

Fiscal Affairs Department *An Update of Activities for the 2007 Annual Meetings*

The IMF's Fiscal Affairs Department (FAD) is a leading source of fiscal policy expertise worldwide. The department undertakes work on a wide range of fiscal issues, including macro-fiscal policy, tax and expenditure policies, revenue administration, public financial management (PFM), decentralization, and transparency.

FAD provides services to member countries through a number of channels and products:

- Fiscal policy analysis and advice, in connection with Fund surveillance and financial assistance, aimed at fostering stability and sustainable growth through efficient and equitable fiscal policies.
- Technical assistance, to help countries improve policies and institutions, through on-site missions and review of legislation, policy proposals, and plans from Fund headquarters or regional TA centers. FAD undertakes over 500 TA missions and expert visits annually, involving in-depth, on-site review and advice.
- Policy development and research on traditional and emerging fiscal policy issues and trends, often at the direct request of finance ministries, and
- Outreach, targeted seminars, and training events.

FAD aims to closely integrate its policy development and research work with TA and macro-fiscal analysis and advice, to ensure that past experience and new trends are reflected in the design and implementation of fiscal reforms.

ACTIVITIES

Macro-fiscal analysis

FAD devotes significant resources to macro-fiscal policy analysis, design, and advice. FAD assigns on a long-term basis some 45 economists to Fund country mission teams in emerging markets and oil-producing, post-conflict, and low-income countries. FAD also provides on-going guidance and support to Fund mission teams covering other Fund member countries, including by assigning fiscal specialists to missions to analyze specific policy issues in the context of Fund surveillance or Fund financial support.

An important example of fiscal analysis is the Global Fiscal Model (GFM). The GFM is a multi-country simulation model designed to analyze the macroeconomic effects of fiscal policies, including their international spillovers. Specific country applications by staff include analyzing tax and pension reforms and aging in Germany, South Korea, Ireland, and the Czech Republic; evaluating the macroeconomic implications of alternative forms of fiscal adjustment—including spillovers—in the U.K. and Japan; ranking tax distortions in Canada; and analyzing long term fiscal sustainability in Norway in the light of aging and declining oil revenues.

A new area of work is assisting member countries assess and manage fiscal risks. These efforts draw on past FAD work, including a series of Board papers on government guarantees, contingent liabilities, extending fiscal coverage and improving accounting, and public-private partnerships (PPPs). FAD also provides TA to member countries to establish or provide advice to macro-fiscal policy units.

Tax policy

FAD helps member countries enhance the efficiency, fairness, and productivity of their tax systems through TA, review of draft tax reform proposals, and research.

- **Tax reform.** FAD's advice covers the design and implementation of reforms of corporate and personal income taxes, taxes on capital income and financial institutions, VAT and other indirect taxes, and local property taxes.
- **Coordination, customs unions, and incentives.** Increased mobility of capital and products—amplified by growing regional trade arrangements—has highlighted the importance of improved tax coordination. FAD has assisted regional groupings and customs unions in improving tax coordination, strengthening domestic revenue mobilization (in connection with trade liberalization), and assessing the revenue impact of tax exemptions.
- **Natural resource revenues and management.** A growing work area for FAD has been the provision of advice on all facets of natural resource revenues. This has included guidance on the appropriate fiscal framework for mining, oil and natural gas, on the establishment of sound macro-fiscal frameworks for short-, medium- and long-term management of resource revenues, and on transparency. FAD has developed financial models to help assess the impact of variations in price and extraction amounts on the fiscal take, to guide policy decisions.
- **Development of financial markets.** Together with the Monetary and Capital Markets Department, FAD has reviewed the taxation of financial instruments and institutions in a number of emerging market countries, providing recommendations on taxation aspects of capital market development, especially for derivatives and secondary markets.
- **Climate change.** This is a new and growing area of work, and FAD has begun analyzing the fiscal consequences of climate change for Fund member countries and potential policy responses. This work was featured in the Fall 2007 World Economic Outlook, and further analysis is being prepared for the Spring-2008 WEO and for the Fund's Executive Board.

Revenue administration

An effective revenue administration system is critical to providing Fund member countries with sufficient and sustainable fiscal resources in an efficient and non-distortionary manner.

- FAD provides TA in tax and customs administration to help member countries develop reform strategies and generate sustainable revenue increases. TA is delivered in the form of full diagnostic missions that review tax and customs operations, follow-up expert visits in specific areas, analytical support and advice from experts attached to regional TA centers, and workshops and seminars. FAD TA focuses on management and organizational issues, the appropriate treatment of different taxpayer segments, and improved administration of specific taxes (VAT, income taxes, excises, customs duties and social contributions). FAD also undertakes research on, and dissemination of best practices and emerging trends in tax and customs administration.

