

Managing Fiscal Risks –IMF Toolkit and Lessons from International Experience

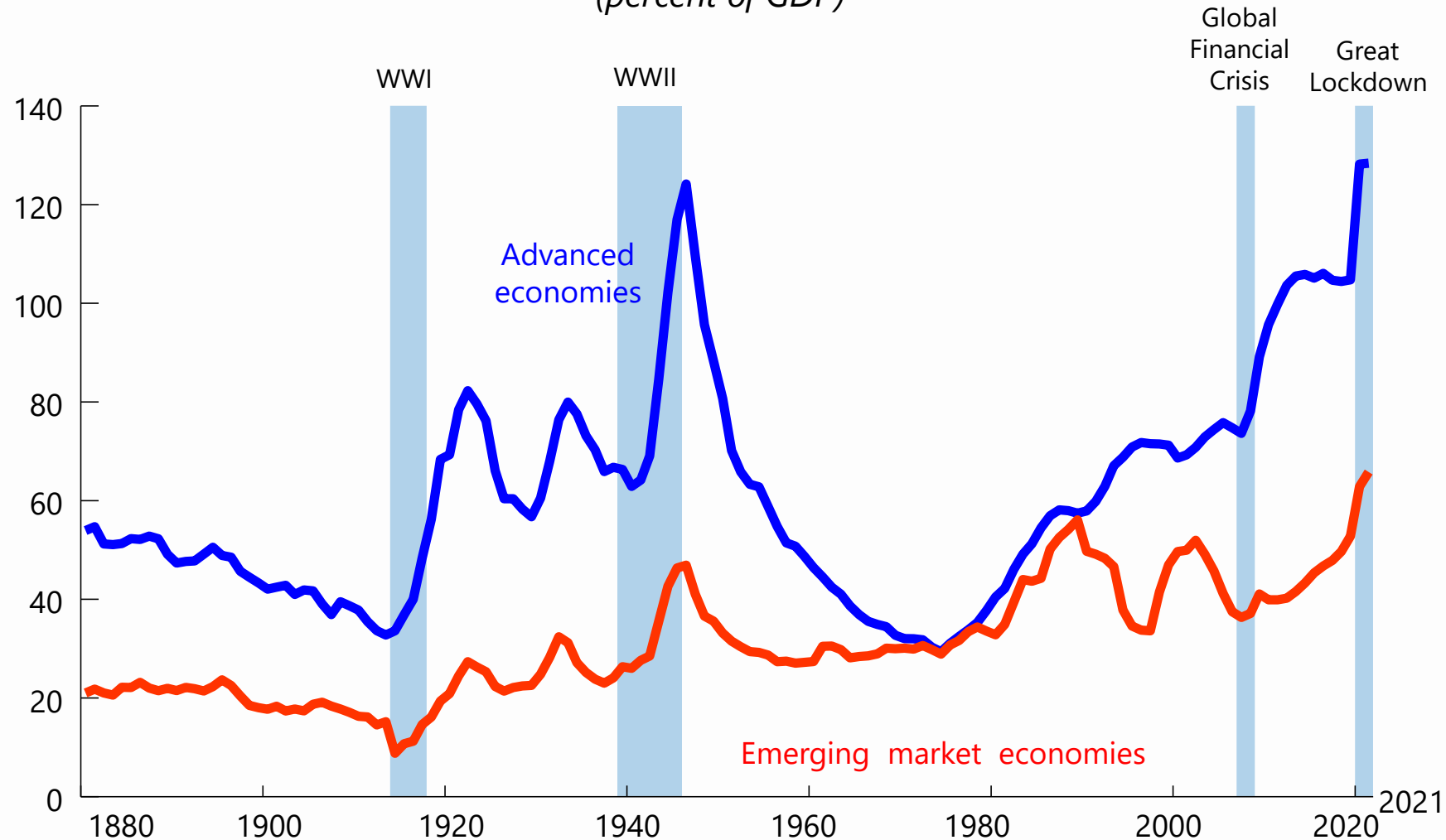
THE SIXTH TOKYO FISCAL FORUM

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Public debt to exceed post-World War II peak

AE and EM: Public debt
(percent of GDP)



Sources: Historical Public Debt Database, Maddison Database Project; IMF, *World Economic Outlook*; IMF VE database; IMF staff calculations.

