GFSAC–15/04

Meeting of the IMF Government Finance Statistics Advisory Committee

Washington, D.C.

March 9–10, 2015

GFS in Latin America, General Government Versus Nonfinancial Public Sector and Coverage of Central Banks

Prepared by Hector Hernandez

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Defining GFS coverage

Initially, and being consistent with the *2008 SNA* sector definitions, GFS institutional coverage would be limited only to the general government sector. According to this definition, GFS should be compiled for the consolidated central government, plus state governments plus local governments, including nonprofit institutions serving these different levels of government.

However, as stated in paragraph 2.1 of the *GFSM 2014*, GFS "should cover all entities that materially affect fiscal policies". This conceptualization allows expanding the GFS institutional coverage to also include the effect of quasi-fiscal operations carried out by public corporations (financial and non-financial) for which we have two methodological options:

1. If the quasi-fiscal operations are separable and measurable, they can be added as part of the activity of the level of government to which the public corporation belongs.
2. If the quasi-fiscal operations are difficult to separate and/or measure, then makes sense to expand the GFS coverage to the nonfinancial public sector (NFPS; general government plus nonfinancial public corporations) or to the public sector (PS; general government, plus nonfinancial public corporations plus financial public corporations).

Problems applying the coverage definition in Latin America

Most countries in Latin America have trouble registering operations under the recommended basic level of coverage, i.e., the general government. Moreover, there are countries that have problems to compile GFS that completely cover all central government institutions.

In simple terms, there are problems getting information from various entities claiming some degree of autonomy from the executive branch. In particular, although they remain part of the central government, there are institutional units that have special statutes allowing them to formulate budgets independently and/or are not required to report the execution of its budget to the Executive's financial authority. In this situation we can find: (i) institutions of the legislative branch; (ii) entities of the Judiciary; (iii) autonomous entities; (iv) decentralized bodies; and, (v) entities excluded from the public sector by especial legal statutes. State and local governments also can have their own "special" entities.

Even countries with complete coverage (or which could be deemed as relatively complete) at the level of central government and state governments, still face the problem of information gaps generated at the level of local governments due the lack of human and technological to obtain reports with the required periodicity and timeliness. Additionally, estimation methodologies are not used to solve this missing information issue.

The problems faced by countries in compiling GFS are reflected in the IMF's statistical publications. Of twenty Latin American countries[1], only thirteen reported annual 2012 data for inclusion in the last *Government Finance Statistics Yearbook*. The seven that did not report were Argentina, Bolivia, Ecuador, Guyana, Mexico, Panama and Venezuela. Of the thirteen that did report, eight (Brazil, Chile, Colombia, Paraguay, Peru, Uruguay[2], Costa Rica, El Salvador and Honduras) report General Government data; the other five report only Budgetary Central Government data. In *International Finance Statistics*, eleven countries report high frequency GFS data. The nine countries that do not report are the same seven countries that don't report annual data, as well as Belize and Costa Rica. Coverage is much more limited: Brazil, Chile and Uruguay report high frequency Central Government data, but all other countries report Budgetary Central Government data only.

However, while many Latin American countries are able to report for general government, or one of the sub-sectors for publication in IMF statistics publications, the coverage used for fiscal analysis in IMF Article IV reports and surveillance is typically not based on a statistical definition of the public sector or general government, for example:

- Bolivia presents operations of the combined PS, but excludes some mixed ownership companies that may be classified as public sector.
- Brazil combines the Federal Government, Social Security System and the operational part of Central Bank and also includes a presentation of the NFPS but excludes Petrobras.
- Colombia presents operations of the combined PS, but exclude the Central Bank and the state owned oil company from some aggregates.
- Guyana presents operations of the NFPS.
- Paraguay presents a consolidated PS, but t it only includes the NFPS, and the Central Bank.
- Peru presents data for the NFPS, but also has data on General Government.
- El Salvador presents data for the NFPS, but does not fully record revenue and expense for public corporations, but just the operating surplus.

