

The Hidden Corners of Public Finance: A Synthesis of Country Case Studies that Look Beyond the Core Budget ¹

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Executive summary

Budget transparency is key to ensuring that citizens, oversight institutions, media, and other actors can access information and hold governments accountable for how they raise and spend public resources. As part of its efforts to promote budget transparency worldwide, the International Budget Partnership (IBP) developed the Open Budget Survey (OBS), which measures the public availability and comprehensiveness of eight key budget reports that all governments should publish according to existing international standards. But not all public spending happens through the budget, and not all public resources are captured in budget documents. Certain categories of government activity may be carried out by **state-owned enterprises** (SOEs), for example in the form of **quasi-fiscal activities** (QFAs), or financed through **extra-budgetary funds** (EBFs) or **tax expenditures** (TEs). To better understand how these “hidden corners” of public finances work, how they could be made more transparent and subject to greater accountability, and what are the key issues and topics that groups interested

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in monitoring each of these four areas should consider, IBP commissioned eight case studies looking at the above four topics in different countries.

The case studies revealed a wide variety of country circumstances and approaches, but in many cases show that in order to gather information on these four areas of public finance it is necessary to look beyond the key budget documents that the Open Budget Survey focuses on. Many of the governments in the case study countries approve laws and publish reports that are specific to government-funded activities and operations beyond the core budget. These take the form of SOE annual reports, special appropriation laws for EBFs, and TE reports, among others. Some areas, such as QFAs, remain more difficult to detect and monitor, and some extra-budgetary institutions are still not reported on in any detail. Some of these improved transparency practices resulted from both domestic and external pressure, as governments sought to respond to calls for more accountable fiscal management and for the adoption of international good practice standards. The findings from these more advanced countries, however, do not necessarily apply to all countries. In fact, the majority of governments are more likely to be using some of these instruments without providing public access to detailed information, adequate reporting, or opportunities for citizen engagement and broader accountability.

Some of the practices highlighted in the case studies could serve as examples for other countries. As such, they served as the basis for compiling a list of specific topics and issues that organizations interested in monitoring government policies and operations in each of the four areas covered by this paper should look at. These can be found in the Annex, and indicate the minimum transparency, participation, and accountability requirements that governments should comply with in order to allow for independent scrutiny by civil society, the media and other accountability actors.

We hope that this synthesis report, the case studies, and the list of topics in the Annex will spur further interest in what are very important areas of public finances that are often not well understood and just as often shielded from public scrutiny.

Acronyms

| | |
|---------|--|
| APN | News Agency of Petroleum (Brazil) |
| ASF | Superior Auditing Office of the Federation (Mexico) |
| BNDES | The Brazilian Bank for Economic and Social Development |
| COA | Federal Court of Auditors (Germany) |
| CoA | Court of Accounts (France) |
| COPA | Committee on Public Accounts (South Africa) |
| DBSA | Development Bank of South Africa |
| EBF | Extra-budgetary fund |
| ESKOM | Electricity Supply Commission (South Africa) |
| FAT | Workers' Support Fund (Brazil) |
| GCU | General Comptroller's Office (Brazil) |
| GDP | Gross Domestic Product |
| HRT | Croatian Radio and Television |
| IBP | International Budget Partnership |
| IFF | Federal Financial Institutions (Brazil) |
| IFRS | International Financial Reporting Standards |
| IPSA | International Public Sector Accounting |
| LABSA | The Land and Agriculture Bank of South Africa |
| MME | Ministry of Mines and Energy (Brazil) |
| MPOG | Ministry of Planning, Budget and Governance (Brazil) |
| PAC | Program for Accelerated Growth (Brazil) |
| PFMA | Public Finance Management Act (South Africa) |
| PSI | Program for Sustained Investment (Brazil) |
| OBI | Open Budget Index |
| OBS | Open Budget Survey |
| QFA | Quasi-fiscal activity |
| ROSNANO | The State Corporation of Nanotechnologies (Russia) |
| SAI | Supreme audit institution |
| SOE | State-owned enterprise |
| SPE | State Productive Sector (Brazil) |
| TCU | Federal Court of Auditors (Brazil) |
| TE | Tax expenditure |

1 Introduction

Since the late 1990s civil society organizations around the world, as well as international financial institutions, have been pushing governments to provide the public with more comprehensive budget information. As part of these efforts, the International Budget Partnership (IBP) developed the Open Budget Survey (OBS), which measures the public availability and comprehensiveness of eight key budget reports that governments should publish in order to enable civil society groups, oversight institutions, the media, and members of the public to monitor public spending, participate effectively in the budget process, and hold governments to account for how they use public money. The survey results in an Open Budget Index (OBI) that ranks countries on a 0 to 100 scale, and has been carried out biennially since 2006. In its 2012 iteration, it covered 100 countries.

More recently, IBP has begun to explore areas of public finance that fall outside the scope of the central government's core budget, and that are not well captured in the survey. Some of these are complex and less well understood activities, which in some countries can represent sizeable shares of public spending. Not surprisingly, they can be especially vulnerable to efforts to shield them from public scrutiny, and often suffer from governments' limited capacity to manage and regulate them effectively and transparently. Four of these areas are the subject of this paper: state-owned enterprises (SOEs), quasi-fiscal activities (QFAs), extra-budgetary funds (EBFs), and tax expenditures (TEs). IBP regards these four as being particularly important for countries that are already satisfying basic criteria of budget transparency, and that could be pushed to do more in terms of opening up their operations to independent scrutiny and public engagement. However, the four areas are problematic for all countries, and the case study findings and observations have potential relevance for countries at all levels of development.

In 2012 IBP commissioned eight case studies, looking at the above four topics in different countries. The objectives were to deepen understanding of country practices, and to inform the possible development of civil society monitoring, analysis, and advocacy activities in these four areas. For this purpose, the case studies also sought to identify key issues and topics that could be explored through questionnaire-based surveys that would complement the OBS in

measuring countries' levels of transparency in these areas outside of the core budget. Reflecting the recent international trend in budget transparency, the case studies also moved beyond disclosure practices to explore issues of public participation in these public finance activities.