Outline

- Types and nature of fiscal risks
- Risk realizations and build-up related to COVID-19
- Governments response: Do what it takes, keep the receipts
- IMF fiscal risk management toolkit
- Lessons from Asian countries' risk management practices

Fiscal risks caused by a variety of sources. Most common is macroeconomic risks, but SOEs, guarantees, and local governments also affected by economic downturn

Definition

Fiscal risks are factors that may cause fiscal outcomes to differ from forecasts or expectations

Categories

Macroeconomic

Specific (including contingent liabilities)

Institutional



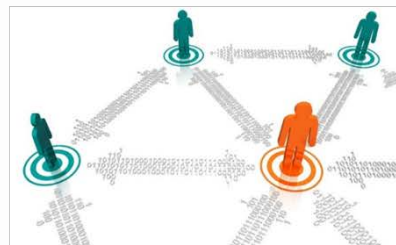
Financial Sector



State-Owned Enterprises



Guarantees



Public Private Partnerships



Local Government

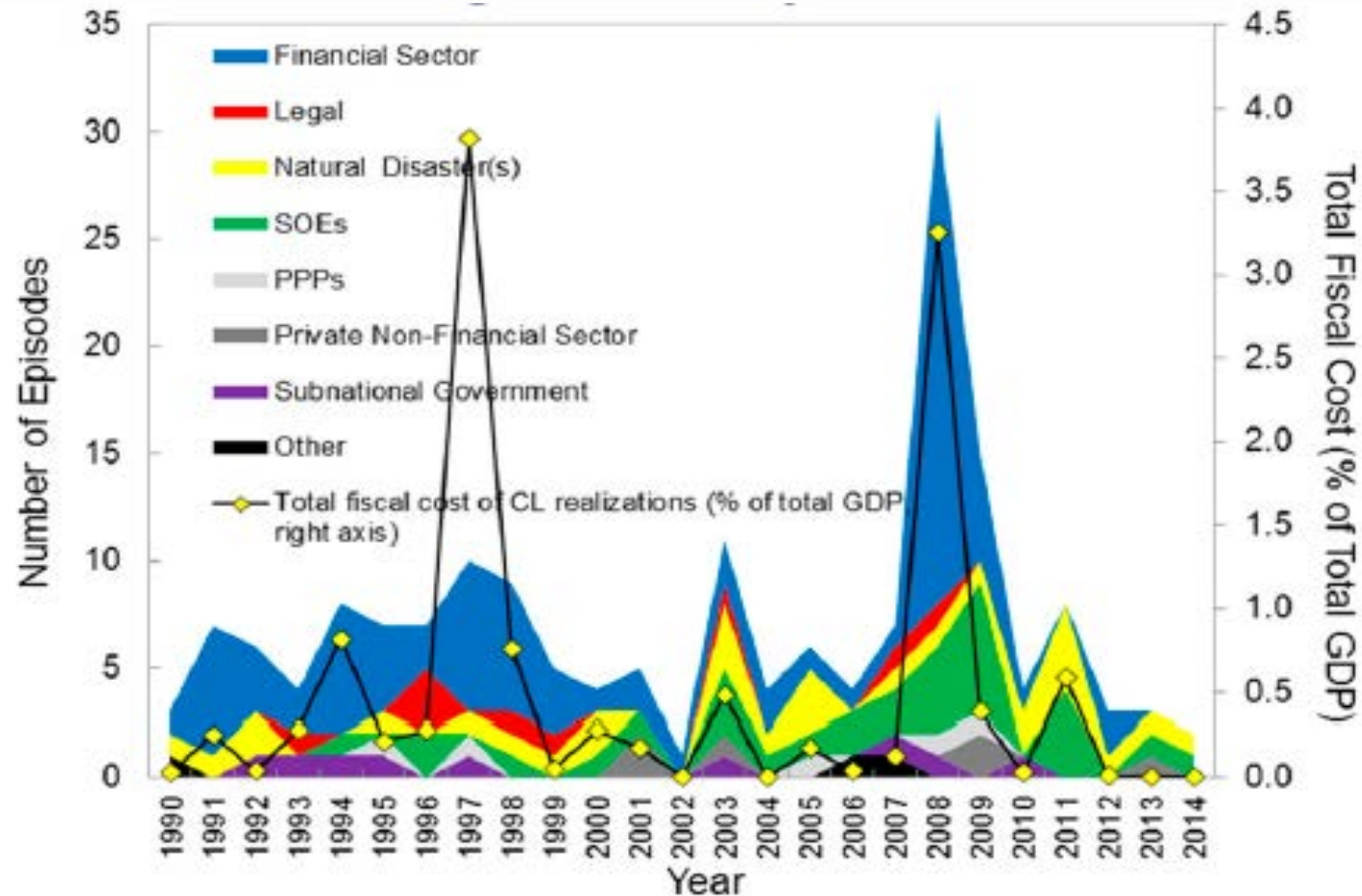


Natural or man-made Disasters

Particularly affected and vulnerable during COVID-19 pandemic

Fiscal risks tend to be large, correlated and occur surprisingly often

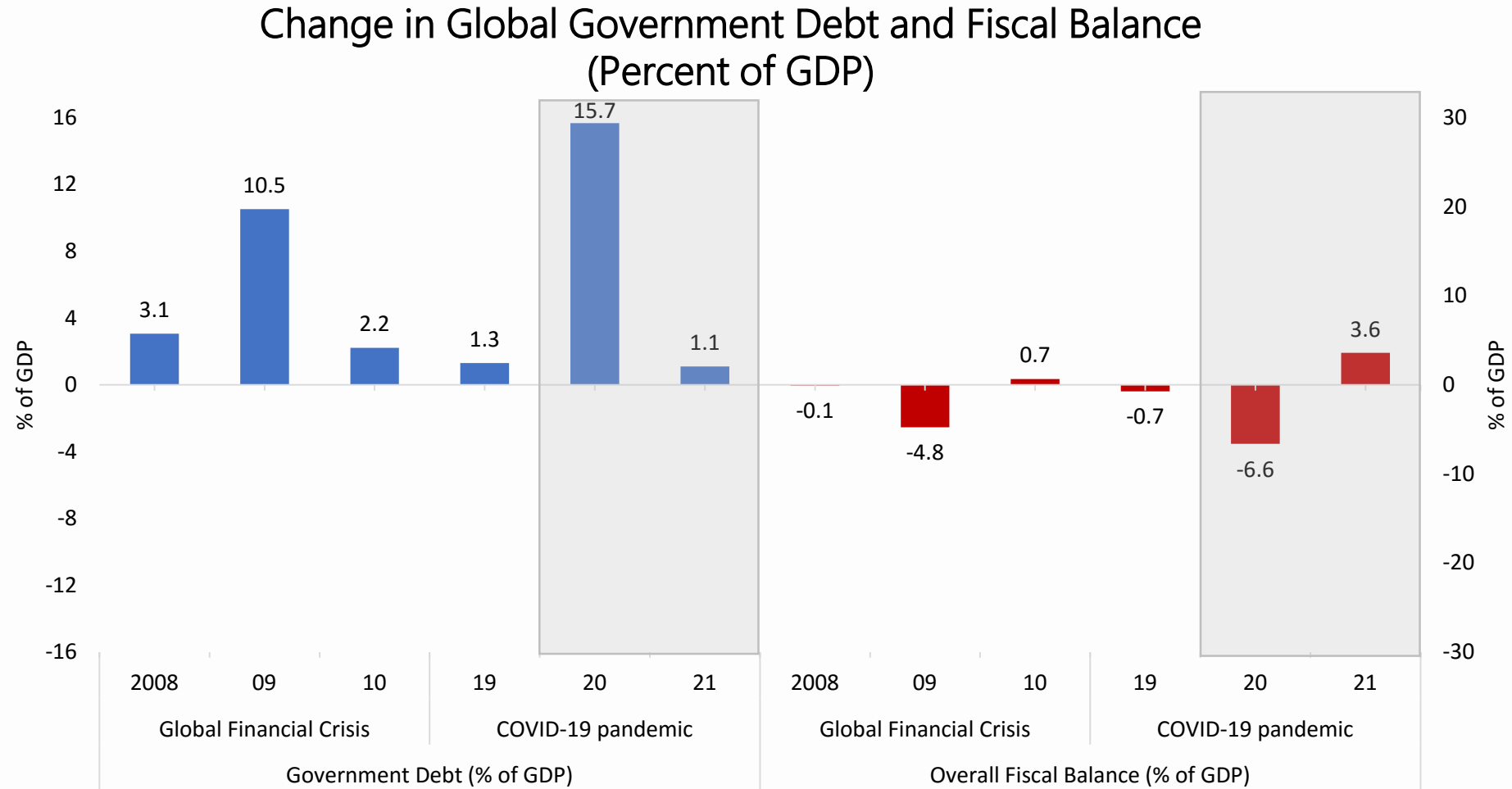
Historical occurrence and cost of contingent liability realizations



Nature of fiscal risks

- Large
- Tilted towards the downside
- Correlated (“when it rains it pours”)
- Non-linear

Impact of COVID-19 pandemic on debt and deficit levels more significant than during Global Financial Crisis

