



FISCAL AFFAIRS

STRENGTHENING FISCAL GOVERNANCE

Paolo Mauro
Deputy Director
Fiscal Affairs Department
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Framework for Enhanced Fund Engagement on Governance and Corruption

How did we get here?

1997: Good Governance: The IMF's Role

First formal guidelines to staff

2017: The Role of the Fund in Governance Issues—Review of the Guidance Note

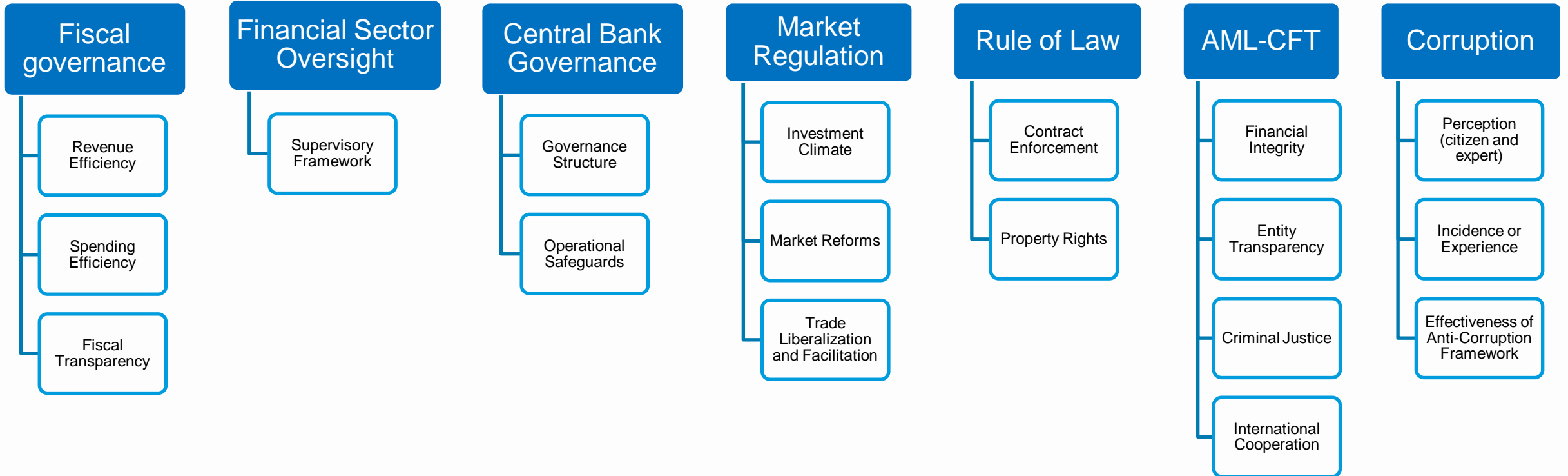
Stocktaking exercise--found 1997 guidelines are still appropriate

But lack of candor, uneven treatment (especially for Article IV's), too general

2018: Review of 1997 Guidance Note on Governance—Framework for Enhanced Fund Engagement

Calls for more candid, evenhanded, and operational engagement on key state functions as outlined in next slide. Fiscal Monitor fleshes out for fiscal governance

Six Key Governmental Functions



Supply Side and International Facilitation of Corruption

New policy urges all members to **volunteer for IMF assessment** of their own legal and institutional frameworks in surveillance to determine whether:

- they criminalize and prosecute the **bribery of foreign public officials** and
- have an **effective AML/CFT system** designed to prevent foreign officials from concealing corruption proceeds
- **G7, Austria, Czech Republic** and **Switzerland** have so far volunteered
- IMF staff will rely on **work/collaborate with the UNODC, OECD and FATF**

INTERNATIONAL MONETARY FUND

FISCAL MONITOR

Curbing Corruption

2019
APR



Curbing Corruption

Fiscal Affairs Department

- **Corruption and Government: Channels and Fiscal Costs**
- **The Role of Fiscal Institutions**
- **International Cooperation**
- **Concluding remarks**

Corruption

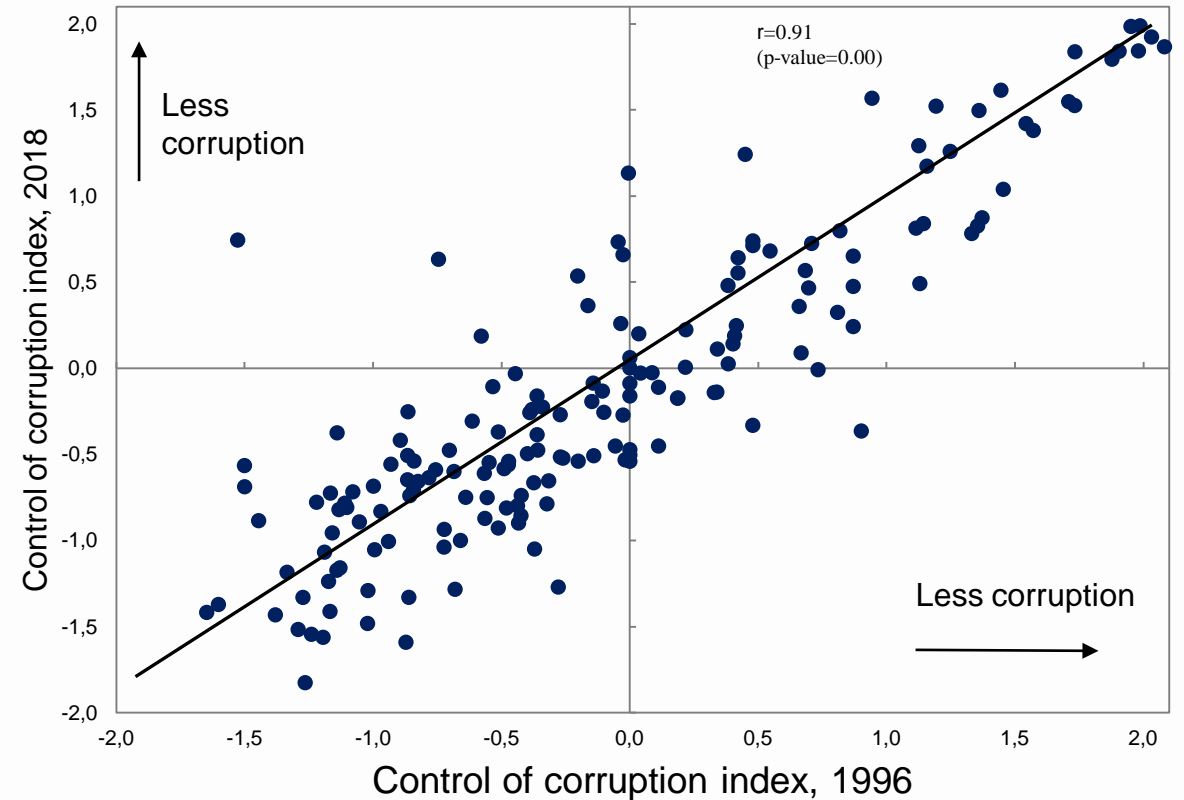
Definition: The abuse of public office for private gain

- ▶ **State capture vs administrative corruption**

Difficult to measure: Largely based on perceptions

Persistent and correlated with level of development

Corruption in 2018 versus 1996



Sources: Worldwide Governance Indicators; IMF, WEO Database.



