example, provided a summary of central government loan guarantees that indicated an increase of nearly 16 percent over the previous year and a total guarantee level amounting to almost 12 percent of GDP. Around three quarters of the total value of these guarantees was to cover foreign loans (IDASA 2005).

The Indian government's recently approved accounting standards on guarantees require it to disclose a number of details, including the maximum amount for which guarantees have been given during a specific year, details of commissions and fees, whether a reserve fund exists for the purpose of paying the loans, and the designated authority for guarantees within the government (GASAB 2010: pp. 5-6). The U.K. government provided extensive detail in the Treasury's Resource Accounts for 2009-10 on the possible liabilities arising from financial sector bailouts in the wake of the financial crisis. However, in some cases it deemed maximum potential liabilities “unquantifiable” (HM Treasury 2010).

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

Information on contingent liabilities provides only some indirect help to civil society organizations in understanding the level and composition of funds spent by their governments, though the level of a government's contingent liabilities may be of particular interest to those who are concerned about government debt and related issues. However, if available information on contingent liabilities indicates that the government is providing significant support to private sector companies through guarantees and other instruments that result in contingent liabilities, civil society organizations could use this information to make the argument that the government should be spending more money directly on poverty reduction, rather than on the relatively wealthier business community.

This is particularly true in cases in which implied guarantees are used to facilitate the provision of loans to wealthy or influential individuals, who are then not required to repay them. For example, the 2009 banking crisis in Nigeria resulted in large part from many of the major banks providing loans to friends or colleagues of the banks' chief executives or board members that were not repaid. The government bailout of these banks would suggest, in retrospect at least, that these loans had been implicitly guaranteed by the government and so should have been reported as part of its contingent liabilities. This would have allowed civil society organizations to campaign for using the public funds for poverty reduction rather than to support powerful members of the elite.

## D. Relevant materials, websites, and “model reports”

- ➔ Government Accounting Standards Advisory Board. *Indian Government Accounting Standard (IGAS) I: Guarantees Given by Government: Disclosure Requirements* (pp. 142-146). Delhi: Government Accounting Standards Advisory Board. 2010.  
[www.gasab.gov.in/pdf/IGAS%20I\\_Guarantees\\_Final.pdf](http://www.gasab.gov.in/pdf/IGAS%20I_Guarantees_Final.pdf)
- ➔ HM Treasury (United Kingdom). *HM Treasury Resource Accounts 2009-10*. London: The Stationery Office. 2010.  
<http://www.official-documents.gov.uk/document/hc1011/hc02/0261/0261.pdf>
- ➔ IDASA. *Budget Transparency and Participation: Nine African Case Studies*. Cape Town: IDASA. 2005.  
<http://www.idasa.org/media/uploads/outputs/files/Nine%20African%20Budget%20Transparency%20&%20Participation%20Case%20Studies.pdf>
- ➔ International Monetary Fund. *Manual on Fiscal Transparency* (esp. pp. 47-48). Washington, D.C.: International Monetary Fund. 2007.  
<http://www.imf.org/external/np/pp/2007/eng/051507m.pdf>
- ➔ International Public Sector Accounting Standards Board. *IPSAS 19: Provisions, Contingent Liabilities and Contingent Assets*. New York: International Accounting Standards Board. 2011.  
<http://web.ifac.org/media/publications/0/2011-ifac-handbook-of-inter/ipsas-19-provisions-cont-3.pdf>
- ➔ Organization for Economic Cooperation and Development. *Best Practices for Budget Transparency*. Paris: OECD. 2002.  
<http://www.oecd.org/dataoecd/33/13/1905258.pdf>
- ➔ Polackova, H. *Contingent Government Liabilities: A Hidden Risk for Fiscal Stability*. World Bank Policy Research Working Paper 1989. Washington, D.C.: World Bank. 1998.  
[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=604971](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=604971)

➔ Republic of South Africa National Treasury. *Consolidated Financial Information for the Year Ended 31 March 2009* (p. 81). Pretoria: National Treasury. 2009.  
<http://oag.treasury.gov.za/Publications/04.%20Consolidated%20Financial%20Information/06.%20For%20fin.%20Year%20ending%2031-03-2009/Consolidated%20Financial%20Information%202008-09/2010-08-18-Consolidated-Financial-Annual-Report.zip>

## Chapter 5

# Future Liabilities

Future liabilities affect a government's medium- and long-term fiscal position, based on current government policies. They include expenditure projections with regard to pension and social security schemes, for example. Not many non-OECD countries include information on future liabilities in their budget documents, and practice shows that the necessary analysis may need to be updated only every few years. Nevertheless, civil society organizations should at least be aware of their possible utility in assessing the strategic policy choices that their government faces.