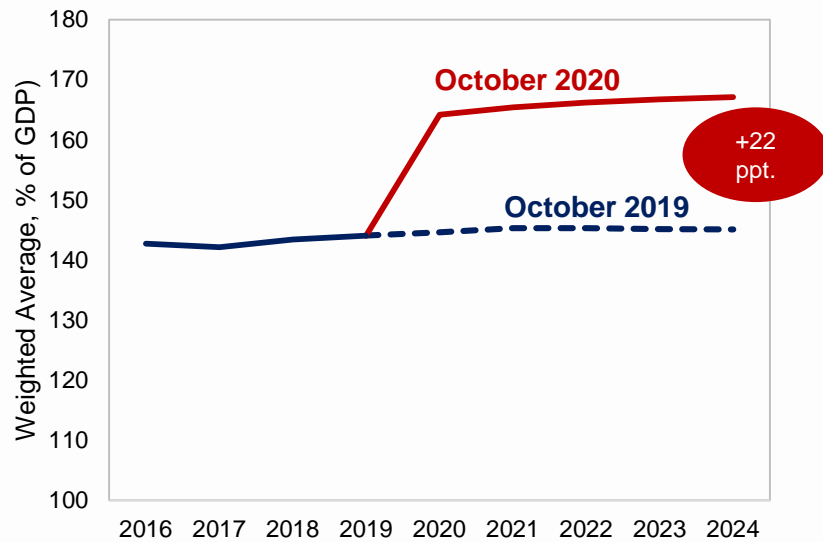


Source: World Economic Outlook Update October 2020 and Staff Calculation

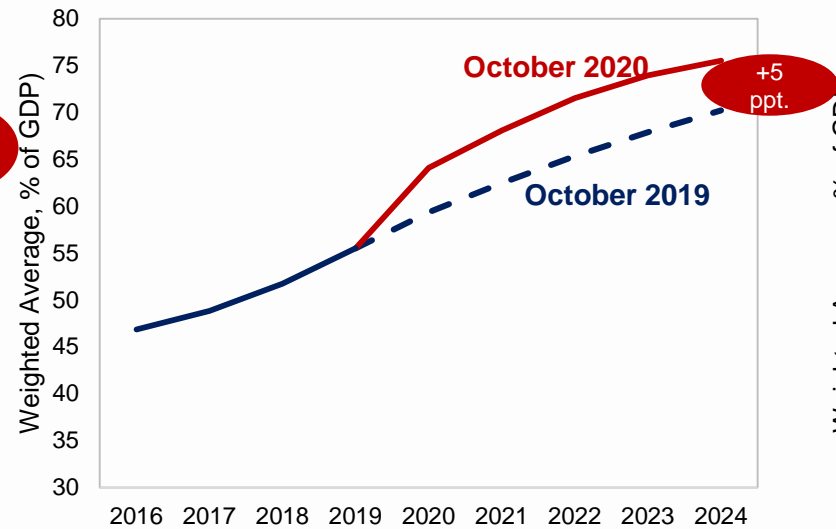
In Asia-Pacific, increase in debt forecasts particularly large in advanced countries

General Government Debt in Asia-Pacific (Weighted Average, Percent of GDP)

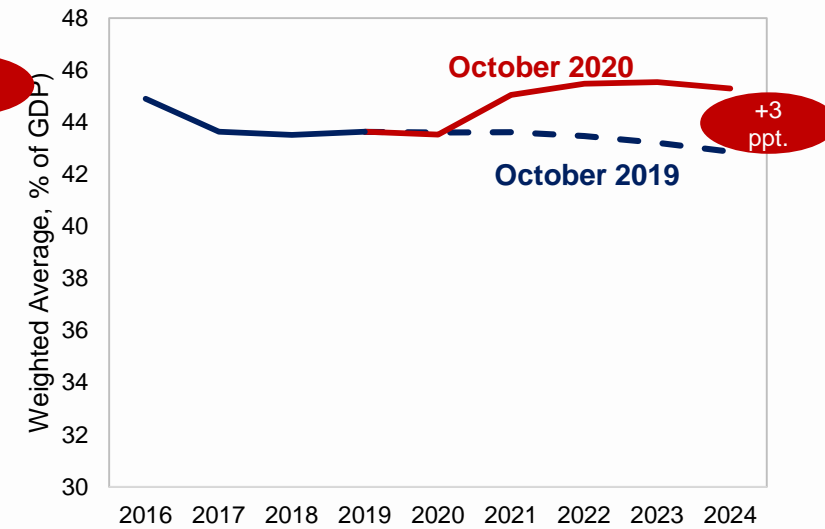
ADV (n=8)



EME (n=18)