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Corruption in Government: Hotspots

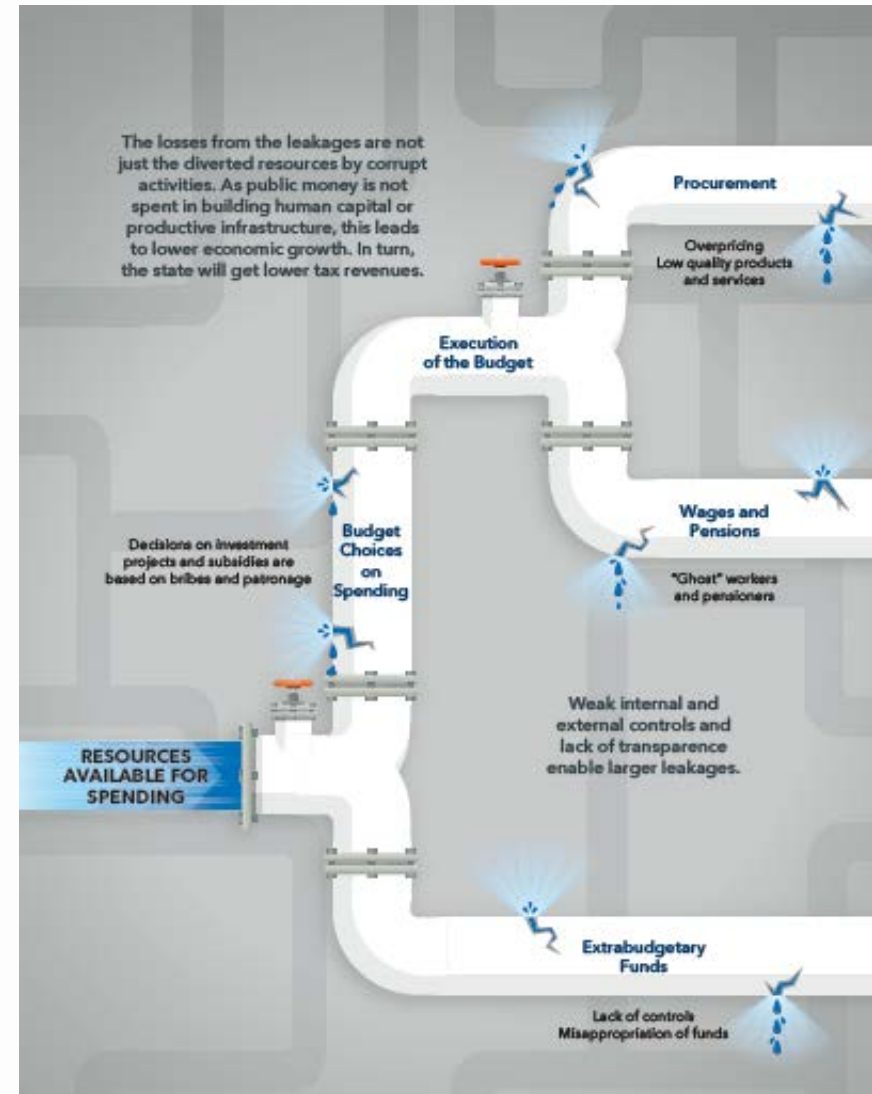
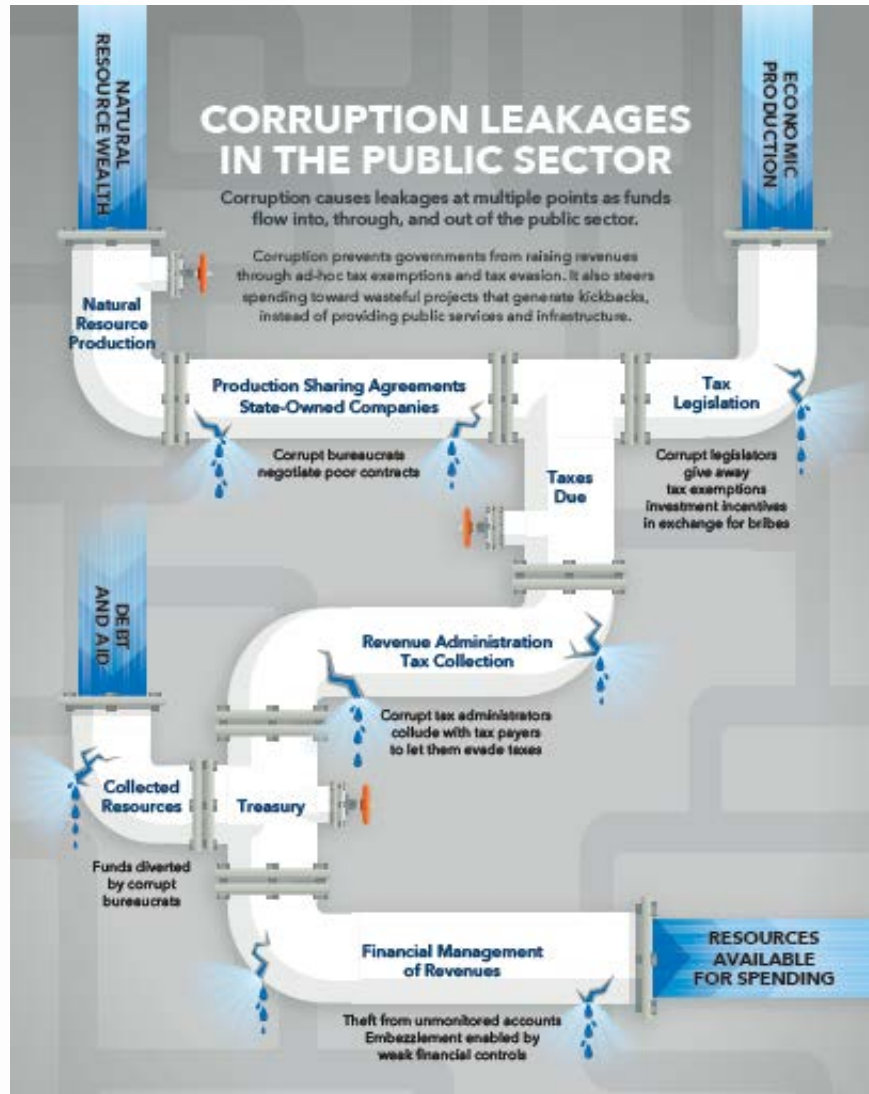
Revenues

- Corruption enhances tax evasion
 - ▶ Tax laws
 - ▶ Tax administration
 - ▶ Undermines culture of tax compliance
- Management of Natural resources