This report summarizes and synthesizes the findings from the eight country case studies, and identifies some of the key points that civil society groups interested in doing research and advocacy in each of these areas should consider. It is organized as follows:

- Section 2 describes the research approach and the selection of country cases.
- Section 3 attempts to clarify some of the difficult definitional issues.
- Section 4, the main body of the paper, summarizes the main findings from the case studies for each of the four areas.
- Section 5 draws out some conclusions, including cross-cutting themes and findings from the cases.
- An Annex provides a list of suggested topics and issues for organizations interested in monitoring each of these four areas.

2 Research approach and case study selection

The following criteria were used in selecting the case study countries:

- a) the relevance of the issue in the country concerned, based on prior knowledge from the OBS country research, and from a review of existing materials published by governments or international institutions, such as International Monetary Fund (IMF) Reports on the Observance of Standards and Codes (ROSCs);
- b) an OBI score of 50 or above, to ensure that basic budget transparency practices were being observed in the country;
- c) ensuring geographical spread; and

d) the availability of knowledgeable in-country research partners to conduct the studies.

In one instance (South Africa), the case study covers two of the four topics (SOEs and QFAs) because of the close links between them. All of the other cases focus on just one of the four topics.

| Table 1: The Country Cases | |
|-----------------------------------|---------------------------------------|
| State-owned enterprises | Brazil South Africa South Korea |
| Quasi-fiscal activities | Croatia South Africa |
| Extra-budgetary funds | France Russia |
| Tax expenditures | Germany Mexico |

Country-based researchers carried out the research over the period of August-December 2012 in close collaboration with IBP staff and the authors of this synthesis paper. All of the country studies was based on a common template that drew on relevant international standards, key reference materials, and a series of questions for the case study authors to consider.

The case studies are listed individually by author in the first part of the References section and can be accessed on the IBP website at:

<http://internationalbudget.org/publications/hidden-corners>

3 Definition of key terms

One of the difficulties that became clear during the research process was that some of the terms commonly used in the four focus areas of public finance do not have well-recognized definitions; they are used at different times and in various contexts to mean different things. The discussion in this section is an attempt to identify some of the more authoritative definitions that exist, and to contribute to greater clarity in this area.

A useful starting point to frame how these areas fit together is to define the government sector, and the different components of the wider public sector of which it is part. According to

international standards for fiscal statistics (e.g., the IMF's GFS Manual 2001) and the U.N. System of National Accounts, the public sector can be defined as comprising two categories of entities.

3.1 General government

The first category is general government, which in turn includes the central government and subnational governments. Central government is defined as all government institutional units that are agencies or instruments of the central authorities of a country, and that are covered by or financed through the budget or extra-budgetary funds. The central government sector is composed of:

- budgetary central government: the ministries, departments, agencies, and legislative and judicial authorities that make up the single institutional entity of central government, and that in general are funded by a single annual legislative appropriation;
- extra-budgetary units or entities: entities with a separate legal identity that engage in nonmarket activities and which are owned or controlled by government. They may have substantial autonomy over their expenditures and a direct source of revenue, such as earmarked taxes, although this is not always the case (see below for some examples); and
- social security funds operated by central government to promote social protection through the provision of social benefits, such as medical services, unemployment compensation, and social security pensions.

3.2 State-owned enterprises

The second category consists of public corporations, referred to in this paper as state-owned enterprises (SOEs), the first of the four areas of public finance covered in this study. SOEs are commercial enterprises established as separate legal entities that are fully or majority government-owned, or are controlled by government. They may either be financial corporations (e.g., state-owned banks, development banks), or nonfinancial corporations (e.g., energy companies, telecommunications companies, and so on). They are mostly created for the

purpose of producing goods or services for sale on the market and are a source of potential profit or other financial gain to the owner.

SOEs are important for four main reasons: 1) in some sectors they can have a major impact on the economic development potential of a country; 2) they often provide important public services and impact the communities in which they operate; 3) the SOE sector is often very large in relation to the size of the overall economy; and 4) without transparency, SOEs can be used to advance political objectives, for example government guarantees can be provided to support SOE activities, political patronage can influence board appointments, or governments can impose uncompensated public service obligations on SOEs, in the form of QFAs. The other three areas of public finance fall within one of these categories.

3.3 Quasi-fiscal activities

Quasi-fiscal activities (QFAs) are perhaps the most problematic among the four areas of activity covered in this paper, as they have proven to be one of the most complex and difficult issues of fiscal transparency. In technical terms, these fiscal activities involve the provision of nonmarket services and the redistribution of income and wealth, financed primarily by taxes and other compulsory levies on nongovernment sectors. QFAs are best thought of as fiscal activities conducted, and often financed, by institutions outside the government sector.

For example, a government may want to reduce the cost of electricity for low-income households below the market price. It could do this by calculating the amount of the subsidy required and paying it to an energy utility SOE (the payment of such a subsidy would be a fiscal activity and would appear in the budget). Alternatively it could direct the SOE to charge lower prices, and the SOE would either incur losses or make up its losses by charging higher prices to other customers (i.e., a cross-subsidy). The cost of these QFAs typically would be hidden in the SOE's accounts — perhaps until the losses accumulate enough for the government to need to provide fresh capital.

QFAs come in a wide variety of types and sizes. For example, national oil companies may be forced to sell petrol to domestic consumers at below-market prices; public corporations may be

expected by government to employ more people than are warranted by purely commercial considerations; publicly owned banks may be told to lend to specific clients at subsidized rates; and central banks may be asked to provide subsidized lending to insolvent private banks as part of bank rescue operations. As can be seen, QFAs mostly happen through SOE activities, and are therefore closely linked to fiscal transparency practices relating to SOEs. However, there are many other transparency, participation, and accountability issues with respect to SOEs beyond just QFAs — for instance, pricing policies and regulation, annual reporting, auditing, social and environmental impacts, and opportunities for public engagement.

3.4 Extra-budgetary funds

The term extra-budgetary funds (EBFs) is used in this study to describe a wide variety of phenomena. Following Allen and Radev (2006), EBFs can be defined as government entities, often with separate banking and institutional arrangements, whose expenditures are not appropriated in the annual budget. Legislative approval for their activities is through a mechanism other than the annual budget.