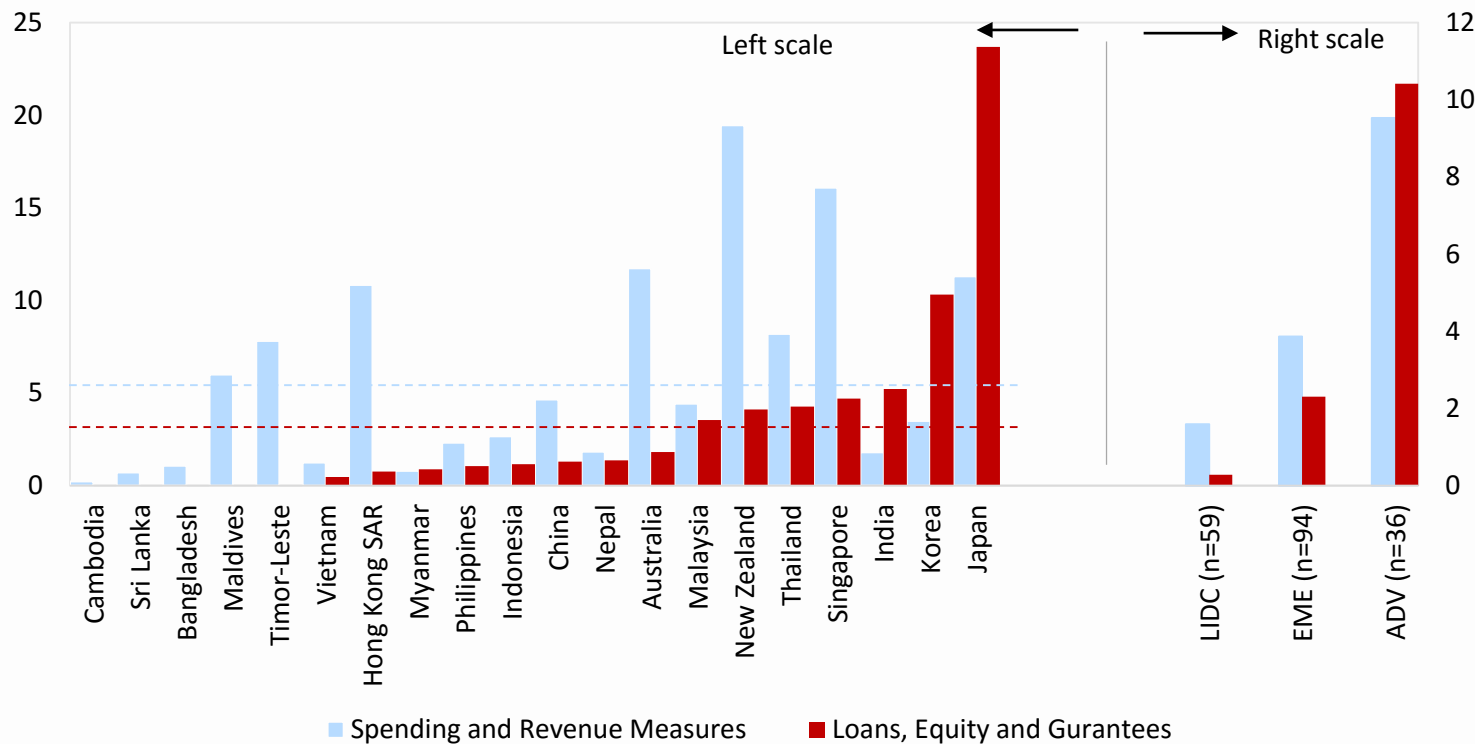
LIDC (n=11)



Source: IMF, World Economic Outlook October 2020.

Governments' policy response to COVID-19 creates future risks

Fiscal response to COVID-19, as of October 2020 (in percent of GDP)



- Fiscal response larger in advanced economies
- Generally, richer countries, tend to use more below-the-line measures
- Quasi-fiscal activities by public corporations and central banks add to size of response shown

Source: IMF, World Economic Outlook October 2020.

In response to COVID-19, governments should “*do whatever it takes but keep the receipts*”

Doing What it Takes

- Fiscal policies at the forefront of responding to COVID-19 pandemic
- Focus on saving lives; protecting the most affected people and firms; reduce the number of infections

Keeping the Receipts

- Enact response measures based on fiscal transparency, public accountability and institutional legitimacy
- Principles to guide all stages – design, implementation, and oversight

Dealing with the Legacy

- Ensure fiscal sustainability
- Institutional arrangement for fiscal risk management
- Manage fiscal risks stemming from COVID-19 response measures in coherent framework

Focus on fiscal transparency to determine long term costs and benefits of policy changes and future fiscal risks