Expenditures

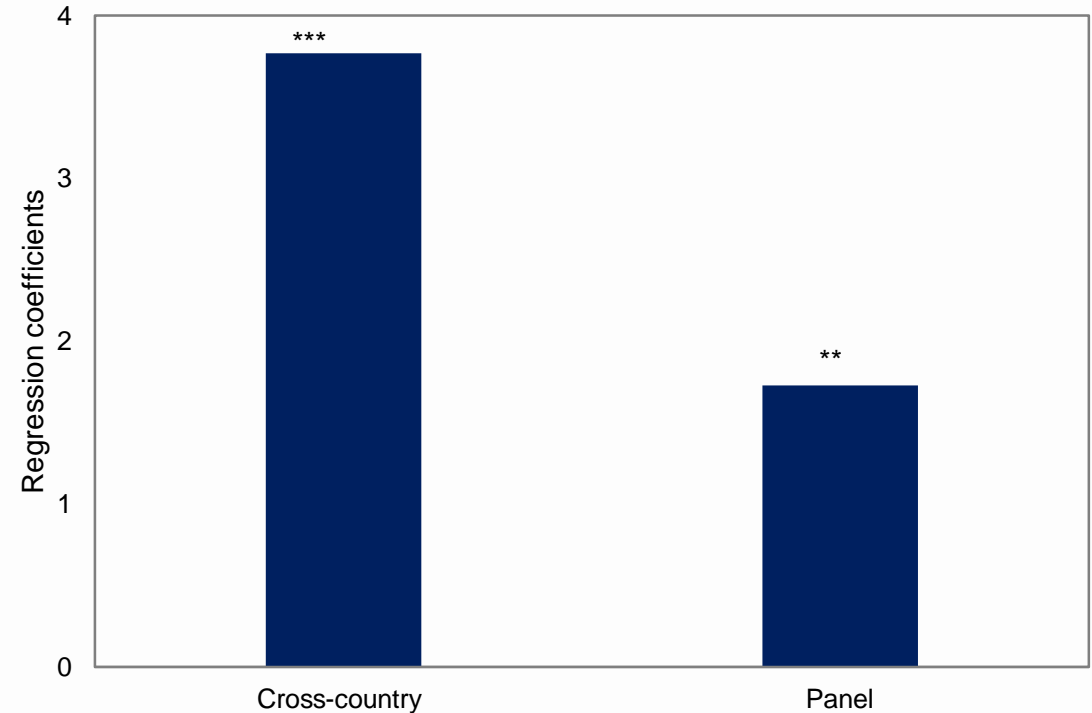
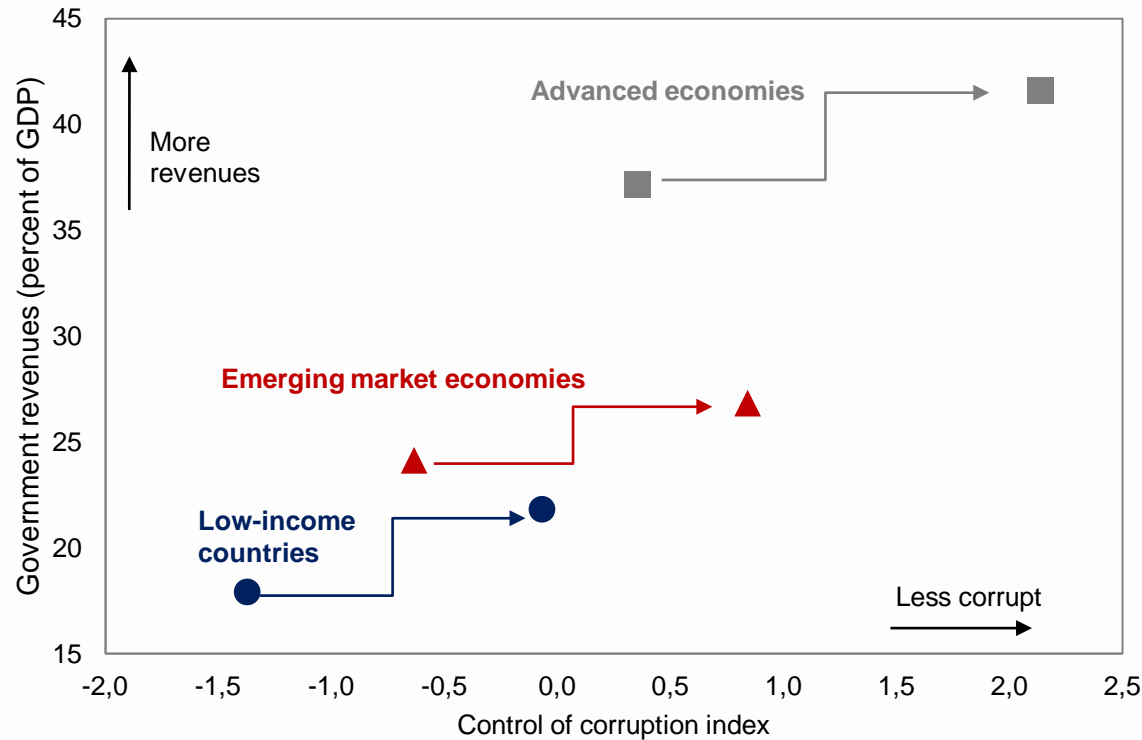
- Distorts budget decisions
- Implementation of policies
 - ▶ Procurement/public investment
 - ▶ Wages and pensions
- Extrabudgetary funds
- State-owned enterprises

