Chapter 2

Fiscal Transparency

2.1 Introduction

The International Monetary Fund refers to fiscal transparency as "the information available to the public about the government's fiscal policymaking process".[1] Fiscal transparency is a multi-dimensional concept involving six main elements, which can be evaluated in relation to three different pillars (see Table 2.1 and Table 2.2).

Table 2.1: Elements of fiscal transparency

Clarity	The ease with which reports can be understood by users
Reliability	The extent to which reports are an accurate representation of the government's fiscal operations and finances
Frequency	The regularity with which fiscal reports are published
Timeliness	The time lag involved in the dissemination of the fiscal reports
Relevance	The extent to which the fiscal reports provide users with the information they need to make effective decisions
Openness	The ease with which the public can find information and hold governments accountable for their fiscal policy decisions

Source: IMF

In 2018, the IMF carried out a Fiscal Transparency Evaluation, at the request of the Maltese government.[2] This evaluation forms part of the IMF's policy dialogue and capacity building efforts with its member countries. In relation to each principle included in the Fiscal Transparency Code, the IMF rated Malta's current practices vis-à-vis best practices. The IMF used a four-grade rating scale to evaluate the practices and a three-grade scale to differentiate between their level of importance (see Table 2.3).

[1] IMF (2018) Fiscal Transparency Handbook, available on https://www.elibrary.imf.org/view/IMF069/24788-9781484331859/24788-9781484331859/24788-9781484331859.xml.
[2] The report is available on https://www.imf.org/en/Publications/CR/Issues/2018/09/27/Malta-Technical-Assistance-Report-Fiscal-Transparency-Evaluation-46266.

Table 2.2: Pillars of fiscal transparency

Fiscal reporting	Fiscal reports should provide a comprehensive, relevant, timely, and reliable overview of the government's financial position and performance.
Fiscal forecasting and budgeting	Budgets and their underlying fiscal forecasts should provide a clear statement of the government's budgetary objectives and policy intentions; as well as comprehensive, timely, and credible projections of the evolution of public finances.
Fiscal risk analysis and management	Governments should disclose, analyse, and manage risks to the public finances and ensure effective coordination of fiscal decision making across the public sector.

Source: IMF

Table 2.3: The assessment grading used by the IMF

Rating of practice	Colour code	Level of importance	Colour code
Not met		High	
Basic		Medium	
Good		Low	
Advanced			

Source: IMF

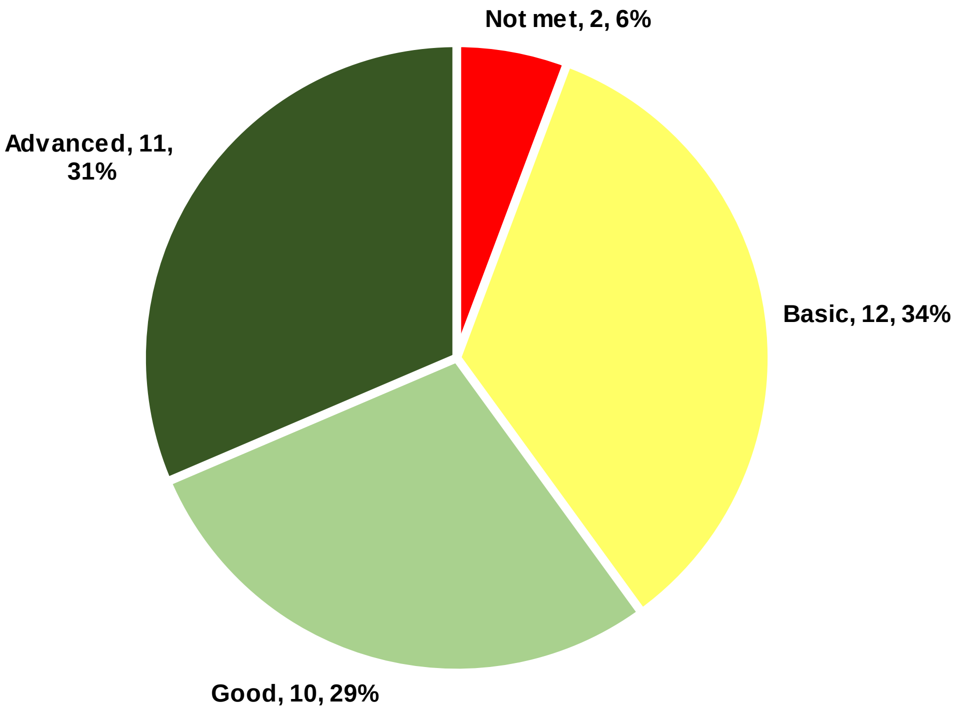
Out of the 35 principles which were assessed, Malta's current practices were considered by the IMF as 'advanced' with respect to 11 cases principles, and 'good' with respect to another 11 principles (see Chart 2.1).[3] On the other hand, there were 2 principles which were 'not met', one of which was considered of high importance and the other of medium importance (see Chart 2.2).