Within this wide array of EBF permutations there are four main types of EBF that in practice are the most significant around the world: 1) Social Security Funds; 2) Natural Resource Funds and Sovereign Wealth Funds; 3) other dedicated expenditure funds, such as Road Funds and Environment Funds; and 4) various forms of off-budget donor financing in lower-income countries. It has been estimated that, on average, EBFs account for around 40 percent of total central government spending in both developed and transition/developing countries. They therefore are critical to overall fiscal transparency, participation, and accountability.

3.5 Tax expenditures

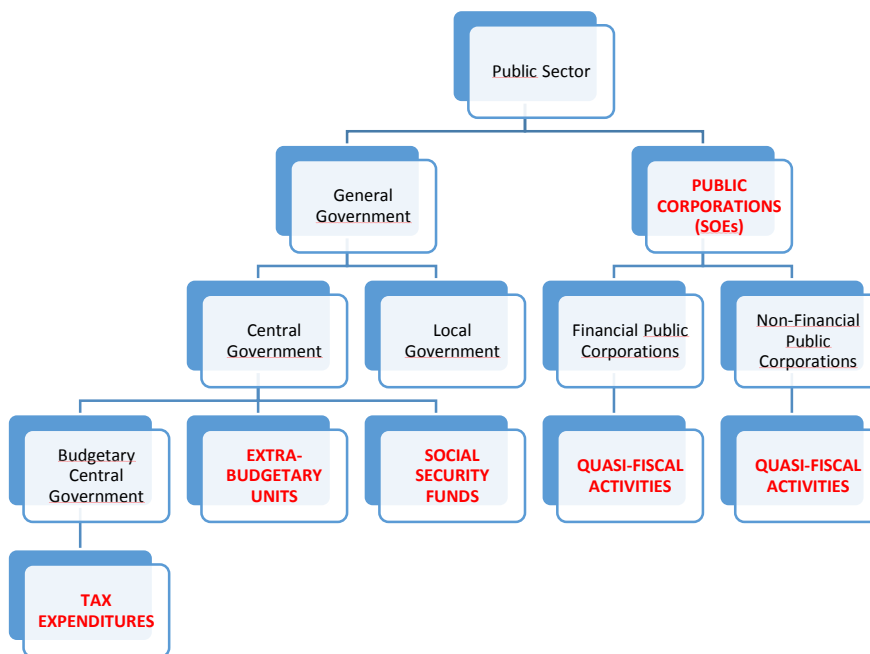
Finally, there are a variety of definitions of tax expenditures (TEs). The International Public Sector Accounting Standards Board defines TEs as “preferential provisions of the tax law that provide certain taxpayers with concessions that are not available to others.” TEs are intended to encourage or support a specific type of activity, or to benefit particular taxpayers. For that reason, they should be viewed as substitutes for alternative means of achieving such policy objectives, such as direct government spending (subsidies, government service provision),

regulations, or government ownership. TEs are, however, clearly fiscal activities, as they are variations to the tax (or customs) code that reduce the revenue that would be collected in their absence, and are typically implemented by agencies within the government sector. In this sense, they are less transparent operations carried out by budgetary central government entities.

Common examples of TEs include tax incentives or tax-based support for foreign investment, research and development, saving, energy conservation, environmental protection, regional development, culture and sports, home ownership, or to supplement the incomes or consumption of individuals or households with low incomes. The precise definition of TEs is, however, a matter of considerable technical complexity. It requires the specification of a “normal” or “benchmark” tax system, departures from which constitute a TE. This can lead to debate and controversy over whether a specific provision in the tax law constitutes a TE or not.

Figure 1 below depicts how the different components of the public sector fit together and relate to each other, and highlights where the four types of fiscal policy operations covered in this study can usually be found.

Figure 1. The public sector, its components, and the “hidden corners”



4 Main findings by area

In this section the main findings from the research are presented and summarized for each area of activity, drawing on relevant material from the country case studies. Key issues are highlighted, identifying specific challenges related to transparency, participation, and accountability.

4.1 State-owned enterprises

Looking across the Brazil, South Korea, and South Africa case studies of state-owned enterprises (SOEs), the following general issues emerge:

SOEs in all three countries constitute an important arm of government operations, not only contributing to governments' public investment policies but also having a major influence on governments' fiscal and budget operations. In some cases, this significance is to the detriment of fiscal transparency.

The sheer scale of Brazil's SOEs is impressive. The two SOEs selected for more in-depth analysis in the case study are large on a global scale. Total loans disbursed by Brazil's National Bank for Economic and Social Development (BNDES) since 2007 are estimated as being at least twice the size of the combined lending of the World Bank and the Inter-American Development Bank; while Petrobrás (the Brazilian state oil company) was the world's 23rd largest company in 2012.² In South Africa, the 21 SOEs classified as "Schedule 2 entities" under the Public Finance Management Act (PFMA) roughly produce between 6 percent and 8 percent of the country's total GDP (DPE, 2005).

Following the global financial crisis, the Brazilian government has used public financial corporations to increase public spending in a way that is not captured in measures of government spending. In this way, it simultaneously managed to sustain large-scale investments through SOEs, while at the same time obtaining a primary budget surplus. For

² See <http://money.cnn.com/magazines/fortune/>.

example, it relied heavily on Petrobrás' investment capacity, strategic position, and massive footprint in order to advance its macroeconomic program and to effectively implement investment policies.³

South Korea also has a history of SOEs being used to implement government policies, including noncommercial obligations, and this persists to some extent. For example, after the 2007 election the new President wanted to push through a restoration project for the country's four main rivers at a cost of 8 trillion won (approximately US\$7.8 billion) to stimulate the economy. Lacking sufficient support in the National Assembly to do this through the budget, he instead used the Water Resource Corporation. The corporation was allowed to issue bonds the repayment burden of which will eventually fall on the government. The total cost amounted to 35 percent of the 2011 budget for the parent Ministry of Land, Transportation, and Maritime Affairs.

Overall, the case studies point to a series of interesting examples of transparency and participation practices that allow for public scrutiny of SOE operations. These range from SOE-specific reports and websites, to centralized publications and portals managed by government ministries, to the publication of different types of audit findings. They also illustrate various instances of citizen engagement with different aspects of SOE operations, either directly or through other accountability institutions, such as ombudsman offices and parliamentary committees.