Multiple leakage points throughout public sector



Fiscal Costs: Leakages in revenues across all income groups

More corruption, Less Government Revenues

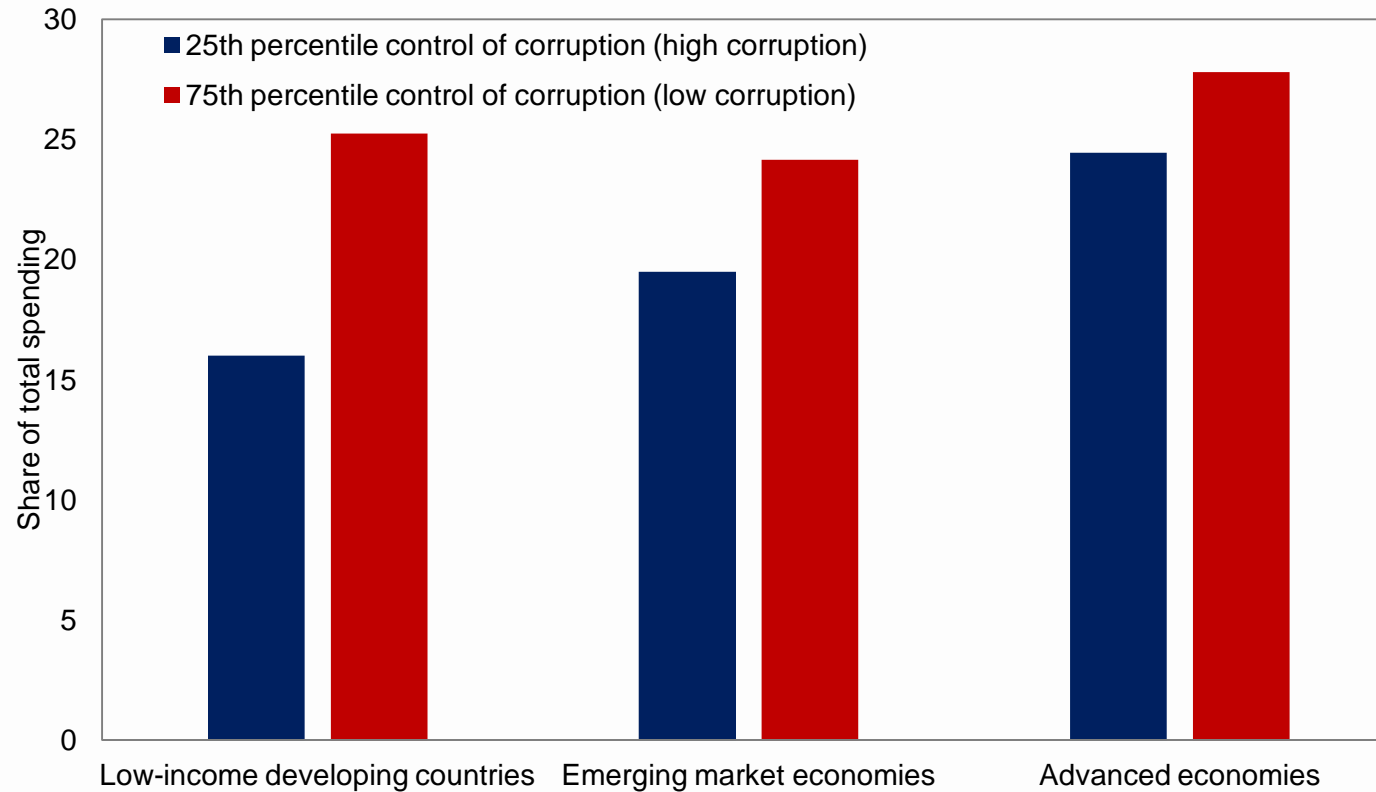


Source: Worldwide Governance Indicators, World Economic Outlook, and staff estimates.
 Note: average government revenues as share of GDP for countries with the lowest levels of corruption (top 25% of the control of corruption) and highest levels of corruption (bottom 25%) for each group. It excludes oil exporters

Note: IMF staff estimates based on cross-country and panel regressions. Shows the impact on government revenues when there is one standard deviation improvement in the control of corruption (WGI). *** statistically significant at 1%; ** significant at 5%.

Fiscal Costs: Corruption affects core policies

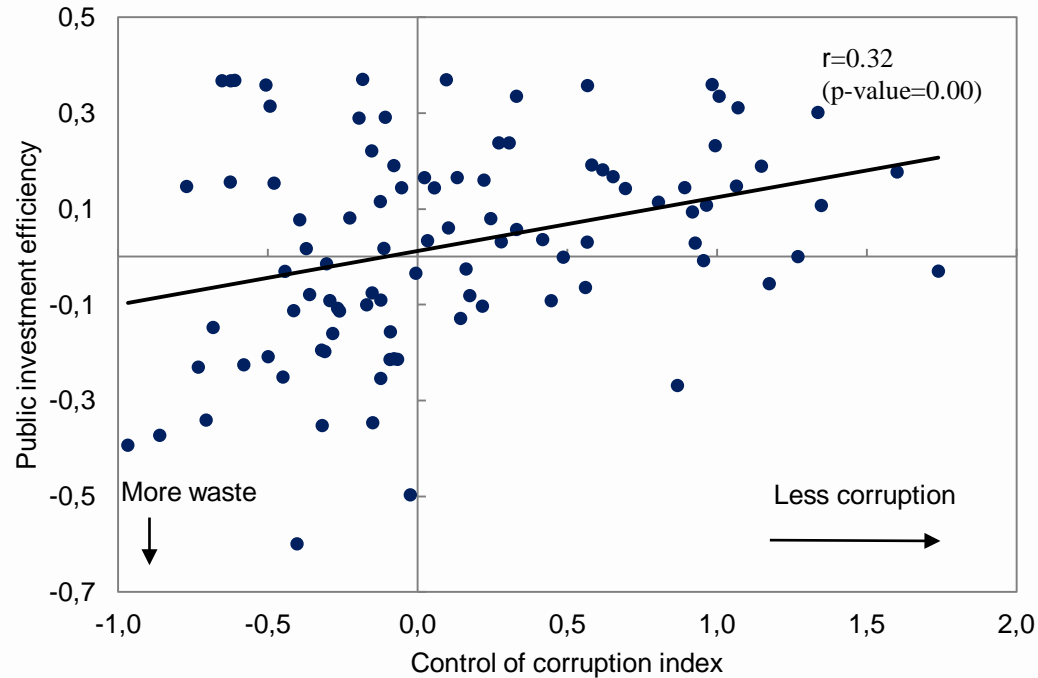
Public Spending on Education and Health (2016)



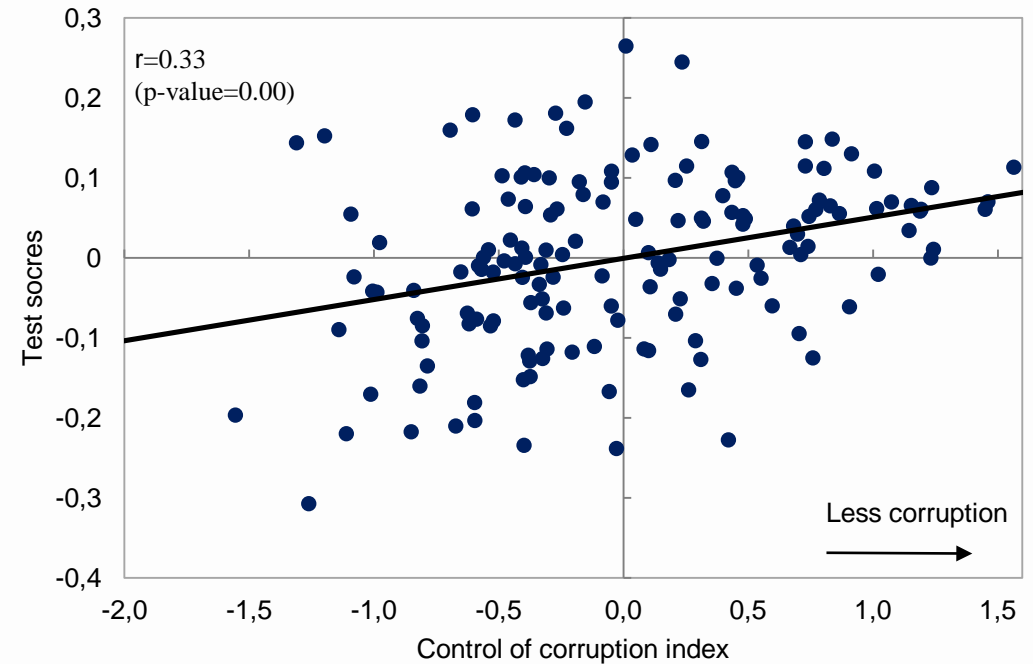
Source: IMF, Governance Finance Statistics; and IMF staff estimates.

