

Michael Teig

Fiscal Transparency and Economic Development
Definitions, Concept, Possible Transmission Mechanisms, and
Policy Implications

Editor of the Series:

Prof. Dr. Dr. h.c. H.-Dieter Wenzel
Director of BERG
Bamberg University
Germany
public-finance@sowi.uni-bamberg.de

Author:

Michael Teig

ISBN: 978-3-931052-68-3

BERG-Verlag, Bamberg

Bibliographic information is published by Die Deutsche Bibliothek

Die Deutsche Bibliothek lists this publication in the Deutsche Nationalbibliografie; detailed bibliographic data is available in the internet at <http://dnb.ddb.de>.

Zugl. Bamberg, Univ., Diss., 2008

This work is subject to copyright. All rights are reserved, whether the whole or part of the material is concerned, specifically the rights of translation, reprinting, reuse of illustrations, recitation, broadcasting, reproduction on microfilm or in any other way, and storage in data banks. Duplication of this publication or parts thereof is permitted only under the provisions of the German Copyright Law of September 9, 1965, in its current version, and permission for use must always be obtained from BERG-Verlag. Violations are liable for prosecution under the German Copyright Law.

BERG-Verlag Bamberg 2009

Our service provider for printing:

Buch bücher dd ag
www.DD-AG.de

Vorwort

Die vorliegende Arbeit wurde von der Sozial- und Wirtschaftswissenschaftlichen Fakultät der Otto-Friedrich-Universität Bamberg im Mai 2008 als Dissertation angenommen. Sie entstand während meiner Tätigkeit als wissenschaftlicher Mitarbeiter bei Prof. Dr. Dr. h.c. H.-Dieter Wenzel am Lehrstuhl für Volkswirtschaftslehre, insbesondere Finanzwissenschaft an der Otto-Friedrich-Universität Bamberg.

Danken möchte ich besonders meinem Erstgutachter Prof. Dr. Dr. h.c. H.-Dieter Wenzel für die jahrelange Unterstützung und Förderung, die mir schon als Student und während der Diplomarbeit zuteil wurde. Sein Angebot, mein Studium mit einer Promotion am Lehrstuhl zu vertiefen, habe ich sehr gerne angenommen.

Großer Dank gilt auch meinem Zweitgutachter Prof. Dr. Dietmar Meyer von der Budapest University of Technology and Economics (BME) in Budapest, der durch seine zahlreichen Hinweise und Anregungen während verschiedener gemeinsamer Konferenzen zum Gelingen der vorliegenden Arbeit beigetragen hat.

Der Teamgeist, die angenehme und familiäre Atmosphäre am Lehrstuhl waren ein nicht zu vernachlässigender Baustein für den erfolgreichen Abschluss meines Promotionserfahrens.

Die Tätigkeit am Lehrstuhl war eng verbunden mit einer vom Deutschen Akademischen Auslandsdienst (DAAD) geförderten Forschungs- und Bildungskooperationen, insbesondere mit Albanien, Bosnien-Herzegowina, Mazedonien und Ungarn. Die Kontakte zu Verwaltungs- und Bildungseliten der Länder führten zu zahlreichen (Er-)Kenntnissen, die mittelbar in diese Arbeit einfließen.

Besonderer Dank geht an Carissa Champlin, Angelina Jedig, Anna Pechan, Heike Teig und Frederik Flemmig für aufmerksames Korrekturlesen und die tatkräftige Unterstützung bei der Literaturverwaltung.

Nicht zuletzt möchte ich meinen Eltern danken für ihre jahrelange uneingeschränkte Unterstützung meines Studiums und den Rückhalt für das Promotionsvorhaben.

Contents

List of Figures	6
List of Tables	8
List of Abbreviations	9
I FISCAL TRANSPARENCY: DEFINITIONS, CONCEPT, AND LITERATURE REVIEW	11
1 Introduction	12
2 Institutions and Good Governance in Public Finance and Economic Development	16
2.1 Institutions in General	17
2.2 Fiscal and Budgetary Institutions	19
2.3 Good Governance in Public Finance	24
2.4 Chapter Summary and Conclusions	27
3 Literature Review on Fiscal Transparency	28
3.1 What is Transparency? – Some Basic Transparency Definitions	28
3.1.1 Definitions of Transparency in General	29
3.1.2 Definitions of Fiscal Transparency	31
3.1.3 Definitions of Budget Transparency	33
3.1.4 Section Summary: Some Basic Transparency Definitions	34
3.2 How Does Fiscal Transparency Affect Economic Outcomes?	35
3.2.1 Fiscal Transparency and Financial Markets	35
3.2.2 Fiscal Transparency, Corruption, and Economic Growth	37