In all three countries, the operations of SOEs are based in specific legislation, detailing the scope of their activities and often key transparency requirements. For example, Brazil's Constitution refers to SOEs as being part of the state's indirect administrative body. As such, nonfinancial SOEs are incorporated into all key budget documents, from the Pre-Budget Statement to the Enacted Budget, to Year-End Reports. State-dependent enterprises are

³ For example, the government controls domestic prices of oil and gas by-products in order to curb inflation. However, since Petrobrás faces competition in these markets it incurs financial losses, and other mechanisms are used to compensate the company, e.g., a reduction in a separate fuel industry levy, which benefited Petrobrás to the order of R\$420 million (US\$209 million) but which was still not enough to offset the 15 percent gap between domestic and international gasoline prices.

covered in the fiscal and the social security budgets, while state-controlled corporations are covered in the investment budget.

All information on SOEs in South Korea is published on a single government website (www.alio.go.kr). This is an important and convenient site for collecting data about SOEs. Through this mechanism, the government also publishes an annual aggregate report on SOEs, providing citizens with a clear view of the overall performance and evolution of the government's portfolio, and the main financial indicators for the most recent reporting period. In addition, individual SOEs publish regular, timely, and informative Annual Reports, which contain their financial and operating results, remuneration policies, related party transactions, and governance structures and policies. They also report payments of taxes, royalties, etc. to government; financial support received from government (such as guarantee of loans); and the cost of noncommercial obligations imposed on them.

In Brazil all SOEs are monitored by the Ministry of Planning, Budget, and Management (MPOG), which is responsible for formulating the investment budget that integrates government and SOE investment spending. MPOG publishes two official aggregated SOE reports: the Profile of SOEs; and an Annual Report. Both documents contain extensive and detailed information on each SOE. The investment budget presents extensive multiyear information on each SOEs' budget and actual expenditures by government program, by supervising ministry, by function, by economic classification, by geographic region, and by financial source. Moreover, all SOEs are subject to the Law for Public Access to Information enacted in 2011, though the law allows SOEs that operate in competitive markets to withhold commercially sensitive information.

In South Africa the PFMA and Treasury Regulations spell out the various reporting requirements for SOEs. The reporting cycle begins with the development of a corporate plan, a budget, and a shareholder compact prior to the beginning of the financial year. SOEs also have to produce several In-Year Reports for monitoring purposes by the executive authority. The SOE is expected to report on its activities for the year and the way it spent its funds in the annual report, which includes the annual financial statements.

As far as citizen engagement in SOE operations is concerned, in South Korea each SOE is controlled by a Board of Directors, in which nongovernment experts are to be in the majority and one of whom chairs the board. This has also been the case at the Development Bank of South Africa. South Africa has another interesting mechanism aimed at increasing citizen engagement in SOE-related matters. When the parliament passes legislation on SOEs, the legislative process has an inbuilt participation process whereby the public is invited to make written or oral submissions. The findings of these submissions are discussed by the portfolio committee, leading to the adoption of recommendations or the submission being noted. Nevertheless, the parliament has in recent years been reprimanded by the courts and criticized by the press for not allowing such active participation to take place.

In Brazil the BNDES created two important accountability offices: the auditing committee, included in the bank's statute in 2004, and a client relations' service established in 2007. The auditing committee, among other roles, assesses the quality of budget information and the observance of Brazil's Central Bank financial norms applicable to all financial institutions. The client relations' service is dedicated to conflict mediation and the formal treatment of client complaints, including proposing corrective measures and improvements.

Finally, in all three countries SOE operations come under the external scrutiny of audit institutions, whose reports are shared with legislative committees for analysis and follow up.

There exist fundamentally different models of the role of SOEs in the economy — both over time in a single country, and across different countries.

Brazil today illustrates what has been described as “state capitalism,” in which the government uses its SOEs to promote the growth of national and global champions. The Brazilian approach, which is common among emerging and developing countries (exemplified by China), features the pursuit by SOEs of multiple commercial and noncommercial objectives. This complicates measurement and assessment of performance, and makes transparency, direct public engagement, and accountability particularly important, especially given the sheer size of many SOEs under this model. An alternative model is one in which SOEs operate at a more arms-length from government, are primarily commercially focused, and there is competitive

neutrality between SOEs and other domestic and international competitors. South Korea and South Africa illustrate this model, also present in a strong form among EU member countries, in which an arms-length relationship is legally codified and enforced by independent competition authorities in the context of the EU single market.

There are also fundamentally different approaches to the relationship between the central government budget and SOE expenditures.

For instance, Brazil illustrates the approach common in Latin America of incorporating the investment spending of nonfinancial public enterprises with central government investment spending, in an augmented investment budget presented to and authorized by the legislature each year.⁴ South Korea and South Africa illustrate the approach typical outside Latin America in which SOE finances are not incorporated in the central government budget, apart from the fiscal flows between SOEs and government (e.g., taxes and dividends paid by SOEs to government, and subsidies paid by government to SOEs).

There is a distinctly Korean approach to performance evaluation of SOEs, involving systematic annual assessments against published criteria by nongovernment experts and published performance ratings.

An interesting and important aspect of transparency and accountability of SOEs in South Korea is the external performance evaluation system. Initiated in 1984, it was further codified in the 2007 Act on the Management of Public Institutions. The evaluation of management performance is based on 18 indicators in three categories (leadership and strategy, management system, and business performance), with the indicator weightings customized to each individual SOE, but with commercial SOEs subject to a higher quantitative component. The evaluation is conducted by a special team appointed each year for each SOE, composed of experts from the private sector (around 70 experts participate in the evaluation each year). Each SOE is rated on a six-point scale (from excellent to very poor). Grades are determined by the Committee for Management of Public Institutions, chaired by the Minister of Strategy and

⁴ See International Monetary Fund, "Public Investment and Fiscal Policy," 12 March 2004., pp. 18-19 for a summary of the different coverage of public enterprises in fiscal statistics in Latin American countries compared to other regions.