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[1] As defined by the IMF's Western Hemisphere Department (WHD), Latin America includes Mexico and the rest of mainland Central and South America, namely:
- In South America: Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Guyana, Paraguay, Peru, Suriname, Uruguay and Venezuela;
- In Central America: Belize, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama;
- Plus Mexico.

[2] Uruguay only reports General Government data below the line. Above the line data are limited to Central Government only.

- Guatemala has data for Central Government and the rest of the NFPS, to arrive at a consolidated NFPS balance.
- Mexico presents the authorities preferred approach, which combines Central Government and NFPS entities but exclude state and local governments, alongside a *GFSM 2001* presentation of the PS.

General Government versus Nonfinancial Public Sector

In general, it can be assumed that the level of quasi-fiscal activity in Latin America is relatively important. Much of subsidies to corporations, especially to small producers in primary activity sectors, are channeled through public corporations operating in these sectors. Additionally, in the utilities sector public transfers are delivered to consumers by means of widespread or targeted price cuts applied by the public corporation that provides the service; a similar situation can be seen in the financial sector where public corporations often provide services at lower costs than the rest of the market. Thus, we have an active involvement of public corporations in implementing fiscal policy that is often financed with resources that come from the public corporations and without any identification of these activities in the government accounts.

It is equally important to consider that in Latin America is a recurring fact that large public corporations are actively involved in strategic productive sectors (e.g., mining and hydrocarbons) becoming, in some cases, important players in the global market. Although these large public corporations do not perform quasi-fiscal activity, its importance in generating revenue for general government through taxes, profits and other transfers, makes it necessary to analyze their accounts together with the level of government that controls them and therefore, provides an additional argument for using the NFPS, or PS, as the benchmark for GFS institutional coverage.

A general assessment must also consider the legal framework governing public corporations, specially the degree of independence for planning and executing its operating and investment activities, as well as the existence of rules to prevent political intervention to divert these corporations of its objective as a market entity. In this respect, there is little existing legislation in Latin American countries to prevent the involvement of public corporations in quasi-fiscal activities. Both general legislation (explicit constitutional provisions or statutes of public corporations) and specific legislation (applicable only to an individual corporation) in Latin American countries, show few examples of legislation preventing public corporations performance as agents of fiscal policy.

Of course, if we consider that the coverage must extend to the NFPS, or PS, there are various problems that compilers must face to get information from public corporations. These problems usually stem from laws, or restrictive interpretations of statutes, that limit access to information, whether in terms of:

1. Periodicity: We can only have information for quarterly, semi-annual or annual basis, but not for every month.
2. Timeliness: Lag in the delivery of information is tailored to apply the same of private corporations.
3. Detail of transaction: For example, a full breakdown of expenditure is not available but only a cost of sales that includes salaries, goods and services, and consumption of fixed capital.
4. Legal exemption: The legislation explicitly excludes some public corporations from the PS, whether they perform or not quasi-fiscal activity.

From the above, the need arises, as a minimum, for assessing in each country the relevance of compiling GFS using as reference coverage the NFPS, or the SP. This is especially important in the case of countries where compliance with fiscal rules is facilitated by excluding public corporations from the scope of these rules, which in turn allows deflect quasi-fiscal activity from corporations within the coverage to which are outside or, more straightly, allows governments to replace fiscal transactions by quasi-fiscal activity operations implemented by out of the scope corporations.

<u>The case of the Central Banks</u>

Following the global trend, Latin American countries have been implementing institutional arrangements that deliver specific tasks to their central banks (usually inflation control) and grant them independence for managing the policy tools that help to achieve those objectives.

A starting point for discussion is precisely this: What is the degree of independence that Central Banks have? In Latin America there are cases ranging from complete independence (constitutionally established) to those where such independence is rather nominal (legally established, but with additional rules that limit its enforcement) or nonexistent.