Public financial management (PFM)

Strong PFM systems are key to ensure effective delivery of intended budget policies. FAD provides PFM advisory services, through HQ review, TA missions, and resident and short-term experts. These cover:

- Diagnostic assessment of the efficiency, effectiveness, and transparency of PFM systems.
- Strategic advice on the development, sequencing, and prioritization of PFM reform programs.
- Advice on drafting legislation, including organic budget laws and fiscal responsibility legislation.
- Advice on “first generation” reforms, such as budget preparation, expenditure and revenue classification, accounting and fiscal reporting, cash management, treasury systems, and internal control and audit.
- Advice on “second generation” reforms, such as medium-term expenditure frameworks, performance budgeting, accrual accounting and fiscal risk assessments.
- Advice on restructuring ministries of finance, state treasuries and debt management offices.

Expenditure policy

The quality of spending has a direct bearing on growth and social development in Fund member countries. FAD provides a growing range of analytical and advisory services in this area.

- **Expenditure efficiency.** FAD work, often in close collaboration with the World Bank, has provided advice on short-term expenditure rationalization, aimed at identifying sustainable ways of raising the efficiency of government spending. It has also included more focused advice, for example on pensions, health spending, and social insurance. Empirical research into the measurement of expenditure efficiency and rigidity has provided important inputs into this advice.
- **Poverty and Social Impact Analysis (PSIA).** FAD's PSIA group has assessed the poverty and social impacts of macro-critical policy options in over twenty low-income countries in 2006-07, and advised on mitigating measures. Topics addressed have included subsidy reform (in particular fuel subsidy reform), tariff and tax reform, agriculture sector reforms, and devaluation.
- **Public-private partnerships (PPPs).** Over the last year, FAD has provided TA on PPPs to several countries in Africa and Europe. The advice has aimed at realizing efficiency gains from PPPs, while managing risks. It has focused on establishing appropriate institutions, with a key role for finance ministries, improved public investment planning, comprehensive legal frameworks, and transparent accounting and reporting of PPPs. FAD has held regional seminars on PPPs for senior officials in Europe, Africa, Asia and Latin America.

Decentralization

- FAD's policy advice and TA on fiscal decentralization focuses on strategic guidance in the design and reform of intergovernmental fiscal relations. This includes revenue assignment, expenditure responsibilities and devolution, intergovernmental transfers, and subnational borrowing. During the past year, work has intensified with a number of emerging market countries—including in the form of joint work products with some national authorities—and some post-conflict states. FAD held workshops on decentralization in Brazil aimed at South American country authorities, in Italy aimed at international organizations and bilateral donors, and in China.

Fiscal transparency

- FAD has continued its work on fiscal transparency, including preparation of fiscal ROSCs. Key reference materials were updated in the past year, including the Code of Good Practices on Fiscal Transparency, the Guide on Resource Revenue Transparency, and the Manual on Fiscal Transparency. FAD has also provided support to the Extractive Industries Transparency Initiative (EITI), including its new governance structure and validation procedures.

FAD RESEARCH

FAD research aims to assess emerging issues, trends, and practices in all areas of public finance, and to inform FAD's advice. Research takes a number of forms, including policy-related papers presented to the Fund's Executive Board, "selected issues papers" prepared by FAD economists, papers issued in the IMF Working Paper series, and external publications, often in international economics and finance journals.

Research highlights of the past year include the following:

Fund Board papers aim to review and analyze important recent fiscal policy developments and to provide guidance to member country officials. Six Board papers were prepared by FAD since last year's Annual Meetings:

- Fiscal Policy Response the Scaled-Up Aid.
- Fiscal Policy Responses to Scaled-Up Aid—Macro-Fiscal and Expenditure Policy Challenges.
- Fiscal Policy Responses to Scaled-Up Aid—Strengthening Public Financial Management.
- Revision to the Code of Good Practices on Fiscal Transparency.
- Public Private Partnerships and Fiscal Risk.
- The Role of Fiscal Institutions in Managing the Oil Revenue Boom.

Selected issues papers (SIPs) are policy-oriented research papers prepared by FAD economists, usually in the context of Article IV consultations and often at the request of country officials to consider pressing issues. Over the past year, over 30 SIPs were prepared for a wide range of developing, emerging and industrial countries. They covered a broad spectrum of topics, including the market benefits of trade liberalization, reforms to broaden tax bases, application of the GFM to consider strategies for fiscal reforms, creating fiscal space, managing and controlling extra budgetary funds, reviewing civil service reform options, analyzing and addressing fiscal risks, estimating cyclically-adjusted fiscal measures, analyzing fiscal-federal arrangements, considering options for phasing out fuel subsidies, and assessing long-term fiscal sustainability in natural resource-producing countries and with respect to aging populations.

FAD staff also prepared **IMF Working Papers** on such topics as macroeconomic modeling, government size and economic uncertainty, assessing expenditure efficiency, distributional impacts of specific tax reforms, sequencing structural reforms, and Asian equity markets.

FAD staff contributed **journal articles and conference papers** on a range of fiscal topics, including financial conditions and fiscal performance, creating fiscal space, indirect taxes on international aviation, VAT fraud and evasion, the link of the exchange rate to fiscal consolidation, capital mobility, fiscal decentralization, the costs of holding international reserves, fiscal policy and long-term expenditure uncertainty, applying a “fan-chart” approach to fiscal sustainability analysis, fiscal rules and fiscal councils, and the determinants of tax amnesties. A book on performance budgeting was recently published by the department. *FAD publications are available at www.imf.org*

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