Key aspects of Fiscal Transparency Code

Focus on outputs rather than processes

Take account of different levels of country capacity

Greater emphasis on fiscal risk disclosure and management

Align with recent advances in standards & practices

IMF's Fiscal Transparency Code

I. Fiscal Reporting

1.1 Coverage

1.2 Frequency and timeliness

1.3 Quality

1.4 Integrity

II. Fiscal Forecasting & Budgeting

2.1 Comprehensiveness

2.2 Orderliness

2.3 Policy orientation

2.4 Credibility

III. Fiscal Risk Analysis & Management

3.1 Risk analysis & disclosure

3.2 Risk management

3.3 Fiscal coordination

IV. Resource Revenue Management

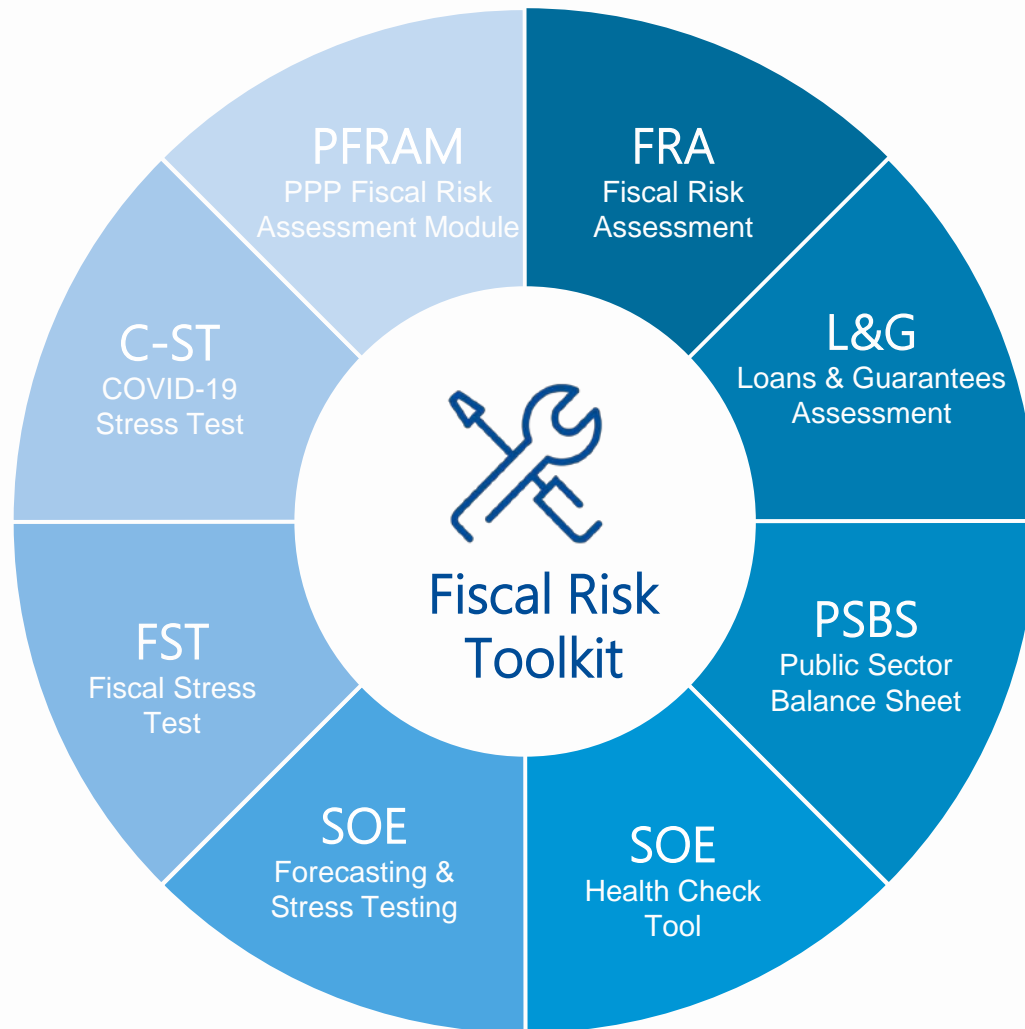
4.1 Ownership, contracting, & fiscal regime

4.2 Fiscal reporting

4.3 Fiscal forecasting & budgeting

4.4 Fiscal Risk Analysis & Management

IMF analytical tools help keeping the receipts and dealing with the legacy



Better understand risk exposures



Improve management of fiscal risks



More transparent reporting of risks



More resilient public finances

Indian state of Odisha systematically identifies and prioritizes risks ...