Finance, Vice Ministers of other Ministries, and up to 11 private sector experts. All the grades are published. Recently a survey of customer satisfaction has been added, conducted by independent organizations (from 2007 every public institution providing services directly to the public is required to conduct a customer satisfaction survey at least once a year).

4.2 Quasi fiscal activities

Looking at the case studies of Croatia and South Africa, but also taking into account information from some of the previous case studies on SOEs, the following general issues emerge with respect to quasi-fiscal activities (QFAs):

It is often quite difficult to clearly identify QFAs, and to estimate their cost, given their complexity and the level of technical expertise required to do so.

For nonfinancial public corporations, it appears that QFAs in case study countries often take the form of below-market pricing or cross-subsidizing between different consumer groups. For financial public corporations, the most common QFAs are directed toward lending and concessionary loans.

In South Africa, for example, DBSA is mandated to support the government's land distribution and agrarian reform through its lending function, and interest rates charged on some programs are significantly lower than the prime lending rate. It is unclear whether the bank is fully compensated by the government for all the costs associated with these noncommercial activities. Similarly, all SOEs are mandated to assist the government to fulfill its local economic empowerment initiatives through affirmative procurement. Affirmative procurement implies that price is no longer the sole criterion in procuring goods and services for government. Given that alternative cheaper procurement channels exist, procuring from uncompetitive suppliers in the name of empowerment has cost implications that SOEs like Eskom are not compensated for, and that are difficult to quantify.

In a number of countries, like South Africa and Brazil, SOEs pursue multiple and conflicting commercial and noncommercial objectives, which may entail substantial QFAs embedded in SOE accounts. In some cases, however, what may at first sight appear to be QFAs may on

deeper analysis turn out to be compensated from the government budget, thus transforming them from QFAs into normal fiscal activities. This was the case for some categories of activities in Croatia, probably due to the influence of recent EU rules on state aid.

SOE Annual Reports are a key source of information and data on the existence and size of QFAs.

Given that by definition QFAs do not appear in government budgets, reporting by SOEs themselves, though often incomplete and unreliable, is usually the only source of information on QFAs. Many SOEs — particularly those listed on stock exchanges and/or issuing public debt securities — have in fact an incentive to disclose such information, in order to identify noncommercial obligations that may act as a constraint on their profitability.

In Brazil the Petrobrás Management Report for the 2011 Fiscal Year described the QFAs undertaken by the company. These projects amounted to an expenditure of R\$640.9 million (US\$349 million), or 2.5 percent of what the company paid that same year in royalties and special participations to the federal government, the states, and the municipalities. They consisted of: a) Social Projects: R\$ 207 million (US\$ 112.7 million); b) Environmental Projects: R\$ 171.6 million (US\$ 93.5 million); c) Cultural Projects: R\$ 182.3 million (US\$ 99.3 million); and d) Sporting Projects: R\$ 80 million (US\$ 43.6 million). To put these in context, the spending on social projects represented less than 1 percent of total federal spending on social assistance, while the spending on cultural projects represented 13 percent of federal spending in the cultural portfolio. Yet, these figures may not cover all there is to know about QFAs that the company carries out.

In South Africa there is no requirement for SOEs to disclose any noncommercial obligations imposed on them by government. This makes it difficult to identify QFAs. However, some of them may come to light when SOEs apply for tariff increases, as part of their justification for the increase. This was the case with Transnet, which used high port tariffs in order to subsidize its loss-making operations.

In Croatia information about the QFAs carried out by the radio and television company HRT could be obtained through some public media, based on discussions which mostly occurred within government and occasionally in the parliament. However, the fact that for many years HRT has not published annual reports of its operations on its website, and the ensuing lack of public access to high-quality, complete information on HRT financing means it is not possible to obtain an objective view of its operations.

Independent regulatory institutions can have an important impact on making SOE price-setting more transparent, and on reducing the ability of governments to influence pricing decisions for noncommercial purposes.

This was true in Croatia, South Africa, and Brazil, although the impacts were especially strong in Croatia due to the EU single market laws enforced by an independent competition authority. Prior to 2006 individual companies had administratively fixed prices that were set below the cost of production. Since 2006 Croatia has liberalized markets and set up independent regulatory bodies that set binding regulated prices. This has reduced the scope for QFAs and discretionary decisions of politicians and officials.

The harmonization of Croatian legislation with that of the EU (particularly with respect to state aid) has helped to better determine the financial relationship between the state and public companies, and has made it easier to recognize when certain financial instruments (loans and guarantees) constitute state aid. The payment of budget subsidies in Croatia, to compensate for the cost of noncommercial obligations, is a result of, or at least clearly associated with, the harmonization of policy with EU policy under the Stabilization and Association Agreements.

4.3 Extra-budgetary funds

Looking at the case studies of France and Russia, two interesting findings emerge with respect to extra-budgetary funds (EBFs):

In both France and Russia, the budgets of the Social Security Funds are appropriated by the legislature each year, at the same time and following a similar process as the main central government budget. Therefore, it is arguable whether they should be regarded as “extra-

budgetary”. There is a very high degree of transparency and accountability applying to these Social Security Funds, especially in France, probably representing international best practice.

Spending by the four branches of the French Social Security (SS) system (health, work accidents, pensions, and family) is very large. In 2012 it represented more than half of central government spending. Full information is publicly available on the revenues, spending, deficits, and debt of the SS system, and, since 1996 it has been presented to parliament as a draft SS financing law at about the same time as the annual draft budget law. The SS financing law is adopted separately from the annual budget law covering the rest of central government spending. Although the two laws are approved separately, a consolidated framework pertaining to “general government” is presented to parliament for discussion twice a year: in midyear (June) for a pre-budget debate and again in October when the detailed draft budget laws are submitted to parliament for approval.

The government provides a wealth of budget-related information on the SS funds, central government transfers to noncommercial government agencies, and special funds. The information ranges from summary “SS budget in brief” or “key figures of SS” to dense analytical documents on the budgets and policies of the SS system, transfers (direct and indirect) to the SS system, and special accounts. The Court of Accounts (CoA) audits the SS accounts and, more generally, conducts performance analyses of the entire public finance system into which the SS system fits. Civil society groups, notably trade unions, employers’ federations, and specialists in matters pertaining to specific extra-budgetary activities, are well represented on the governing boards of the EBFs.