### A. What are future liabilities, and why are they of interest?

Future liabilities are estimates of the future costs of current government programs that have a bearing on medium- and long-term fiscal policies and outcomes. These estimates need to be based primarily on projected changes in population. For example, estimates of changes in the number of young people are used to project the future cost of education, while estimates of the number of older people assist with projecting future health costs. Future liabilities may also include the future costs of pension schemes for government employees, based on projected attrition rates.

A calculation of future liabilities provides a long-term view of the financial sustainability of the government's current policies. It is important to note that while an assessment of long-term budgetary trends can provide a critical perspective, the corresponding estimates are very sensitive to the assumptions underlying them. Indeed, minor changes to the assumptions can have a major impact of the long-term view of the government's finances. In this sense, estimates of future liabilities should be interpreted as mere projections, rather than as actual indications of future government fiscal policy. The governments of the United States and the United Kingdom, for instance, issue estimates of future government income and expenditure for the next 25 and 50 years respectively, based on current government policies.

### Below are two examples of future liabilities.

*Government or state employee pension obligations* – Many governments provide a pension scheme for all or some of their employees. An estimate of the costs of providing pensions to retired state employees is usually provided each year in the government’s budget. The accounts then show the actual payments made compared with the budget. Additionally, there are a range of variables and assumptions used to determine the adequate level of resources needed to meet future pension payment obligations. Some of the most important estimates include:

- ➔ age at which employees will retire;
- ➔ number of years after retirement that employees will live and so be entitled to a pension;
- ➔ future salary increases of state employees;
- ➔ future rates of inflation;
- ➔ future levels of promotion of state employees; and
- ➔ the discount rate to be used to calculate the current value of future pension schemes.

In February 2008 the International Public Sector Accounting Standards Board issued *IPSAS 25: Employee Benefits*, which includes requirements for governments that report on the accrual basis (almost all governments still report on the modified cash basis) to account for their employee pension schemes.

*Obligations for social security benefits* – Most governments pay social security benefits to their citizens, the most common being state pension schemes (which cover all citizens of a country and not just its public employees) and the provision of education and health services. The uncertainties surrounding accounting for such schemes are similar to those related to accounting for employee pension schemes. However, it is much easier for a government to change its policies on the provision of social security benefits. For example, the U.K. government increased state pensions in line with average salaries between 1974 and 1980. Subsequently, state pension increases have been based on the inflation rate, which has increased less than salaries. As a result, the value of a basic state pension has fallen dramatically below that which it would have been under the old rules. This drop in income likely has contributed to the fact that now nearly one fifth of U.K. pensioners live below the poverty line. In addition, the age at which a pensioner can receive the state pension is being raised.

On the basis of current policies, state spending on education in the U.K. is expected to increase from 5 percent to 5.6 percent of GDP over the next 50 years. Over the same time period, spending on health is expected to increase from 7.4 percent of GDP to 9.9 percent (HM Treasury 2008). However, the policies themselves can change. For example, students in higher education in the 1970s and 1980s in the U.K. received a grant. This subsequently was changed to a loan, and most university students are

now also required to provide tuition fees of at least £3,000 a year. Policy changes such as these should reduce or contain the government’s future costs for higher education.

## B. What information should governments include in budget documents and other reports on future liabilities?

Most governments do not report on future liabilities, and the level of information that might be reported may vary from country to country. Information on future liabilities is based on estimates, assumptions, and future projections, which may be subject to a large measure of variation. In addition, minor changes to one or two assumptions can radically change the nature of the projections (as in the case of oil price projections for countries that rely heavily on oil revenues to finance expenditure). For these reasons, ranges should be provided for future projections to indicate the level of the uncertainties involved.