Assessment and prioritization of fiscal risks



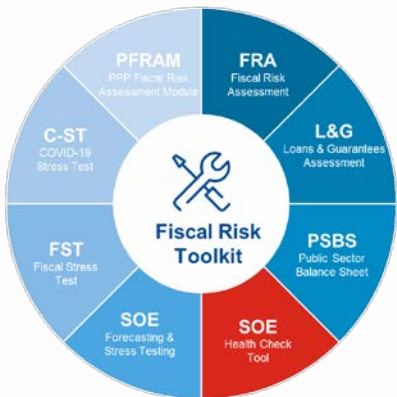
Fiscal impact	High (>0.5% of GSDP)	<ul style="list-style-type: none"> Growth slowdown Central transfers 	<ul style="list-style-type: none"> Non-performing assets of public financial institutions Investment scams of small-scale investors GST revenues Mining-related revenues 	<ul style="list-style-type: none"> Electricity sector Natural disasters
	Medium (0.1% - 0.5% of GSDP)		<ul style="list-style-type: none"> Public sector undertakings Social security programs Food Supply Department 	
	Low (<0.1% of GSDP)	<ul style="list-style-type: none"> PPPs Tax refunds under litigation Pension schemes Inflation surprises 	<ul style="list-style-type: none"> Foreign-currency debt Line departments 	
		Low (<10%)	Medium (10%-50%)	High (>50%)
Likelihood of realization				

Source: Finance Department, Government of Odisha.

... and conducts in-depth analysis of state-owned enterprises, supported by institutional reforms

SOE health check reveals that electricity sector requires urgent reform

Strengthened fiscal risk oversight at multiple levels



Risk Matrix	Value	Risk Level
Liquidity Indicators		
Current ratio	1	High Risk
Quick ratio	1	High Risk
Creditor turnover days	215	Very High Risk
Debtor turnover days	226	Very High Risk
Solvency Indicators		
Debt to equity	-1	Very Low Risk
Debt to assets	1	Moderate Risk
Interest coverage	1	Very High Risk
Profitability Indicators		
Net profit margin (per cent)	-4 per cent	
ROA (per cent)	4 per cent	Low Risk
ROE (per cent)	7 per cent	High Risk
Financial Performance		
Operating costs to revenue	0	
Cost recovery	76	Very Low Risk
Operative profit margin (per cent)	3 per cent	
Government relationship		
Grants to revenue ratio (per cent)	0 per cent	Very Low Risk
Taxes payable to current liabilities	0	Very Low Risk

- Constituted high-level **fiscal risk committee**
- Established **fiscal risk and debt management unit** at Finance Department
- Relocated **Public Private Partnership Directorate** to Finance Department

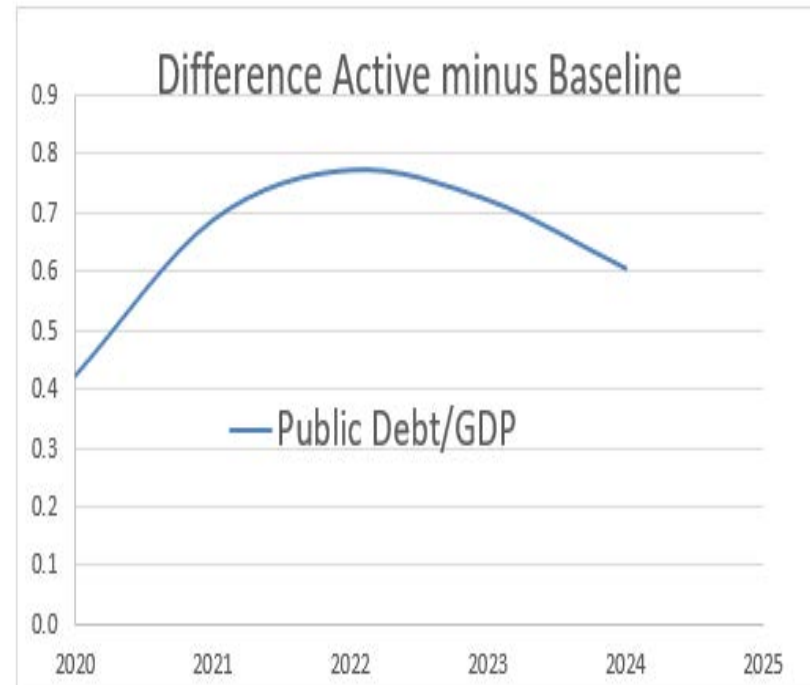
Bangladesh is considering various shocks to macro-fiscal forecasting model

Macro-fiscal model includes an analysis of alternative 'risk' scenarios – shocks that would impact the fiscal.

- supply shocks (drought, flood, interruption of domestic supply chain),
- external (demand, remittances, financing), and
- shocks that originate in the fiscal sector (i.e. more spending, reduced tax collection).