In Russia there are three social security funds: the Pension Fund; the Social Insurance Fund; and the Federal and Territorial Compulsory Medical Insurance Funds.⁵ Their expenditures comprise 60 percent of total budgeted federal central government expenditures in 2012, with the Pension Fund (41 percent) being the largest.

⁵ There are also two funds that are budget funds according to law, and the revenue and expenditures are included in the main articles of revenues and expenditures of the federal budget: the National Welfare Fund and the Reserve Fund.

As in France, the budgets of these funds are submitted by the executive to the legislature each year along with the main government budget proposals. The form of presentation is the same as that of the federal budget, and the interactions of each EBF with the federal budget are described in detail. Reporting on execution of the social EBFs is in the same format as for the main budget. The reports for each EBF are submitted to parliament along with the Year-End Report for the main budget (and at the same time as the proposed budgets for the following year). The Accounting Chamber carries out the audit of the EBFs' budget execution for compliance with legal obligations.

On the other hand, in both France and Russia there is considerably less transparency around the operations of extra-budgetary units that, while a part of central government, have a separate legal identity and engage in nonmarket activities. These units may also have substantial autonomy over their expenditures and a direct source of revenue, such as earmarked taxes.

This is especially the case in Russia, where the activities of the six “state corporations” are subject to low levels of transparency and accountability. These are extra-budgetary units were established by the government to conduct *noncommercial activities* (in this sense, they are not SOEs). They are: the Bank for Development and Foreign Economic Affairs (Vnesheconombank); the Foundation for the Reform of Housing and Communal Services; Russian Technologies (Rostekhnologii); the State Atomic Energy Corporation (ROSATOM); the State Corporation for Construction of Olympic Venues and Sochi Development as Alpine Resort (Olympstroy); and the State Corporation of Nanotechnologies (ROSNANO).

Each of these state corporations is established under its own law, and there are no general transparency, public participation, or accountability provisions that apply to all of them. It is difficult to judge their size as there is no consolidated statistical information available. In general, it is difficult to assess their performance against their objectives. State corporations are not obliged to report to government bodies on their activity, except for the submission of an audited annual report. However, budget transfers to the state corporations are shown in the

federal government budget, and the annual reports of some of the corporations (published on their websites) provide some information on their operations.

A similar thing can be noted in France, where there is no consolidated budget information on non-commercial agencies controlled by the government. Moreover, it is not possible to unambiguously state the total number of such agencies (580 on one count, 729 in another, 1,244 in another), nor accurately estimate their impact on public finances. While a lot of information on government transfers to these agencies is available, there are difficulties in obtaining consolidated information on the agencies' "own revenues" — revenues other than that from the central government, such as income from user charges. The public availability of audited financial accounts of these agencies also needs to be improved considerably.

Further research may be needed to look at other types of EBFs.

Both case studies looked at different types of social security funds and some extra-budgetary units. While social security funds represent two-thirds of public spending through extra-budgetary entities (Allen and Radev 2006), EBFs come in many other shapes and sizes, including sovereign wealth funds, road funds, etc. Further research should focus on these additional types of EBFs and the transparency and accountability arrangements they have in place.⁶

4.4 Tax expenditures

Looking at the case studies of Germany and Mexico, the following points emerge about tax expenditures (TEs):

Both Mexico and Germany provide good examples of countries that regularly report on TEs at the national level. Germany also has state-level reports (though these are not standardized). The German federal report is broader than the Mexican report, covering subsidies more generally (i.e., including direct expenditure subsidies) but is less frequently (every two years rather than annually).

⁶ Some interesting material on transparency and governance of natural resource funds is available in Revenue Watch's Resource Governance Index. See: <http://www.revenuwatch.org/rgi>.

Detailed reporting of TEs has been in place in Germany since 1967, when a requirement to publish a “Subsidy Report” was introduced, making Germany the first country to publish a TE report. Since then, 23 such reports have been published, approximately every two years. In addition, details of the “20 largest tax privileges” have been published along with the annual federal budget documents since 2005, as required by the Budget Law. Reported tax expenditures in Germany amounted to about 8 percent of revenues, or about 3.5 percent of GDP in 2012.

The Subsidy Report focusses on measures that directly or indirectly benefit an economic sector or an enterprise. The report covers subsidies generally, not just tax expenditures. The detailed content of the Subsidy Report is as follows: a) an overview of how subsidies have developed during the period; b) a presentation of the government’s goals and concepts on tax expenditures; c) a summary of changes to existing tax expenditures, and a list of selected new tax expenditures; d) an examination of the development of subsidies by sector (both spending and taxation); e) a discussion of the main guiding principles of subsidy policy and a summary of the implementation status of the subsidy policy guidelines; and f) a discussion of subsidy issues at the European level.

More detailed information specifically on TEs is contained in annexes to the Subsidy Report. This includes an explanation of the concept used to measure them; a description of each TE, its legal basis, and history; the objectives, type of help, economic focus area, and the type of tax (e.g., personal income tax) for the TEs; the amount of estimated cost in terms of foregone revenues for the past three years, as well as estimates for the upcoming year at the federal, state, and local level; the type of subsidy; whether it declines over time; how it is evaluated; and whether the TE is limited or unlimited in time frame. In the 2011 Report, there were 103 TEs overall that amounted to 26.9 billion euros, of which 17.1 billion was at the federal level.

Once the finance ministry produces the final text, the German Cabinet officially approves the report before it is submitted to the legislature. The Finance Committee of the lower house then discusses it before it is published. The Federal Court of Auditors (CoA) also plays an active role in scrutinizing tax expenditures, through two mechanisms. First, it issues an annual report on

the legal aspects of taxation. Second, the CoA has the right to issue rulings on particular matters, such as tax expenditures. For example, in 2008 it issued a special report on the transparency of tax expenditures, arguing that the government should provide more detail on the actual effects of TEs.