Fiscal Costs: Corruption affects quality of public spending

More waste in public investment



Lower test scores



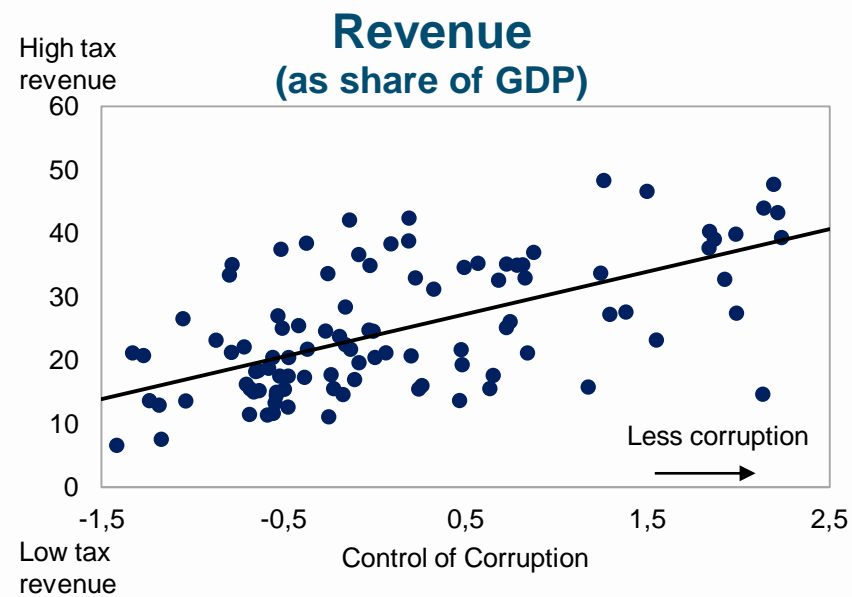
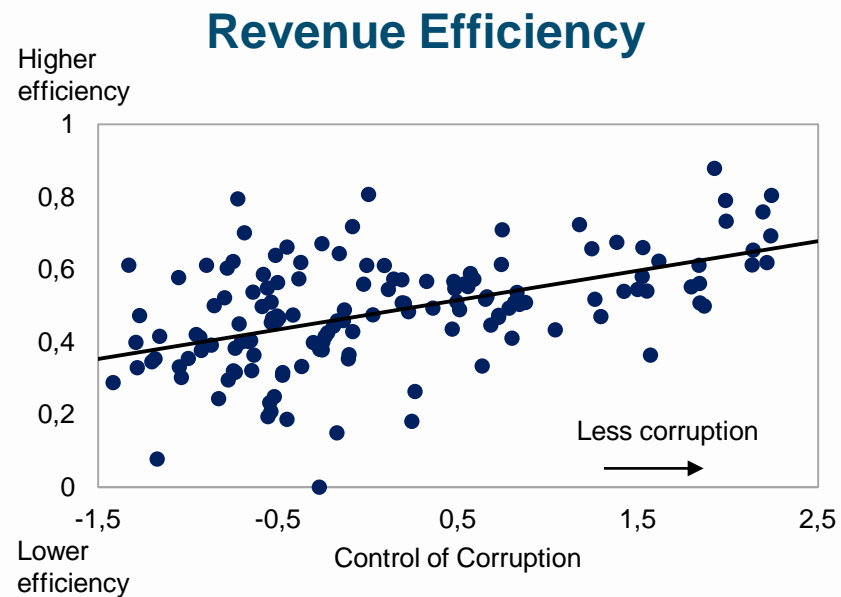
Source: Worldwide Governance Indicators, Patrinos and Angrist (2018), World Economic Outlook, and staff estimates.

Note: Public investment efficiency is estimated using efficiency frontier analysis and measures inefficiency as the distance to the frontier—maximum level of output for given levels of inputs. The output is measured by a physical indicator on the volume of economic infrastructure and social infrastructure. Inputs include capital stock and income. Harmonized test scores across samples. GDP per capita adjusted data.

Corruption and Resource Mobilization

Empirical Evidence

The lower corruption, the higher tax revenue



Note: Revenue efficiency is calculated based on personal income tax and (PIT) and VAT efficiencies. It compares what countries collect relative to what they should collect based on average tax rates.

$R^2 = 0.26$

Source: World Governance Indicators, World Economic Outlook, and staff estimates.

Corruption and Resource Mobilization

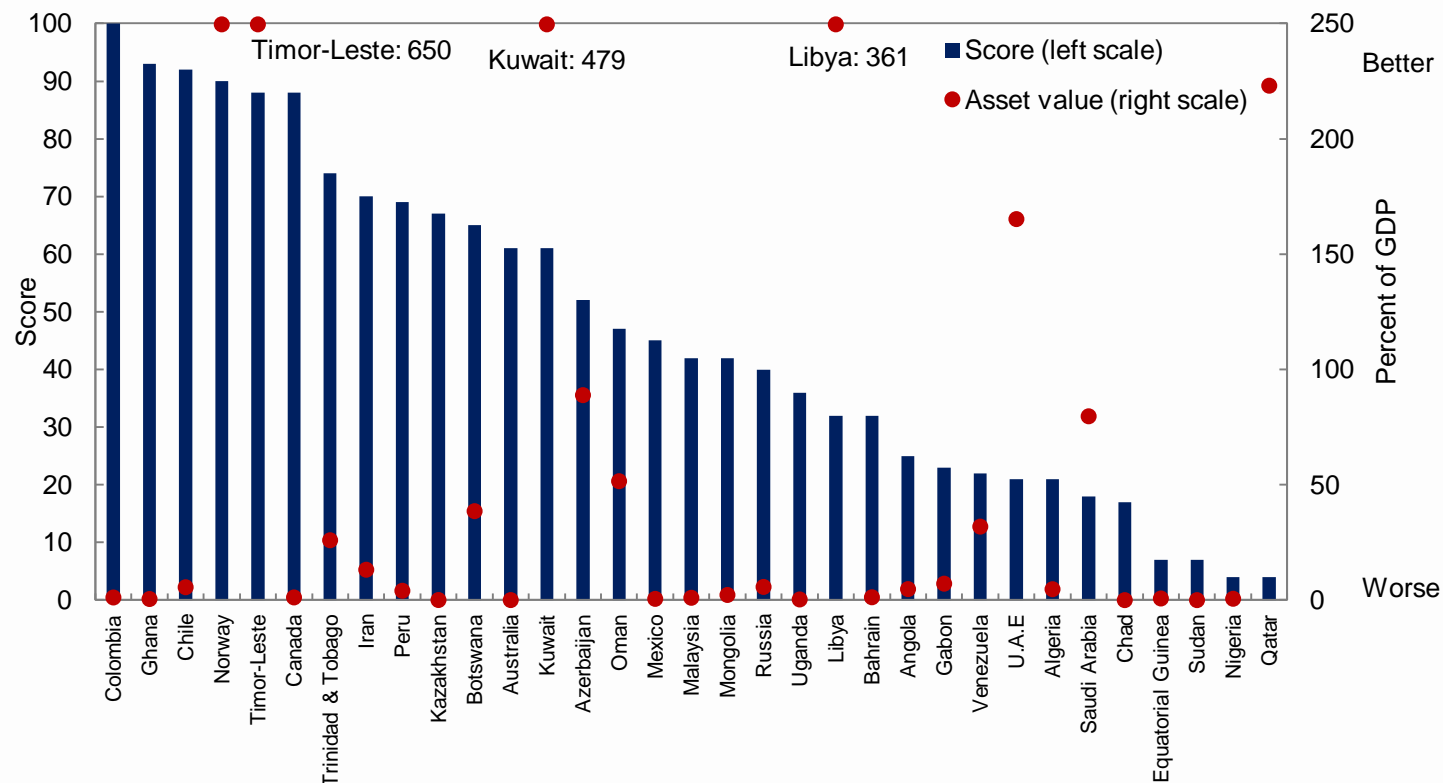
Empirical Evidence

Revenue (5Y-average)	(1)	(2)	(3)	(4)	(5)	(6)
Estimator	OLS	IV	FE Panel	OLS	WALS	WALS
GDP p.c.	2.98***		-1.18	3.44***	2.88**	1.81
Control of corruption	3.77***	9.98***	1.73**	2.86	1.37	1.45
Oil exports, log pop	YES	YES	YES	YES	YES	YES
Fiscal and other institutions	NO	NO	NO	YES	NO	YES
Additional controls	NO	NO	NO	NO	YES	YES
Observations	185	75	810	114	111	87
R ²	0.37		0.19	0.61		

Note: OLS = ordinary least squares. IV = two-stage least square estimator with settler mortality used to instrument control of corruption. FE = Country and year fixed effect estimator. WALS = Weighted Average Least Square estimator.