The IMF identified as highly important the weakness that in Malta the information on fiscal risks was scattered and some specific risks, which could be material, were not

[3] The Fiscal Transparency Code consists of 36 principles. However, one principle relating to natural resources (see Appendix 3 Principle 33) was not assessed as it was considered not applicable in the case of Malta.

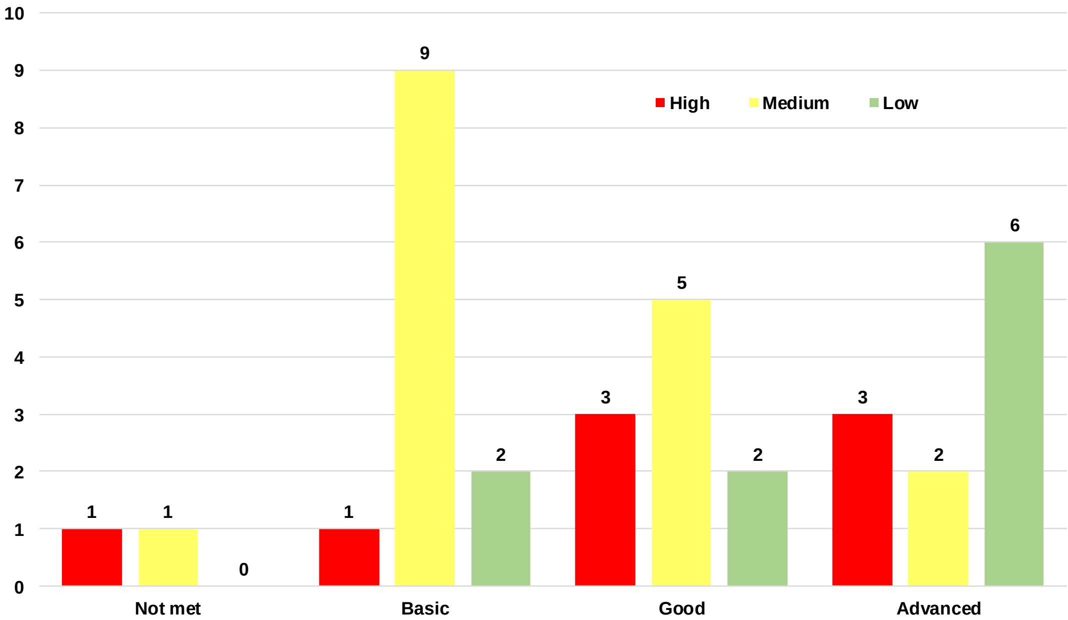
sufficiently well documented. Another lacuna, of medium importance, was the lack of regular reporting on tax expenditures in Malta, despite these possibly being sizable by European standards.

Chart 2.1: Degree of compliance with the IMF's Fiscal Transparency Code



Source: IMF

Chart 2.2: Assessment of Malta's transparency practices by importance



Source: IMF

Turning to those practices which were rated as ‘basic’, and hence where there is margin for improvement, the IMF assigned high importance to the need for comprehensive information on the performance of Malta’s public corporations as this was not generally readily available to the public.

The rest of this chapter focuses on the three areas which the IMF’s assessment revealed as being most pressing to improve fiscal transparency in Malta, in two instances because the principle of transparency was not met, and in another instance because the compliance rating for a highly important factor was only basic. The ratings assigned by the IMF for the full set of principles are reproduced in Appendix 1, Appendix 2 and Appendix 3.

2.2 Specific fiscal risks

Summary reporting of fiscal risks is important for a complete understanding of potential threats to a country’s fiscal position. It is also important for an integrated approach to managing these risks. It allows for an assessment of aggregate risk exposures across government and for the identification of relationships and interactions among risks. It facilitates the examination of whether risks emanating from various sources are offsetting or enhancing one another. It can also promote a better understanding of the true state of public finances, build support for prudent fiscal policies, lead to better risk mitigation, strengthen accountability for risk management, and facilitate better policy responses.

