Fiscal transparency in the European Union

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Abstract. The fiscal transparency is a key point in the fiscal policy stance, which is why a special attention should be paid to this issue. The fiscal transparency provides to the policymakers the ability to accurately analyse the costs and benefits of any changes in the fiscal policy. In addition, the economic turmoil manifested lately led to a strengthening of the fiscal surveillance in the European Union. Thus, in this article the objective is to analyse how fiscal transparency is achieved in the European Union through the changes made or planned to be implemented due to recent economic pressures.

Keywords: fiscal transparency, fiscal policy, public finance sustainability.

JEL Classification: E60, E62, H60.
Introduction

The research on fiscal transparency has been usually emphasized during the periods after economic turmoil, precisely because in such periods fiscal transparency is a key point in economic decisions. Under these conditions, due to the recent global economic pressures, fiscal transparency analysis is increasingly highlighted both in the academic research and in the working papers of national and international economic organizations. The fiscal (budget) transparency is part of the concept of transparency in a broad sense or it is the access to public sector information. This has two dimensions: the first concerns the access to information on the processes and procedures taken and implemented by the public sector and the second concerns access to the information generated, owned and used by the public sector.

According to Kopits and Craig (1998), the fiscal transparency is the openness towards the public of the structures and functions of the government, the fiscal policy intentions, public sector accounts and forecasts. It requires a fast access to information on government activities whether they are taken inside or outside the government sector, information that should be comprehensive, timely and understandable and can be compared with the international ones. In this way, both the electorate and economic agents can more accurately evaluate the true costs and benefits of the government activities, including their present and future economic and social implications.

The benefits of practicing fiscal transparency are numerous and the research in the field confirms this statement. Thus, fiscal transparency improves fiscal transparency (Alt and Lassen, 2006), helps to identify potential risks regarding the fiscal outlook allowing a reaction from fiscal policy to changes in macroeconomic framework (IMF, 2014), reduces sovereign borrowing costs (Glennster and Shin, 2008), reduces corruption (Reinikka and Svensson, 2004) and limits the accounting creativity (Wehner and Renzio, 2013). In addition, a high level of transparency can enhance a country’s fiscal credibility, offering economic and financial stability worldwide (IMF Staff, 2014).

Therefore, budget transparency is the key of good governance (OECD, 2013) and the financial economic crisis highlighted the need for practicing greater transparency.

Major initiatives on fiscal transparency

The assessment of fiscal transparency can be achieved rather in terms of quality than in terms of quantity. Thus, there are three major initiatives on fiscal transparency assessment made by international institutions.

One of the initiatives belongs to OECD, which developed in 2002 Best Practices for Budget Transparency. The Guide describes seven types of reporting to maximize fiscal disclosures. The list includes a comprehensive budget, which should contain all budgetary revenues and expenditure, so that all the necessary compromises between different policy options can be assessed. In addition, the budget should include detailed comments on the budgetary revenues and expenses and also a medium term perspective on their development. The list further comprises a pre-budget reporting in order to
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Encourage debates about budgetary aggregates and about their interactions in the economy describing fiscal policy long term objectives, a report that should be done about a month before the introduction of the budget proposal. Monthly, mid-year and end-year reports are also recommended by the OECD. The monthly reports should show the progress made in the budget implementation, the mid-year ones should include an update of information regarding the budgetary result for the current year and for at least the next two years and finally the end-year report should be evaluated by an independent institution and should show the compliance with the revenue and expenditure ceilings set by the Parliament. Moreover, pre-election reports should be done in order to stimulate public debates and long term reports should be done to evaluate public finance sustainability (OECD, 2002), the topic regarding sustainability being highly debated in the last period emphasized also by Moldovan (2014). The Guide contains also some specific disclosures such as those related to macroeconomic assumptions, tax expenditure, financial assets and liabilities, non-financial assets, pension expenses and contingent liabilities. It is also highlighted the need to practice integrity and budget disclosure in a manner to be publicly accessible.