3.2.3	Fiscal Transparency and Fiscal Outcomes	37
3.2.4	Political Economy and Fiscal Transparency	38
3.2.5	Fiscal Transparency and the Effectiveness of Government Expenditures	39
3.2.6	Section Summary: Fiscal Transparency and Economic Outcomes	40
3.3	How to Measure the Level of Fiscal Transparency? Existing Indices and Problems of Measurement	41
3.4	Chapter Summary and Conclusions	49
4	Critical Policy Areas for Fiscal Transparency	51
4.1	Extrabudgetary Funds	51
4.2	Government Liabilities	53
4.2.1	Direct Government Liabilities	54
4.2.2	Contingent Government Liabilities	56
4.3	Tax Expenditures	58
4.4	Quasi-Fiscal Activities	62
4.5	Chapter Summary and Conclusions	66
5	Key Stakeholders of Fiscal Transparency	68
5.1	International Financial Institutions	68
5.2	Financial Markets	74
5.3	Civil Society	77
5.4	Chapter Summary and Conclusions	79
6	Summary Part One	81
II FISCAL TRANSPARENCY: POSSIBLE TRANSMISSION MECHANISMS ON ECONOMIC GROWTH		83
7	Stylized Facts of Fiscal Transparency	85
7.1	A Note on the Methodology Followed	85
7.2	Economic and Institutional Transparency and Political Transparency	86
7.3	Level of Democracy and Economic and Institutional Transparency	87
7.4	Economic and Institutional Transparency and GDP Per Capita	89

7.5	Economic and Institutional Transparency and Corruption	90
7.6	Economic and Institutional Transparency and Fiscal Outcomes	92
7.7	Economic and Institutional Transparency and Sovereign Credit Ratings	95
7.8	Economic and Institutional Transparency and Foreign Direct Investment	95
7.9	Demand Side Argument of Fiscal Transparency	98
7.10	Chapter Summary and Conclusions	100
8	Political Economy Approach to Fiscal Transparency	101
8.1	The Theory of Fiscal Illusion	102
8.2	Strategic Ambiguity	105
8.3	Chapter Summary and Conclusions	108
9	Fiscal Transparency and the Level of Foreign Direct Investment	110
9.1	Introduction	110
9.2	Are FDI Important for Economic Growth?	112
9.3	Fiscal Transparency and the Level of FDI Inflows	115
9.4	Chapter Summary and Conclusions	116
10	Fiscal Transparency and Government Bond Yield Spreads	117
10.1	Fiscal Transparency and Financial Markets	117
10.2	Decomposing Government Bond Market Spreads	119
10.3	Fiscal Transparency and Bond Spreads	122
10.4	Country Case Study: Greece	130
10.5	Chapter Summary and Conclusions	135
11	Fiscal Transparency and Corruption in a Growth Model	137
11.1	Introduction	137
11.2	The Basic Setup of the Model	139
11.3	Corruption and Efficiency-Enhancing Fiscal Transparency	143
11.4	Simulation Results: Efficiency-Enhancing Fiscal Transparency	148
11.5	Criticism of Efficiency-Enhancing Fiscal Transparency	151
11.6	Positive Corruption and Efficiency Decreasing Fiscal Transparency	152
11.7	Simulation Results: Efficiency Decreasing Fiscal Transparency	154
11.8	Corruption, Fiscal Transparency, and (Re-)Distribution	157
11.9	Chapter Summary and Conclusions	159

12 Fiscal Transparency and the Effectiveness of Government Expenditures	162
12.1 Country Case Study Uganda: Leakage of Educational Funds	162
12.2 Framework Linking Fiscal Policies, Public Expenditure Effectiveness, and Economic Growth	165
12.3 Empirical Analysis of Public Expenditures, Fiscal Transparency, and Pub- lic Sector Outcomes	168
12.4 Critical Stance on the Derived Results	173
12.5 Chapter Summary and Conclusions	173
13 Summary Part Two	174
III FISCAL TRANSPARENCY: MAIN CONCLUSIONS AND POLICY IMPLICATIONS	177
14 Policy Implications of Fiscal Transparency	179
14.1 Policy Implication 1: Budget Process	179
14.2 Policy Implication 2: Contingent Liabilities	180
14.3 Policy Implication 3: Tax Expenditures	181
14.4 Policy Implication 4: Political Transparency and Control of Corruption . .	182
14.5 Policy Implication 5: Fiscal Transparency and Financial Markets	183
14.6 Policy Implication 6: Fiscal Transparency and Corruption	184
14.7 Policy Implication 7: Effectiveness of Public Expenditure	185
15 Five Policy Tools to Improve the Level of Fiscal Transparency	186
15.1 Tool 1: Public Expenditure Tracking Survey	186
15.2 Tool 2: Performance-Based Budgeting	187
15.3 Tool 3: Medium Term Expenditure Framework	188
15.4 Tool 4: Fiscal Decentralization	189
15.5 Tool 5: Setting-up Financial Treasury Systems	190
16 Fiscal Transparency: Conclusions and Outlook	194
IV APPENDICES	196

Contents

A List of ISO No. 3166 3-Alpha Country Codes	197
B Asset Allocation Problem: Optimal Share Invested in the Risky Security	200
C Bond Ratings and Ten-Year Cumulative Default Probabilities	203
D Analytical Solution of the Growth Model of Chapter 11	204
V BIBLIOGRAPHY	207