The IMF handbook provides a list of possible sources of fiscal risks (see Table 2.4). There are two broad categories: explicit risks and implicit risks. Explicit risks are those where the government has a clear and firm obligation, or a declared policy, to provide fiscal support should a predefined event occur. Examples include explicit government guarantees, indemnities, public insurance schemes, or legal action against the government. Implicit risks, on the other hand, arise where there is no explicit (legal or contractual) obligation or policy to provide fiscal support, but there is an expectation that the government would do so should the risks materialize. Examples include bailouts of the financial sector to prevent systemic crises; support for subnational governments or public corporations should they get into financial difficulty; and assistance to victims of natural disasters.

Table 2.4: Possible sources of fiscal risks

Macroeconomic risks	Sensitivity of the fiscal outturn to key economic assumptions and alternative macroeconomic scenarios
Public debt	Sensitivity of the stock of debt and debt-servicing costs to variations in key parameters, such as interest rates and exchange rates
Government lending programs	Outstanding amounts and nonperforming loans
Government guarantees	The likelihood that guarantees will be called and their associated costs
Public-Private Partnerships (PPPs)	Government obligations under PPPs, both direct commitments and any obligations related to contingent liabilities arising from the risks assumed by the government
Public corporations	Any explicit obligations to public corporations
Subnational Governments	Any explicit obligations of the central government to subnational governments
Financial system	Any explicit liabilities to the financial sector
Natural disasters	The country's direct fiscal impact of natural disasters
Legal claims	Any legal claims pending against the state and, where feasible, estimates of gross exposure
Other material fiscal risks	Examples include: uncalled capital; and risks to tax and nontax revenues such as from tax base erosion, tax avoidance and tax evasion

Source: IMF

In its evaluation report the IMF pointed out that “the government has relatively large fiscal exposures related to government guarantees and public corporations, and Malta also faces sizeable long-term fiscal pressures from the ageing of its population. Other potential fiscal risks, which are more specific to Malta, could emanate from changes to international taxation as well as developments in the Individual Investment Program (IIP)”.

Best practice in this area requires that such specific risks to the fiscal forecasts are disclosed in a summary report and discussed at least in qualitative terms. To strengthen the reporting of fiscal risks the IMF recommended: (i) to include a comprehensive list of guarantees, on-lending and indemnities as from the 2019 budget documentation; (ii) to produce a fiscal risk statement as part of the 2021 budget documentation; and (iii) to expand the scope of the fiscal risk statement to encompass a broader range of fiscal risks by 2020-2021. In turn, to strengthen the institutional framework for fiscal risks management, the IMF recommended: (i) to assign responsibility to a unit for preparing a fiscal risk statement by 2018; and (ii) to implement institutional arrangement for fiscal risk analysis and monitoring by 2019.

2.3 Tax expenditures

Disclosure of foregone revenue from tax concessions and exemptions (referred to as tax expenditure) shows the extent of indirect government support to corporations and households through the tax system. Since the foregone revenue benefits some taxpayers, activities, or products and not others, in practice it is equivalent to a subsidy on the expenditure side of the budget. The IMF considers five types of measures which constitute forms of tax expenditures (see Table 2.5).

The IMF reported that Malta does not yet publish an estimate of the revenue loss from tax expenditures, despite possibly being sizeable. Only information about new specific fiscal measures is generally included in the official reports. Furthermore, there is no report that includes estimates of the revenue loss from several existing and new tax expenditures.

To boost fiscal transparency in the field of tax expenditures, the IMF recommended to better report and control tax expenditures by establishing budgetary limits. Specifically, the IMF recommended: (i) to agree on a definition of tax expenditures by 2018; (ii) to produce a report that includes estimates of annual revenue loss from existing and new tax expenditures by 2019; (iii) to set a limit to the size of tax expenditures by 2020; and (iv) to include in the report on tax expenditures information on compliance with the limit by 2020-2021.