Again, the issue is how and how much central banks are involved in performing quasi-fiscal activity. This involvement can take various forms, such as loans at subsidized rates, application of different exchange rate regimes and, in general, market operations that seek to support fiscal policy objectives rather than to control inflation. Measuring the costs of quasi-fiscal activity is complex because such costs are not identified when the operations are performed, so the measurement must rely on indirect tools such as using market benchmarks to determine the effect the quasi-fiscal activity in the bank's accounts. In short, it seems simpler to integrate (consolidate) the operations of the Central Bank with those of the rest of the PS, in order to rapidly develop a comprehensive assessment of fiscal (and quasi-fiscal) activity.

Even if the Central Bank is completely independent, we have to consider since when the bank has been entitled for and the effect of quasi-fiscal operations performed before the implementation of the statute that guarantees independence. A clear example of why this assessment is necessary is the involvement of central banks in financial bailouts: Although the rescue had occurred decades ago, the Central Bank balance sheet can still reflect the losses it had incurred or, in other words, there is an outstanding Treasury debt due the assistance provided by the Central Bank in the period of crisis. Either way, losses and debt, recognized or not, constitute a burden that impacts the bank's ability to carry out its activities and, therefore, they result in the continuation of the Central Bank quasi-fiscal activity through, for example, interest accrued and uncollected from the outstanding Treasury debt, whether the interest payments be deferred, paid at a subsidized rate, or even not recognized at all.

Shortly, as in the case of public corporations, there are elements that advise, as a minimum, to assess the relevance of including the Central Bank within the coverage of the GFS to report in Latin American countries.

<u>Some proposals to address these issues</u>

Although the state of play is different for each Latin American country, there are some valid generalizations that can be mentioned: (i) there is still work to be done to improve the institutional coverage within the General Government and even the Central Government; (ii) public corporations usually perform a significant amount of quasi-fiscal activity and/or have significant effect on government revenue; (iii) in countries that have implemented fiscal rules legal exclusion from the PS of some public corporations may aim to facilitate compliance with the fiscal rule transferring fiscal activity to operations carried out by these out of the scope corporations; (iv) the degree of independence of Central Banks varies greatly between countries, from absolute to none; and, (v) independent Central Banks can continue to make some indirect quasi-fiscal activity.

In short, because the coverage problems faced by Latin American countries show a high variability, no general recommendation can be made regarding what should be the institutional coverage for compiling GFS without a more thorough assessment of the scope of the quasi-fiscal activity performed by public corporations and the central banks. With this in mind, the goal is to fill the current gaps in General Government and to assess the need for broadening the institutional coverage applicable to the region.

Some lines of action can be suggested seeking to reduce the gaps generated by the "Executive control exempted" entities and complete the coverage of local governments either expanding the direct collection of administrative records to include more "out of scope" municipalities or applying sound estimation methodologies. The same proposed actions could be used for assessing the importance of quasi-fiscal activity.

1. Coordination within STA: Sharing information between divisions regarding methodologies used to record and assess data; identifying cross methodological shortcomings, specially those related with institutional coverage.

2. Coordination with other departments of the IMF: Establishing analysis groups with FAD and WHD, for each country aiming to support the work of the TA and Article IV missions in the identification and assessing of the main problems arising from data shortcomings, including, of course, the issue of the what is the relevant institutional coverage (where WHD can provide expertise due its continuous work with countries).
3. Coordination with other international organizations: The implementation of various initiatives aimed at improving the quality of information is an opportunity to develop a joint work oriented to get more useful GFS. For example, analysis of the relevant reporting coverage should be part of the evaluation of projects for FMIS improvement funded by The World Bank and IDB.
4. Transmitting the issue to the fiscal authorities: It would be very important to support the work of STA and GFS country compilers procuring a space at the annual meetings to inform the authorities regarding: (i) the general problems faced at the region level; (ii) describing the particular situation of each country in complaining with the methodological standards; and, (iii) addressing the issue of the appropriate coverage for each country. Also, the meetings held with authorities during missions, especially Article IV ones, should transmit to the authorities the analysis problems generated by the lack of information corresponding to a complete coverage of fiscal activities.