Consolidation: From a PFM and Macro-Fiscal Perspective

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OUTLINE

Primarily focusing on the PFM and macro-fiscal perspective of consolidation of sub-national government

- Relevance of consolidation of sub-national governments
- Impact of subnational government consolidation
- Challenges and PFM tools to facilitate the consolidation of sub-national governments

Relevance of Consolidation of Sub-National Governments

Decentralization at the political, administrative and fiscal level differ from country to county resulting in:

- Different allocations of powers and accountabilities for service delivery
- Different arrangements with regards to funding of sub-national governments
  - Level of transfers from central government
  - Level of sub-national revenue raising powers
  - Level of borrowing powers

Managing and measuring the economic impact of sub-national governments therefore requires:

- A review and analysis of the finances of individual sub-national governments
- A review and analysis of groupings of sub-national governments
- A review and analysis of all sub-national governments as a group
- A review of the impact/relations with other units of the general government sectors

It is only at the general government sector level that comparisons can be made between countries

Relevance of Consolidation of Sub-National Governments

The level of decentralization and the inter-governmental fiscal framework will determine the importance/size of consolidation

Examples:

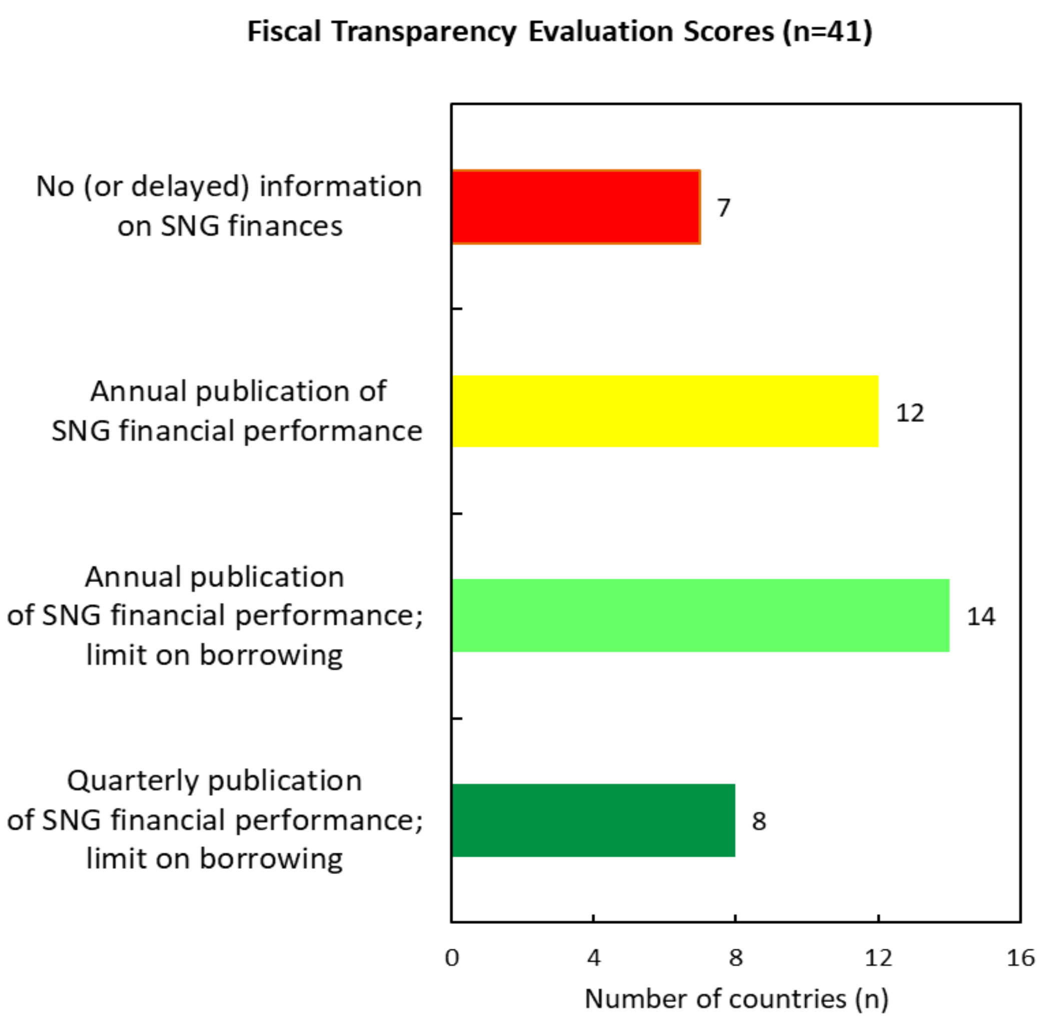
- Large transfers(revenue sharing agreements) versus high level of self-reliance
  - Conditional
  - Unconditional
- On-lending versus independent borrowing powers
- Explicit guarantees received or issued that may results in calls on these guarantees
- Implicit guarantees that may put pressure on governments for bailouts