Management of Natural Resources

Sovereign Wealth Funds: Size and Governance



Source: Natural Resource Governance Institute (2017); and Worldwide Governance Indicators.

Notes: Panel 1 shows the corporate governance and transparency score of the sovereign wealth funds and the size of assets as a percentage of 2016 GDP. Caution is needed in interpreting scores for any individual country as the quality of underlying data can vary across countries and data sources. In panel 2, the boxes show the median as well as the 25th and 75th percentiles, while the whiskers show the bottom and top 5 percent of the data.

Resource-rich countries tend to have higher perceptions of Corruption

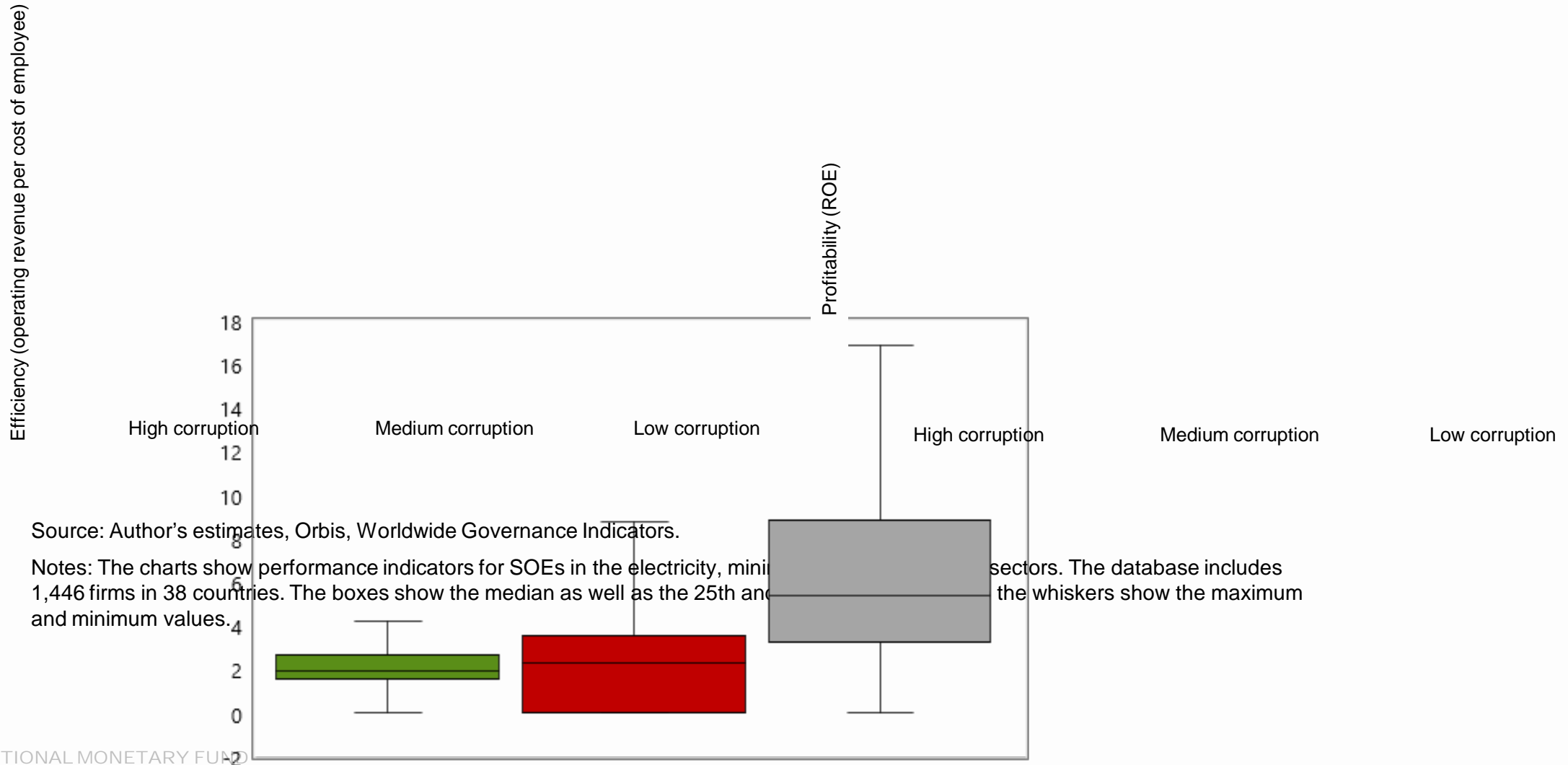
Resource-rich countries

Non-resource-rich countries

State-Owned Enterprises and Corruption

The lower corruption, the more efficient

The lower corruption, the higher profitability



Corruption and education outcomes

Regression results

Years of schooling	(1)	(2)	(3)	(4)	(5)
Estimator	OLS	IV	OLS	WALS	WALS
GDP p.c.	0.07***		0.06***	0.06***	0.06**
Control of corruption	0.05***	0.19***	0.04**	0.02	0.03
Fiscal and other institutions	NO	NO	YES	NO	YES
Additional controls	NO	NO	NO	YES	YES
Observations	153	71	137	98	93
R ²	0.62		0.67		

Test scores	(1)	(2)	(3)	(4)	(5)
Estimator	OLS	IV	OLS	WALS	WALS
GDP p.c.	0.07***		0.06***	0.06***	0.06***
Control of corruption	0.05***	0.19***	0.04**	0.02	0.03
Fiscal and other institutions	NO	NO	YES	NO	YES
Additional controls	NO	NO	NO	YES	YES
Observations	153	71	137	98	93
R ²	0.623		0.672		

Note: OLS = ordinary least squares. IV = two-stage least square estimator with settler mortality used to instrument control of corruption. FE = Country and year fixed effect estimator. WALS = Weighted Average Least Square estimator. All regressions also include a control for education expenditures.