The OECD’s *Best Practices for Budget Transparency* (2002: p. 11) nevertheless provides some advice on reporting long-term fiscal sustainability, though very few governments have adopted this type of reporting. The OECD indicates that long-term reports should be released at least every five years, or whenever major policy changes take place; they should assess the budgetary implications of demographic change; and they should make explicit all key assumptions underlying the projections contained in the report, presenting a range of plausible scenarios.

In New Zealand the government is required to publish at least once every four years a statement on the long-term fiscal position looking out at least 40 years. In October 2009 the second of these reports was issued and provided three scenarios for the future (NZ Treasury 2009). In the U.K. similar reports have been issued with the budget for most years since 1999 and looking forward up to 50 years. The latest one was due to be issued in late 2009, sometime after the budget for that year. These reports “provide comprehensive analysis of long-term demographic developments, and their likely impact on the public finances” (HM Treasury 2008).

Some guidance also exists to indicate what kind of information countries should publish in relation to certain categories of future liabilities. For reporting on pension obligations for state employees, the OECD’s *Best Practices* (2002: p. 13) makes the following recommendations:

- ➔ Employee pension obligations should be disclosed in the budget, the midyear report and the year-end report. Employee pension obligations are the difference between accrued benefits arising from past service and the contributions that the government has made towards those benefits.
- ➔ Key actuarial assumptions underlying the calculation of employee pension obligations should be disclosed. Any assets belonging to employee pension plans should be valued at market value.

Due to the complexities involved, pension liabilities are not usually calculated every year. South Africa makes these calculations every two or three years, and the 2007/08 financial statements provided the following information on its pension schemes in the notes to the government accounts:

36 Post-retirement benefits			
Post Retirement medical assistance	36.1	56,000,000	56,000,000
Pension funds	36.2	-	12,775,000
		<u>56,000,000</u>	<u>68,775,000</u>
36.1 Post-retirement medical assistance			
This contingent liability is the estimated present value of the State's future commitment in respect of government employees' post employment medical assistance (including former members of the National Defence Force, the Police Service and Correctional Services). The valuation is at 29 February 2004. The previous valuation was dated 28 February 1999. This value does not include any contingent liabilities for the very large number of employees who are currently not members of medical aid schemes but who may become members at some future date.			
The State's commitment in respect of post retirement medical scheme assistance is provided for in the annual budget on the votes of the Defence Force, Police Service and Correctional Services in respect of former service members and on the Finance vote in respect of other government employees.			
36.2 Pension funds			
Government Employees Pension Fund	Note	2007/08 R'000	2006/07 R'000
		-	12,775,000
		<u>-</u>	<u>12,775,000</u>
This commitment represents the underfunding/surplus of the pension funds according to the most recent actuarial valuations. Actuarial valuations are conducted every three years. This liability continues to be based on incomplete assessment data.			
Funding levels			
		%	%
Government Employees Pension Fund		101.6	96.5
Temporary Employees Pension Fund		133.5	164.0
Associated Institutions Pension Fund		112.0	155.6
Valuation dates			
Government Employees Pension Fund		March 2006	March 2004
Temporary Employees Pension Fund		March 2007	March 2004
Associated Institutions Pension Fund		March 2007	March 2005
Government Employees Pension Fund, Temporary Employees and the Associated Pension Fund are in surplus with R11 400 million, R80 million and R1 204 million respectively (2006/07: R5 040 million, R74 million and R1 742 million respectively).			

This example indicates the uncertainties involved in estimating pension liabilities. The Associated Institutions Pension Fund was estimated to have a surplus of 55.6 percent of the future pension costs in 2006/07 based on a valuation conducted in March 2005, but the surplus falls to only 12 percent in 2007/08 based on a valuation conducted in March 2007. The South African financial statements do not disclose the assumptions made when calculating these estimates, or whether they have changed from one year to the next (RSA National Treasury: pp. 57-58).

Accounting standards in the area of obligations for social security benefits are less well developed than for reporting on government pension schemes. In February 2008 the International Public Sector Accounting Standards Board issued an Exposure Draft (ED) that covered obligations for social security benefits and long-term fiscal sustainability reporting. This ED suggested that governments should provide as a note to their accounts information on the present value of future payments for social security benefits for those citizens who have met the initial criteria for entitlement (for example, those

who have already retired for public pension benefits) and the key assumptions used when calculating this sum.