Impact of Sub-National Government Consolidation

- Consolidation is a means to an end and not an end in itself
  - Consolidation increase institutional coverage of information to allow broader view of the financial operations and position of government
    - **Facilitate better policy discussions and decisions**

- Consolidation of sub-national government allows an analysis of fiscal risks emanating from the sector/sub-sectors
  - Sub-national include all non-market activities of states, provinces and municipalities
    - Where sub-national public enterprises are significant extension to also analyze them may be needed
  - Fiscal risks refer to all uncertainties that may cause fiscal outcomes to deviate from the forecasts or expectations
    - Macro-economic shocks, such as COVID
      - Price and demand shocks
    - Contingent liabilities (ranging between 3.7 – 12 percent of GDP between 1990 and 2014)
    - Institutional weaknesses

Impact of sub-national consolidation



Fiscal Transparency code requires:

- Basic practice: Annual Reporting
- Good practice: +Limits on borrowing
- Best practice: +Quarterly reporting

FTEs conducted between 2013-23 revealed some bad practices

- No or delayed reporting – not an EU country problem due to reporting requirements
- In almost 50 % of FTEs conducted there is no limits on the borrowing of sub-national governments
  - Government lending to sub-national often need to be written off – explicit risks
  - Poor revenue/expenditure performance put pressure on central government transfers
  - Guarantees expose government to explicit risks
  - Situation is aggravated by implicit risks
    - Continued service delivery

Impact of sub-national consolidation

- Managing the fiscal risks from sub-national governments should be an important objective of central government
  - Process of risk assessment and quantification is the first step
  - Government could deploy direct or indirect risk mitigation measures
  - Governments could provision for residual risks
  - Disclosing fiscal risks from subnational governments

- Analysis of sources of fiscal risks of sub-national governments could inform governments to take timely action:
  - Put a stronger regulatory framework in place
  - Improve fiscal reporting requirements
  - Enhance oversight practices
  - As last resort, governments sometimes need to step in with direct measures

Challenges and tools to facilitate consolidation

- The independence of sub-national governments often results in separate accounting systems with no interfaces to central government systems
  - Standardized reporting requirements from central government could facilitate easier aggregation and consolidation

- Accounting Standards applicable to sub-national government does not prescribe standardized classifications of all operations and positions
  - Using the GFS/SNA/ESA classification structure for standardized classifications
  - Ultimate solution remains a multi-dimensional standardized chart of account
    - Information on counterparts to transactions either derived from the administrative classification of entities, or build into the structure of the economic classification structure
    - Further advantages if the SCoA is used in an integrated financial management information system

Challenges and tools to facilitate consolidation

- The size of sub-national governments—often large in number and value with uneven financial management skills
  - Principle of materiality to be the guiding principle
    - Consolidation of entities – usually largest sub-nationals cover majority of value
    - Consolidation of specific transactions – various types of transfers, loans, called guarantees

- Principle of accounting “control” is often not applicable to sub-national governments
  - Complex administrative structures of government often ensures independence but could establish a hierarchy of entities on which reporting requirements could be placed
  - Statistical principles of sector classification could be used
    - Control determine the boundary of the public sector
    - Non-market vs. market activity determine the boundary of general government and public corporations
    - Sphere of political influence determine the boundary of central and sub-national

Conclusion

- Sub-national consolidation is essential for comprehensive macro-fiscal analysis and management
- Sub-national governments expose the central government to significant risks that need to be appropriately managed
- Challenges in the consolidation of sub-national governments continue to exist
- Ways and means to address those challenges exist and should be considered in PFM reform plans

Thank you for your attention

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