

## **CERGE-EI Research Competition GRC V-077**

### **Non-technical summary**

**Full title:** Transparency of Fiscal Policy in Transition Economies

#### **Abstract**

*General background:* The importance of fiscal transparency is highly appreciated by international organisations such as the IMF and OECD, which recently published Codes of Good Practices on Fiscal Transparency (1998) and the OECD Best Practices for Budget Transparency (2000), respectively. Both organisations emphasise the role of fiscal transparency as a precondition for fiscal sustainability and good governance. Fiscal adjustments that are often advised by these institutions to many countries, in particular to developing and transition economies, can however create the incentives to produce creative accounting practices.

*Objectives:* The general objective of our study is to provide an analysis of fiscal policy institutions in transition economies with a special focus on fiscal policy transparency. More specifically, we aim to achieve the following goals:

- To evaluate the institutional set-up for the conduct of fiscal policy
- To provide measures of transparency in fiscal policy based on an index of transparency
- To examine the relationship between fiscal transparency and fiscal performance

*Methods:* In the first part we provide a detailed analysis of the institutional environment for fiscal policy conduct in transition economies. Poland serves as a case study to evaluate the institutional framework, encompassing both fiscal transparency and policy rules.

In the second part an index of fiscal transparency is constructed to assess quantitatively the stance of fiscal transparency in transition economies. The index includes the following categories:

- medium-term budgeting and analysis
- accounting and data quality
- off-budget fiscal operations
- inter-governmental relations
- the role of auditing in the budgetary process and the relative importance of the Ministry of Finance over spending ministries.

In the third part, an empirical analysis based on a cross-section analysis is conducted. The sample comprises 27 transition economies. The interactions between fiscal transparency and fiscal performance are examined using econometric methods. The specification includes economic and political economy variables that are augmented with fiscal transparency, represented by the fiscal transparency index.

## *Findings:*

### Institutional set-up:

- the implementation of a medium-term budgetary framework that ensures consistency between the budgetary process and medium-term fiscal goals
- this should be accompanied by the introduction of binding constraints on fiscal policy
  - the expenditure rule could be reintroduced to strengthen fiscal discipline
  - maintain fiscal rules at the local government level

### Evaluation of fiscal transparency:

Analysis of the fiscal transparency index shows a clear pattern, indicating the following:

- CEE countries stand out from the other two groups across all categories. This seems to be the result of the anchoring of the New Member States in the EU's structures and procedures.
- SEE countries are behind the first group, experiencing serious difficulties in budgetary process and reporting standards.
- The CIS countries still have a long way to go to meet international standards. They must enhance budgetary practices and accounting procedures, as they lag behind the above groups most clearly in this regard.

### Interactions between fiscal transparency and fiscal performance

The main results of this paper are as follows:

- fiscal transparency has not yet proved to be an important element in establishing prudent fiscal policy in transition economies

This may be for the following reasons:

- lack of consensus among politicians to restrain fiscal policy
- and/or no incentives for politicians to conceal fiscal laxity
- difficulties in measuring fiscal transparency
- the relatively short period of time in which rapid structural changes in both macroeconomic and political environment have taken place

The other finding is

- right-of-centre parties tend to be negatively correlated with debt accumulation. This may be due to the fact that right-of-centre governments in this region tend to have rather conservative views when it comes to legal and religious issues, but are usually in favour of a more pro-social approach when it comes to the conduct of economic policy.

This feature clearly distinguishes the politics in transition economies from those in more mature democracies.

**Keywords:** Fiscal Transparency, Fiscal Rules, Fiscal Discipline, Institutions, Transition Economies