Table 2.5: Types of tax expenditures

Exemptions	Amounts excluded from the base on which tax liabilities are calculated
Allowances	Amounts deducted from the benchmark tax to arrive at the tax base
Credits	Amounts deducted from tax liability
Rate relief	A reduced rate of tax applied to specified classes of taxpayer or taxable transactions
Tax deferral	A relief that takes the form of a delay in paying tax

Source: IMF

2.4 Public corporations

The IMF noted that the public corporation sector in Malta is sizeable and a significant source of fiscal risk. Indeed, the IMF estimated that the liabilities of public corporations (apart from equity) amounted to around 17.6% of GDP in 2016, which is relatively high compared to other European countries. Liabilities are concentrated in the five largest corporations, which amount for some 80% of total liabilities of the sector. Despite some loss-making entities, the sector was on aggregate profitable in 2016. However, the IMF noted that Malta has a history of government intervention to support and restructure public corporations when economic conditions become dire.[4]

[4] Such support was notified and approved by the European Commission in accordance with the EU state aid rules.

Direct transfers to public corporations are regularly disclosed but are not based on a published ownership policy. There is also no consolidated reporting on their financial performance. However, transfers between the government and public corporations in the form of dividends, subsidies and capital injections in cash are disclosed in the budget and Financial Reports. On the other hand, there is no published document that outlines the purpose and objectives of state ownership and the criteria under which public corporations operate. Moreover, there is no published dividend policy. While detailed information on each public corporation can be found in their annual financial statements, there is no document that consolidates financial information on public corporations to present a general overview and assessment of their financial performance on aggregate.

The Government provided subsidies and capital injections to public corporations in recent years.[5] However, the Government has also provided other means of support. These included guarantees, capital injections in kind, seeds capital in kind, cash acquisitions, and re-employment of workers through other public corporations with state funding. While the Ministry for Finance has a deep and ongoing involvement in the key public corporations, and regularly monitors their performance, there is no single entity responsible for developing the ownership policies across the Government, or for monitoring and reporting on the performance of the entire public corporation sector.

In relation to public corporations the IMF thus recommended that the Government should produce and publish information about the financial position of public corporations at individual and aggregate levels, including comprehensive information on actual and expected financial government support, as well as costs of quasi-fiscal activities (for example, public service obligations). Specifically, the IMF recommended: (i) to produce a statement of operations of public corporations consolidated into the statement of operations of the general government by 2019; and (ii) to produce balance sheets of public corporations by 2020. The IMF further recommended: (i) to assign responsibility for comprehensive reporting on the financial performance of public corporations by 2018; (ii) to develop an ownership policy that applies to all ownership agencies by 2019; (iii) to incorporate reporting on financial performance of public corporations in the fiscal risk statement by 2020; and (iv) to consider centralising ownership functions by 2021-2022.

[5] The IMF Report indicates that between 2012 and 2016, subsidies to public corporations amounted to €243.5 million, while capital injections amounted to €148.9 million.

2.5 The reactions of the MFAC

The Council views very positively the fact that the Government took the initiative to request the IMF to carry out this transparency assessment. This is compatible with the recommendations aimed at strengthening the degree of fiscal transparency in Malta, which the Council has repetitively made since its establishment.[6] The Council also welcomes the overall positive ratings obtained, with almost all principles already being adhered to, albeit to varying degrees. The Council fully shares the assessment carried out by the IMF, in terms of the identified strengths and weaknesses and the relative priorities assigned for the proposed actions plans.

To this effect, the Council invites the Government to take the necessary steps to achieve improvements where possible, and within the timeframes suggested by the IMF. Priority should be assigned to the actions necessary to address the two principles which were not met, namely those dealing with the fiscal risks (see Appendix 3 Principle 26) and tax expenditures (see Appendix 1 Principle 4). The Council also invites the Government to boost the information relating to public corporations (see Appendix 3 Principle 36), an area which is highly relevant for Malta. It is also important that improvements are achieved even with respect to the other principles in relation to fiscal transparency.

Finally, the Council is also very satisfied to note that in relation to the areas of macroeconomic forecasts (see Appendix 2 Principle 14), and the independent evaluation of the macroeconomic and fiscal forecasts (see Appendix 2 Principle 22), the IMF considered the current practices in Malta as both 'advanced' in terms of complying with the principles of fiscal transparency.

[6] For an overview of the recommendations made between 2015 and 2017, refer to chapter 3 of the 2017 Annual Report of the Malta Fiscal Advisory Council, available on https://mfac.org.mt/en/publications/Pages/Publications.aspx.