Another initiative belongs to the International Monetary Fund by elaborating in 1998 and then developing in 2001, 2007 and 2014 a Code of Good Practices on Fiscal Transparency. The updated version from 2014 includes also the lessons learned during the global financial crisis of 2008-2009, highlighting the information needed to increase the management efficiency and fiscal surveillance. The 36 principles of the Code are focused more on the results than on the processes, take into account the classification of practices in basic, good and advanced in order to offer clues to less developed countries, highlight the analysis and management of fiscal risks and better complements other tax standards (IMF Staff, 2014).

The Code is structured around four pillars, key elements of fiscal transparency, of which the first three are complete and fourth is going to be completed by the end of 2014 as the principles of the first three need to be adapted to the particular circumstances of the resource-rich countries. The four pillars are:

- **Pillar I: Fiscal Reporting** – should provide complete, reliable and timely information on the performance and financial position of the government;
- **Pillar II: Fiscal Forecasting and Budgeting** – should contain a clear vision on budgetary targets and fiscal policy intentions having complete, reliable and timely forecasts on the public finance evolution;
- **Pillar III: Fiscal Risk Analysis and Management** – should ensure that fiscal risks are presented, analysed and managed and fiscal policy decisions are effectively coordinated;
- **Pillar IV: Resource Revenue Management** – should offer a transparent framework for ownership, contracting and use of natural resources endowments.

Thus, the new Code reflects a massive concentration in the management of fiscal risks as in the context of economic turmoil, large contingent liabilities have been used to diminish the created economic instability. The pillar addresses to the risks arising from macroeconomic shocks, guarantees and other contingent liabilities, fiscal pressures due to
demographic trend, changes in the value of assets and liabilities, public-private partnerships, financial sector, natural resources, state owned enterprises. According to Glennerster and Shin (2008), even when contingent expenditure implies low risks from a macroeconomic point of view – being reduced and uncorrelated with each other – their disclosure leads to a more careful assessment of costs and benefits. Thus, fiscal transparency is associated with the rating of sovereign bonds and with a greater access to international financial markets.

A third initiative belongs to a non-governmental organization called International Budget Partnership that measures fiscal transparency using a questionnaire, called Open Budget Survey. This questionnaire is realised every two years for approximately 100 countries and measures the available information for the public regarding general consolidated budget, the proposals got the budget execution, the budget process (including quarterly reports, mid-year reports, end of year reports, external audit reports), the strength of legislature, citizens budget and public engagement in the budget process (IBP, 2011a). The questionnaire contains 125 questions, of which 95 questions are oriented towards the public availability and understanding about 8 key budget documents that governments should publish in different moments of the budget cycle and the other 30 are oriented to the opportunities for public involvement in the budget process and to the role of legislature and the supreme audit institutions in budget formulation (IBP, 2012). Each question receives a score between 0 and 100. Based on these scores an index is calculated, called Open Budget Index (OBI), as a simple arithmetic average of the scores obtained in the first 95 questions, this index revealing the level of fiscal transparency of a country, with a value between 0 and 100 (IBP, 2014).

In the table below, one can see the index calculated in 2006, 2008, 2010 and 2012 for all countries from the European Union, for which the index is computed.

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Note that the index is addressed only to a limited set of topics related to the legislative strengthen, efficient management of public finance and to the public participation in the budget process. Thus, this index can be used to complement the existing research (IBP, 2011b). In this sense, Tilly (2012) examines the relationship between fiscal transparency...
(measured by OBI) and investor confidence (measured by an indicator of financial market perception, namely 5-year Credit Default Swaps spreads), noting that during pre-crisis period, the fiscal transparency has an insignificant impact on investor perception, just being ignored by investors offering low interest rates to government borrowers even with the most non-transparent budget records. The result is, however, completely different starting with 2008 when markets have become extremely sensitive to the fiscal performance and the relationship between fiscal transparency and investor perception considerably strengthened. In addition, of all the elements of the fiscal transparency, budget execution is the element with the greatest impact on the market, given that according to Trașcă (2014) investor risk aversion is increased during periods of economic turmoil.

Conclusion

The fiscal transparency is a key point in the fiscal policy stance and during economic pressures manifested at a global level the fiscal transparency represents an essential reference in the decisions of economic agents. Each initiative presented above tries to improve the fiscal transparency due to the many benefits that can be achieved by practicing fiscal transparency.

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References