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

Governments seldom report on future liabilities, including pension and social security obligations; it is technically complex and subject to a range of estimates or projections that can change the overall figures significantly from one year to the next. Such estimates are difficult to understand and may be subject to manipulation, which is not always easy or even possible to detect. All of these factors make it challenging for civil society groups to engage meaningfully in debates around reporting on future liabilities.

Nevertheless, where long-term fiscal sustainability reports are being introduced, civil society groups could advocate for specific reporting on the anticipated levels of future spending on clear poverty reduction measures, or on social security benefits for disadvantaged groups. This information would enable civil society to argue for changes in current policies in order to reach long-term goals on these issues.

## D. Relevant materials, websites, and “model reports”

HM Treasury (United Kingdom). *Long-term public finance report: an analysis of fiscal sustainability*. London: HM Treasury. 2008. [http://www.hm-treasury.gov.uk/d/bud08\\_longterm\\_586.pdf](http://www.hm-treasury.gov.uk/d/bud08_longterm_586.pdf)

International Monetary Fund. *Manual on Fiscal Transparency* (esp. pp. 47-48). Washington, D.C.: International Monetary Fund. 2007. <http://www.imf.org/external/np/pp/2007/eng/051507m.pdf>

International Public Sector Accounting Standards Board. *Consultation Paper: Reporting on the Long-Term Sustainability of Public Finances*. New York: International Accounting Standards Board. 2009. <http://www.ifac.org/sites/default/files/publications/exposure-drafts/00281.pdf>

International Public Sector Accounting Standards Board. *Exposure Draft 34, Proposed International Public Sector Accounting Standard: Social Benefits: Disclosure of Cash Transfers to Individuals or Households*. New York: International Accounting Standards Board. 2008. <http://www.ifac.org/sites/default/files/publications/exposure-drafts/00281.pdf>



International Public Sector Accounting Standards Board. *IPSAS 25: Employee Benefits*. New York: International Accounting Standards Board. 2008. [http://www.ipsas.org/PDF\\_ipsas\\_standards\\_ifac/IPSAS25.pdf](http://www.ipsas.org/PDF_ipsas_standards_ifac/IPSAS25.pdf)

New Zealand Treasury. *Challenges and Choices: New Zealand's Long-term Fiscal Statement*. 2009. <http://www.treasury.govt.nz/government/longterm/fiscalposition/2009>

Organization for Economic Cooperation and Development. *Best Practices for Budget Transparency*. Paris: OECD. 2002. <http://www.oecd.org/dataoecd/33/13/1905258.pdf>

Republic of South Africa National Treasury. *Consolidated Financial Information for the year ended 31 March 2008*. Pretoria: National Treasury. 2008. <http://www.treasury.gov.za/publications/annual%20reports/annual%20financial%20statements/Consolidated%20fin%20info%20-%2031032008.pdf>

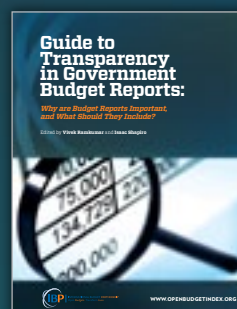


# The Open Budget Initiative

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. The areas covered in this guide include:

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

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



**THE OPEN BUDGET INITIATIVE IS BASED AT THE INTERNATIONAL BUDGET PARTNERSHIP'S WASHINGTON, D.C. OFFICE:**

820 First Street NE, Suite 510  
Washington, DC 20002

**TEL. +1 202 408 1080**  
**FAX +1 202 408 8173**

The IBP also has offices in Mexico City, Mexico; Cape Town, South Africa; and Mumbai, India.

For more information on the Open Budget Initiative or the IBP, contact us at [info@internationalbudget.org](mailto:info@internationalbudget.org) or visit [www.internationalbudget.org](http://www.internationalbudget.org).



**INTERNATIONAL BUDGET PARTNERSHIP**  
Open Budgets. Transform Lives.

[WWW.OPENBUDGETINDEX.ORG](http://WWW.OPENBUDGETINDEX.ORG)