Corruption and investment efficiency

Regression results

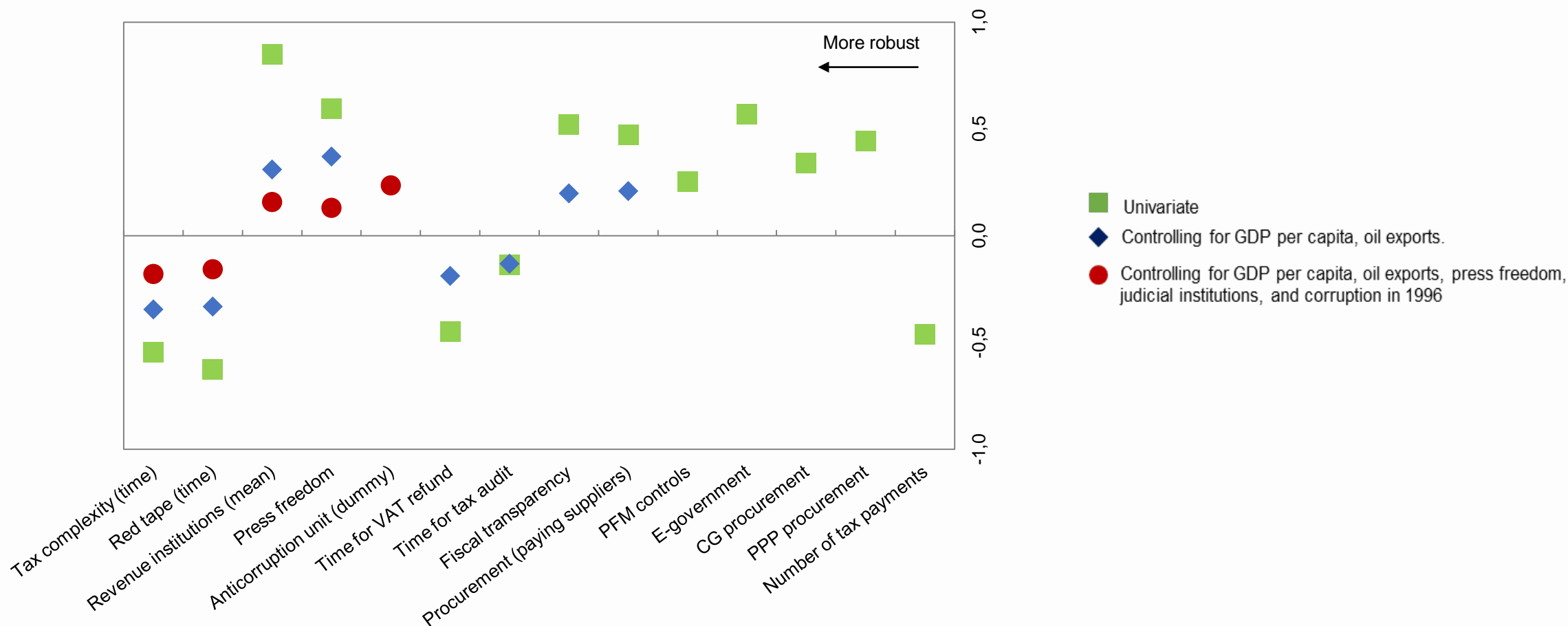
Investment efficiency	(1)	(2)	(3)	(4)	(5)
Estimator	OLS	IV	OLS	WALS	WALS
GDP p.c.	-0.08***		-0.12***	-0.03	-0.04
Control of corruption	0.15***	0.15***	0.10***	0.06*	0.03
Fiscal and other institutions	NO	NO	YES	NO	YES
Additional controls	NO	NO	NO	YES	YES
Observations	118	54	107	85	81
R ²	0.21		0.39		

Note: OLS = ordinary least squares. IV = two-stage least square estimator with settler mortality used to instrument control of corruption. FE = Country and year fixed effect estimator. WALS = Weighted Average Least Square estimator.

The Role of Fiscal Institutions

Cross-country evidence

Corruption and Institutions



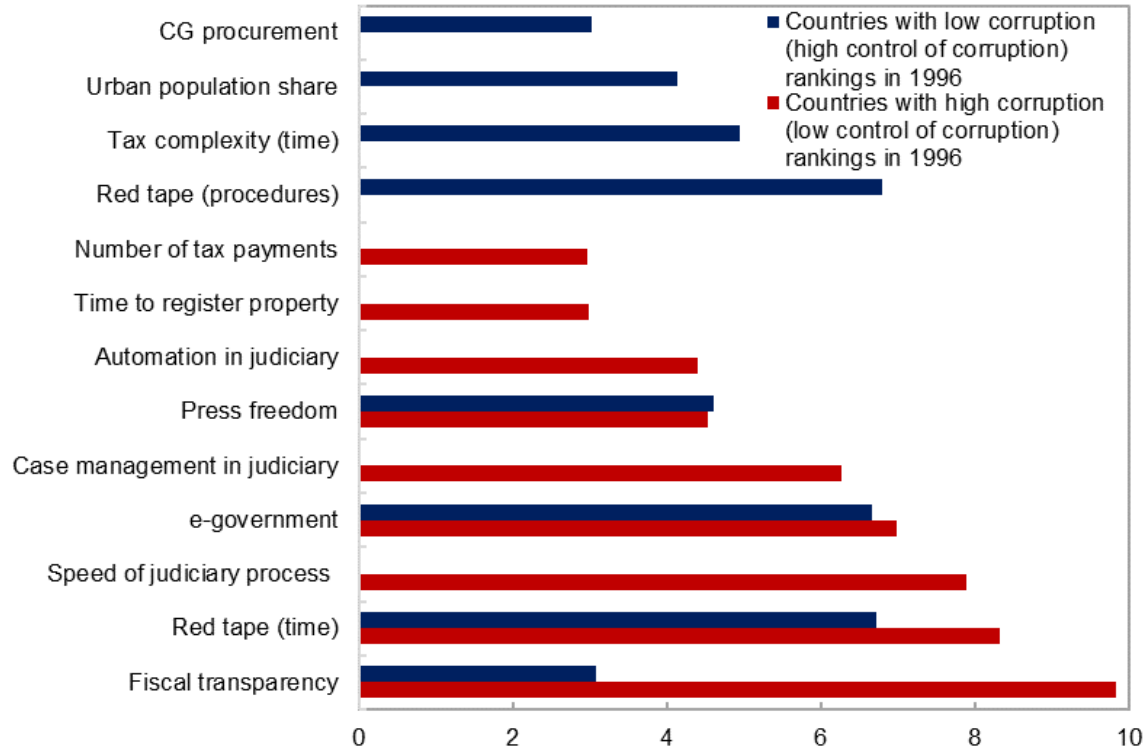
Note: Coefficients are only shown if significant at the 5% level. Series are standardized.

CG - Central Government. PFM - Public financial management. Revenue institutions is an average of limits to discretionary power (RA-FIT), use of third party information (RA-FIT), and the inverted time for tax audit completion (Doing Business).

The Role of Fiscal Institutions

Interactions

Relative importance of fiscal institutions



Source: IMF staff estimates.

Note: Based on regression trees. The results show the top most relevant institutions out of more than 50 variables.

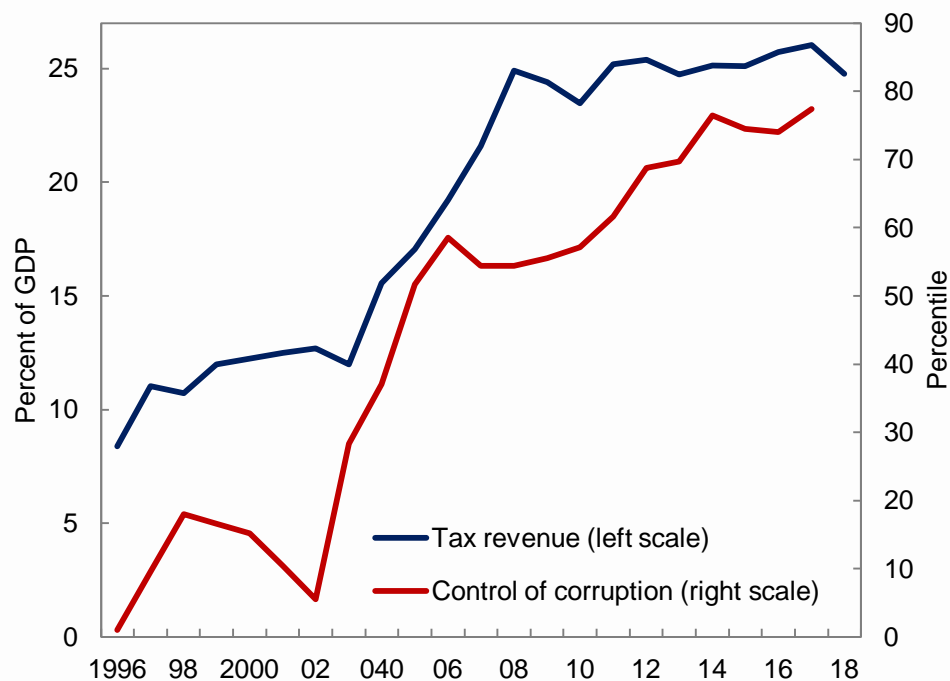
Interactions:

- Transparency and press freedom
- Revenue institutions can compensate for tax complexity
- Judicial institutions enhance fiscal institutions (PFM, red tape)
- Importance of fiscal institutions depends on past levels of corruption

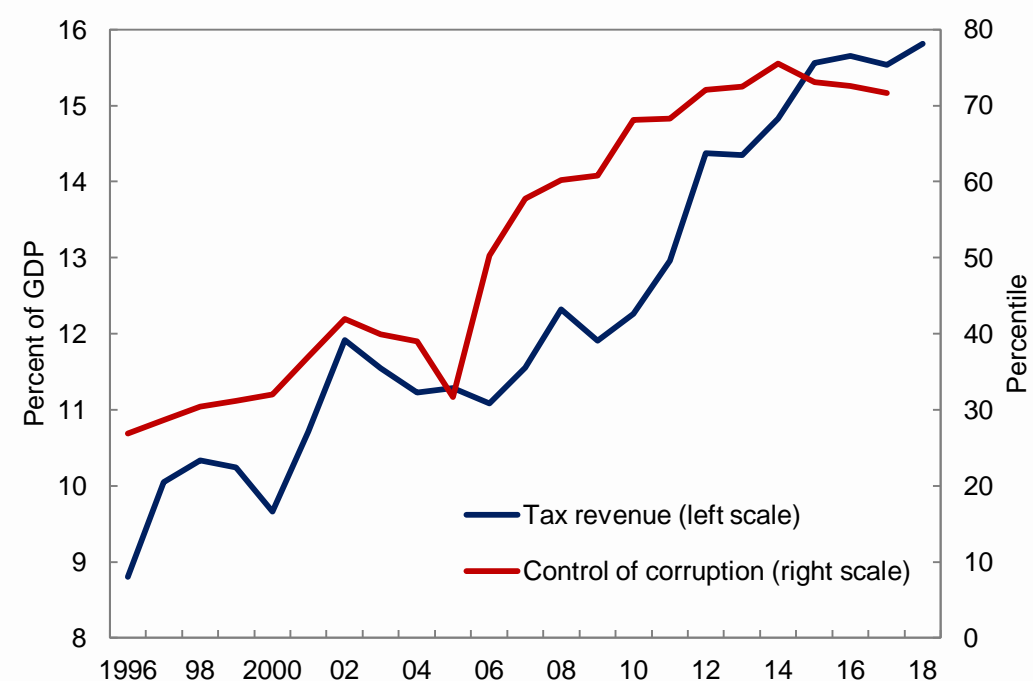
The Role of Fiscal Institutions

Country cases

Georgia. Total Tax Revenues
(Percent of GDP)



Rwanda. Total Tax Revenues
(Percent of GDP)



Source: Country authorities, World Economic Outlook, and IMF staff estimates.

Other cases: Estonia, Chile, and Liberia

The Role of Fiscal Institutions Georgia & Rwanda

- **Political will to tackle corruption**
- **Comprehensive Institutional Reforms**
 - ▶ Tax policy and administration
 - ▶ Public financial management
 - ▶ Civil service reform
- **Simplification of regulations and procedures**
- **Digitalization**
- **Audit institutions**
- **Transparency**
- **Legal framework**

The Role of Fiscal Institutions

Lessons from micro studies and cross-country regressions

- **Institutional design, supported by technology, can create the right incentives**
- **Wages can help, but not by themselves**
- **Monitoring and credible sanctions needed to contain corruption**
- **Transparency particularly effective when supported by free media and civil society participation.**

A Global Challenge

Corruption as a global challenge (“Supply side”)

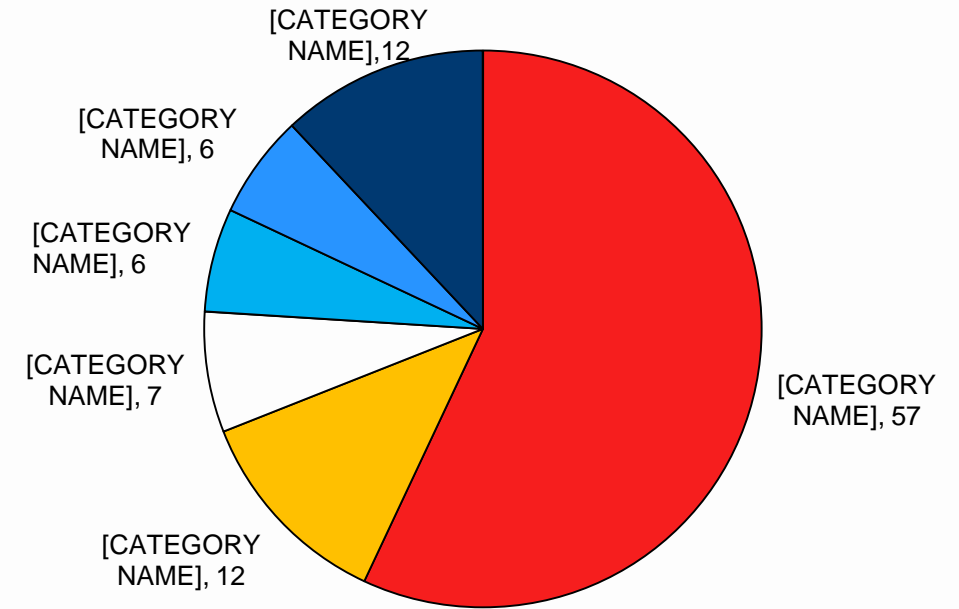
- Multinational companies
- Opaque offshore financial centers

Coordinated action can help

- Prosecuting firms that bribe foreign officials
- Anti-Money Laundering
- Exchange of information

Dissemination of best practices, codes by IFIs

Purpose of Foreign Bribes



Source: OECD (2014).

IMF work on Fiscal Governance

- **Transparency**
 - ▶ **Code and manual; recent work on natural resources industries**
 - ▶ **Fiscal Transparency Evaluations**
- **Governance on public Investment**
 - ▶ **Public Investment Management Assessments (PIMA)**
 - ▶ **Capacity building**
- **Tax Administration diagnostic tools**
 - ▶ **TADAT; RA-FIT; RA-GAP**
 - ▶ **Capacity building**
- **Cooperation with other agencies**
 - ▶ **Public Expenditure and Financial Accountability (PEFA)**
 - ▶ **OECD, World Bank...**

Concluding remarks

- **Curbing corruption helps economy and public finances**
- **Invest in Good Fiscal Institutions**
 - ▶ **Integrity, Accountability, Transparency**
- **Strengthen International Cooperation to fight corruption**