Appendix 1

Fiscal reporting transparency principles (1-12)

			Rating	Importance
1	**Coverage of institutions**	Fiscal reports cover all entities engaged in public activity according to international standards.		
2	**Coverage of stocks**	Fiscal reports include a balance sheet of public assets, liabilities, and net worth.		
3	**Coverage of flows**	Fiscal reports cover all public revenues, expenditures, and financing.		
4	**Coverage of tax expenditures**	The government regularly discloses and manages revenue loss from tax expenditure.		
5	**Frequency of in-year reporting**	In-year fiscal reports are published on a frequent and regular basis.		
6	**Timeliness of annual financial statements**	Audited or final annual financial statements are published in a timely manner.		
7	**Classification**	Fiscal reports classify information in ways that make clear the use of public resources and facilitate international comparisons.		
8	**Internal consistency**	Fiscal reports are internally consistent and include reconciliations between alternative measures of summary fiscal aggregates.		
9	**Historical revisions**	Major revisions to historical fiscal statistics are disclosed and explained.		
10	**Statistical integrity**	Fiscal statistics are compiled and disseminated in accordance with international standards.		
11	**External audit**	Annual financial statements are subject to a published audit by an independent supreme audit institution which validates their reliability.		
12	**Comparability of fiscal data**	Fiscal forecasts, budgets, and fiscal reports are presented on a comparable basis, with any deviations explained.		

Appendix 2

Fiscal forecasting and budgeting transparency principles (13-24)

			Rating	Importance
13	**Budget unity**	Revenues, expenditures, and financing of all central government entities are presented on a gross basis in budget documentation and authorized by the legislature.		
14	**Macroeconomic forecasts**	The budget projections are based on comprehensive macroeconomic forecasts, which are disclosed and explained.		
15	**Medium-term budget framework**	Budget documentation includes outturns and projections of revenues, expenditures, and financing over the medium term on the same basis as the annual budget.		
16	**Investment projects**	The government regularly discloses its financial obligations under multiannual investment projects and subjects all major projects to cost-benefit analysis and open & competitive tender.		
17	**Fiscal legislation**	The legal framework clearly defines the timetable for budget preparation and approval, key contents of the budget documentation, and the powers and responsibilities of the executive and legislature in the budget process.		
18	**Timeliness of budget documents**	The legislature and the public are consistently given adequate time to scrutinize and approve the annual budget.		
19	**Fiscal policy objectives**	The government states and reports on clear and measurable objectives for public finances.		
20	**Performance information**	Budget documentation provides information regarding the objectives and results achieved under each major government policy area.		
21	**Public participation**	The government provides citizens with an accessible summary of the implications of budget policies and an opportunity to participate in budget deliberations.		
22	**Independent evaluation**	The government's economic and fiscal forecasts and performance are subject to independent evaluation.		
23	**Supplementary budget**	Any material changes to the approved budget are authorized by the legislature.		
24	**Forecast reconciliation**	Budget documentation and updates explain any material changes to the government's previous fiscal forecasts, distinguishing the fiscal impact of new policy measures from the baseline.		

Appendix 3

Fiscal risk analysis & management transparency principles (25-36)

			Rating	Importance
25	**Macroeconomic risks**	The government reports on how fiscal outcomes might differ from baseline forecasts due to different macroeconomic assumptions.		
26	**Specific fiscal risks**	The government provides a regular summary report on the main specific risks to its fiscal forecasts.		
27	**Long-term fiscal sustainability analysis**	The government regularly publishes projections of the evolution of the public finances over the long term.		
28	**Budgetary contingencies**	The budget has adequate and transparent allocations for contingencies that arise during budget execution.		
29	**Asset and liability management**	Risks relating to major assets and liabilities are disclosed and managed.		
30	**Guarantees**	The government's guarantee exposure is regularly disclosed and authorized by law.		
31	**Public-private partnerships**	Obligations under public-private partnerships are regularly disclosed and actively managed.		
32	**Financial sector exposure**	The government's potential fiscal exposure to the financial sector is analysed, disclosed, and managed.		
33	**Natural resources***	The government's interest in exhaustible natural resource assets and their exploitation is valued, disclosed, and managed.		
34	**Environmental risks**	The potential fiscal exposure to natural disasters and other major environmental risks are analysed, disclosed, and managed.		
35	**Subnational governments**	Comprehensive information on the financial condition and performance of subnational governments, individually and as a consolidated sector, are collected and published.		
36	**Public corporations**	The government regularly publishes comprehensive information on the financial performance of public corporations, including any quasi-fiscal activity undertaken by them.		

* Not assessed in the case of Malta.