TEs in Mexico have been estimated by the Superior Auditing Office of the Federation (ASF) to have generated a tax revenue loss of \$583 billion pesos, equivalent to 44.3 percent of tax revenues and 4.5 percent of GDP. Under Article 27 of the Federal Revenue Law, current TEs should be reported annually in the Tax Expenditure Budget and published on the ministry of finance website. Also, the report must be delivered to the Finance and Public Credit Committee, the Budget and Public Account Committee, the Center of Public Finance Studies in the Chamber of Deputies, and to the Finance and Public Credit Committee in the Senate. In practice it is also submitted to the Special Committee for the Analysis of the Tax Expenditure Budget in the Chamber of Deputies. With respect to the Tax Expenditure Budget content, by law it is to include: a) the estimated amount of resources the finance ministry will forego for the period; b) the methodology used to determine the estimates; c) the reference or legal basis that supports the inclusion of each item; d) the specific aided sectors or activities for each item, where appropriate; and e) the social and economic benefits associated with each tax expenditure.

The 2012 Tax Expenditure Budget shows, among other things, the revenue loss resulting from the application of each of the 100 existing TEs (although there is no discussion of the reliability of the estimates). It also presents the legal basis for each TE. Furthermore, TEs are classified by type of treatment, tax, and taxpayer, but are not classified by function (and only by economic sector for some TEs). It does not indicate sunset dates, the objectives of each TE, or the number of real beneficiaries.

The Tax Expenditure Budget and the annual budget are presented to the legislature on different dates, on June 30 and in September, respectively. The Federal Revenue Law should include “an explanation on the tax expenditures for the budgeted year” but in practice it only contains a brief reference to the largest TEs. As a result, legislators do not have complete information on TEs at the time of the annual budget.

The ASF has the constitutional power to review TEs. In 2009, the ASF carried out a special audit of the way in which the finance ministry managed TEs and compared this against international best practice. It also analyzed information on TEs in the 2010 Public Account, making a series of recommendations including the need for the finance ministry to present a systematic evaluation of the effectiveness and efficiency of TEs, and an assessment of their economic and social impact.

It is interesting to note the longstanding and influential role played by a civil society institution in Germany in producing a regular “alternative TE Budget” and in critiquing official reports on TEs.

A further interesting feature of TE reporting in Germany is that a civil society TE report is also published, and has been continuously since 1979. The Kiel Institute for the World Economy, which is an economic institute based at the University of Kiel, produces a report separate from the government one. Its reasons for doing so include that the Federal Report may miss the subsidies at lower levels of government, and that the definition of “subsidies” has not been consistent across Federal Reports, with each revision reducing the size of overall subsidies. While the Kiel Report is largely based on the Federal Report, it covers subsidies at the federal, state, and EU level, presenting a more comprehensive picture than the Federal Subsidy Report or any of the individual state reports. Its definition of a subsidy is also broader. The press coverage mainly cites the Kiel Report as an alternative measure of subsidies when the media is reporting on the publication of the Federal Subsidy Report.

Confusion arises from the variety of terms used to describe TEs.

TEs are referred to by many different names: tax benefits, tax incentives, tax concessions, tax breaks, tax subsidies, etc. As in Germany, this can lead to multiple definitions of TEs, even between different actors in the same country.

5 Conclusions

In its efforts to promote transparency, participation, and accountability in the management of public resources, IBP embarked in 2012 on a research project to investigate some of the issues and challenges related to specific areas of public finance that involve large shares of public resources, but that are often marred by weak government controls, suffer from lack of transparency, or for which accountability mechanisms are different and separate from the ones that apply to the regular budget process. Eight country case studies were commissioned from country-based experts, in an effort to better understand some of the practices that have emerged around reporting on state-owned enterprises, quasi-fiscal activities, extra-budgetary funds, and tax expenditures, and the challenges that organizations interested in monitoring these types of government activities might face.

The case studies revealed a wide variety of country circumstances and approaches. Many cases show that by looking beyond the key budget documents that the Open Budget Survey focuses on it is often possible to gather extensive amounts of information on the four areas of public finance that the research examined. Many of the governments in the countries studied approve laws and publish reports that allow for building a reasonably detailed picture of government-funded activities and operations beyond the core budget. These take the form of state-owned enterprises (SOE) annual reports, special appropriation laws for extra-budgetary funds (EBFs), and tax expenditure (TE) reports, among others. Some areas, such as quasi-fiscal activities (QFAs), remain more difficult to detect and monitor, and some extra-budgetary institutions are still not reported on in any detail.

It is important to remember that case study countries were partly selected because of their good levels of basic budget transparency, and in light of their interesting approaches and experiences in some of the areas covered. In most countries in the world, normal practices around reporting and publishing information on EBFs and SOEs, for example, will be much worse than those described in this paper and covered in more detail in the country case studies. One of the key purposes of this project was, in fact, to document interesting and innovative practices that could be used as examples by other countries.

Some broad cross-cutting issues also emerge from the case studies with regard to some of the factors that may have led governments to disclose information on these categories of activities. In a number of countries, for example, international influences, including those from regional economic agreements (e.g., the EU), international capital markets, and international financial institutions and the United Nations, have shaped government responses and improved transparency practices. For instance:

- a) With respect to TE reporting in Germany, the EU has played an important role, both for initiating the first Subsidy Report back in 1967 and in current Bundestag debates about new tax expenditures, where parliamentarians regularly ask whether the European Commission will rule that such new expenditures contravene EU state aid rules. The EU legal framework regulating state aid to industries has also been decisive in changing some practices with respect to SOEs in Croatia, reducing QFAs or making them more transparent.
- b) The practice of incorporating investment spending of nonfinancial public enterprises with central government investment spending in an augmented investment budget in Brazil arose partly due to the influence of the IMF following the debt crises of the 1980s. World Bank lending practices have influenced BNDES environmental safeguards. Likewise, the issuance of debt securities on U.S. capital markets — in terms of awards for sustainability reporting and the introduction of protected disclosures for employees — has had an impact on the reporting practices of SOEs in both Brazil and South Korea, alongside signing up to the UN Global Compact.