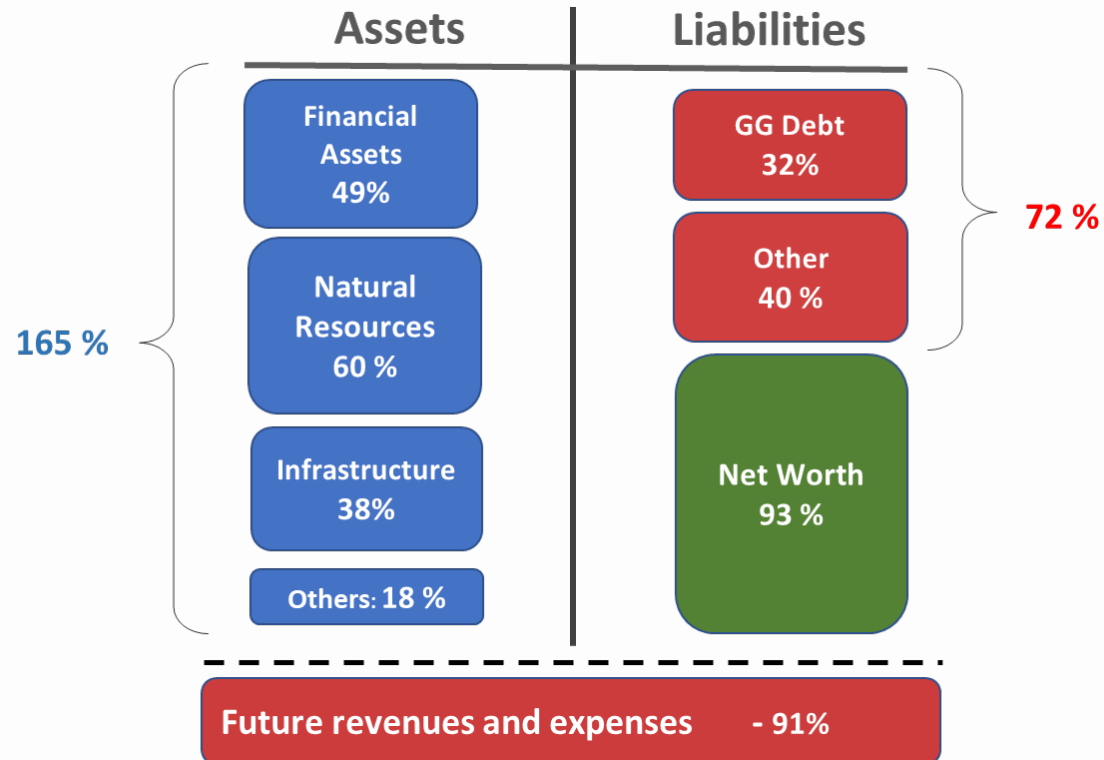
The model is under development, the macro-fiscal wing is making steady progress

Lower remittances means higher debt ratios higher debt ratios

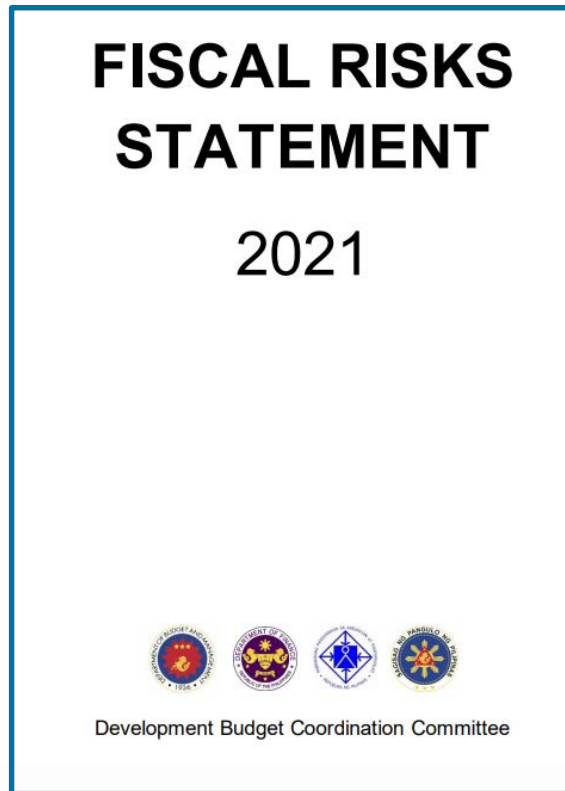


Indonesia has holistic perspective on assets and liabilities contributing to increased revenue, reduced risk and improved fiscal policymaking

Public Sector Balance Sheet (2016, in percent of GDP)



Philippines is transparent about fiscal impact of COVID-19 and government's response



Fiscal Risk Statement supports transparency about impact of COVID-19 and government's risk management strategy

- Significant contraction but resilient macroeconomic fundamentals
- Fiscal space allows government to respond to pandemic
- Banking system remains robust
- SOEs source of dividends to support fiscus and providing relief
- Local governments experience fiscal stress
- Exposure to natural disasters remains critical

Selected References

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