The case studies also revealed diverse sources of incentives for governments to be more transparent, participatory, and accountable in these four areas. Important general sources of influence, in addition to international influences, include:

- a) political transitions and democratization processes in South Africa, Croatia, Brazil and South Korea, which resulted in a “modernization” of the legal framework;

- b) legislatures playing an important role in bringing about greater transparency of EBFs in France, and with respect to TEs in Mexico. This was complemented by the active role of the supreme audit institution (SAI) in both countries (on the other hand, legislative oversight appears to be particularly weak in South Africa and Croatia, although SAI reports in Croatia have helped to expose QFAs); and
- c) the varying role of civil society organizations, which ranged from very limited (South Korea, South Africa) to playing an increasing role in lobbying for more accountability (Brazil) and publishing independent analysis of SOEs and QFAs (Croatia), to a longstanding actor in the national debate on TEs (Germany).

Civil society groups and other actors interested in monitoring government activities and operations in these four areas can use this synthesis report and the related case studies as a resource to gain a better understanding of some of the issues involved, some of the innovative practices that exist around the world, and some of the key topics that they should look into if they decide to investigate any of the areas above in further detail in their own countries. The Annex presents a more detailed checklist of the types of information that can help in their efforts and that governments should make publicly available.

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Annex

This Annex contains suggestions of specific topics and issues that organizations interested in monitoring government policies and operations in each of the four areas covered by this paper should look at. These are informed by the general literature in these areas, by the material in the case studies, and by the suggestions of the case study authors. They indicate the minimum transparency, participation, and accountability requirements that governments should comply with in order to allow for independent scrutiny by civil society, the media, and other accountability actors.

A. State-owned enterprises

Good practices require the public disclosure of the following types of information:

- The legal/regulatory framework clearly defining SOEs (and categorizing different types of SOEs as relevant), and a published schedule of all SOEs
- A statement of the objectives of SOEs in general, and those of individual SOEs, to enable accountability for performance in achieving objectives
- A statement clearly outlining the roles within government with respect to the different interests/functions of central government (e.g., the state's role as owner of SOEs, as regulator of SOEs, as policy maker on sector issues, and as "commissioner"/purchaser of services from SOEs)
- Forward-looking SOE plans (Strategic Plans, Annual Plans, Shareholder Compacts)
- In the government's annual budget documents, information on the financial relationships (tax payments and any tax reductions or arrears, dividend flows, capital injections/withdrawals, loans, guarantees, subsidies, grants) between the government sector and SOEs
- Comprehensive Annual Reports of individual SOEs containing audited financial statements, related party transactions, actual financial flows to and from government, details of noncommercial obligations imposed by government, nonfinancial performance, and information on social and environmental policies and impacts
- Consolidated information on the financial performance and position of the SOE sector as a whole
- Reports resulting from independent audit of SOEs; and details of accounting and auditing standards

In addition to these disclosures, some additional aspects to be taken into account include:

- The availability of information on all SOEs at a single site, such as a web portal, or consolidated annual reports published by the government entity responsible for supervising SOE operations

- Publishing information on the operation and effectiveness of legislative oversight of SOEs
- The application of general accountability mechanisms to SOEs (e.g., FOI laws, employment and procurement regulations, judicial review)
- Opportunities for citizen engagement in SOE operations with respect to legislative oversight, policy changes, pricing, and service delivery issues

B. Quasi-fiscal activities

Good practices require the public disclosure of the following types of information:

- The legal, regulatory and/or policy framework under which governments impose noncommercial obligations on SOEs, setting out the purpose/justification, performance expectations, and reciprocal obligations of government and of the entities implementing noncommercial obligations
- Detailed information on QFAs is in the government’s annual budget documents, or in a consolidated report on the SOE sector, or in the report of another government agency (this should include a consolidated list of all QFAs and quantitative data on the financial impact of individual QFAs)
- Information on QFAs is in the Annual Reports of individual SOEs or of the Central Bank
- Results of independent audits of QFAs

In addition to these disclosures, some additional aspects to be taken into account include:

- The role of the legislature in scrutinizing or debating QFAs
- Opportunities for direct citizen engagement with respect to legislative oversight, policy changes, pricing, and regulation of pricing
- Civil society or media engagement in analyzing, publicizing, or debating any QFAs

C. Extra-budgetary funds (and extra-budgetary units)

Good practices require the public disclosure of the following types of information:

- The legal and regulatory framework, in general, and with respect to individual EBFs and EBUs, including different categories of EBF and EBU
- A consolidated list of all central government EBFs and EBUs, including financial information on their aggregate size
- Details on how the expenditures of the EBF and EBU are authorized by the legislature
- Information in the annual central government budget documents on each individual EBF and EBU, and on the financial flows between individual EBFs/EBUs and the government budget
- Data on the “own-revenues” of EBUs in budget documents and fiscal reports
- A unified presentation of the budget that consolidates budgetary central government, EBFs, and EBUs

- Information on the comparability in the classification of revenues, expenditures, and financing of EBFs and EBUs in relation to the classification systems used for core government
- Information on EBFs and EBUs in In-Year and Year-End Reports
- Results of independent audits of EBFs and EBUs

In addition to these disclosures, some additional aspects to be taken into account include:

- The operation and effectiveness of legislative oversight of EBFs and EBUs
- Opportunities for direct citizen engagement with respect to legislative oversight, policy changes, pricing, and service delivery issues relating to EBFs and EBUs

D. Tax expenditures

Good practices require the public disclosure of the following types of information:

- The legal, regulatory and policy framework for TEs, including clear concepts and definitions of TEs, and the benchmark tax system(s)
- Quantitative and qualitative information on TEs published in (or at the same time as) the annual budget documents or in other documents (e.g., the annual report of the tax and customs or competition authorities)
- Additional information on performance orientation of TEs: a) information for each TE on its public policy purpose, its duration, and the intended beneficiaries; b) classification of each TE by type of tax, and the functional classification of expenditure; c) comparisons of individual TEs against other instruments, such as direct spending; d) nonfinancial performance measures; and e) results of periodic evaluations
- Results of any independent audits of TEs

In addition to these disclosures, some additional aspects to be taken into account include:

- The operation and effectiveness of legislative oversight of TEs
- Opportunities for direct citizen engagement with respect to legislative oversight, policy changes, proposed new TEs, and impacts of TEs
- Existence and content of any civil society analyses or reports on TEs