Fiscal Space in Low-Income Countries

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IMF-JICA Conference

FISCAL RISKS, FISCAL SPACE, AND THE SUSTAINABLE DEVELOPMENT GOALS

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Background

WP/17/XX

IMF Working Paper

Managing Fiscal Risks in Low-Income Countries

by Anja Baum, Andrew Hodge, Aiko Mineshima, Marialuz Moreno Badia and Rene Tapsoba

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December 2016

ASSESSING FISCAL SPACE: AN INITIAL CONSISTENT SET OF CONSIDERATIONS

IMF staff regularly produces papers proposing new IMF policies, exploring options for reform, or reviewing existing IMF policies and operations. The following document(s) have been released and are included in this package:

- The **Staff Paper** prepared by IMF staff and completed on November 18, 2016.

> The paper prepared by IMF staff and presented to the Executive Board in an informal session on June 30, 2016. Such informal sessions are used to brief Executive Directors on policy issues. No decisions are taken at these informal sessions. The views expressed in this paper are those of the IMF staff and do not necessarily represent the views of the IMF's Executive Board.

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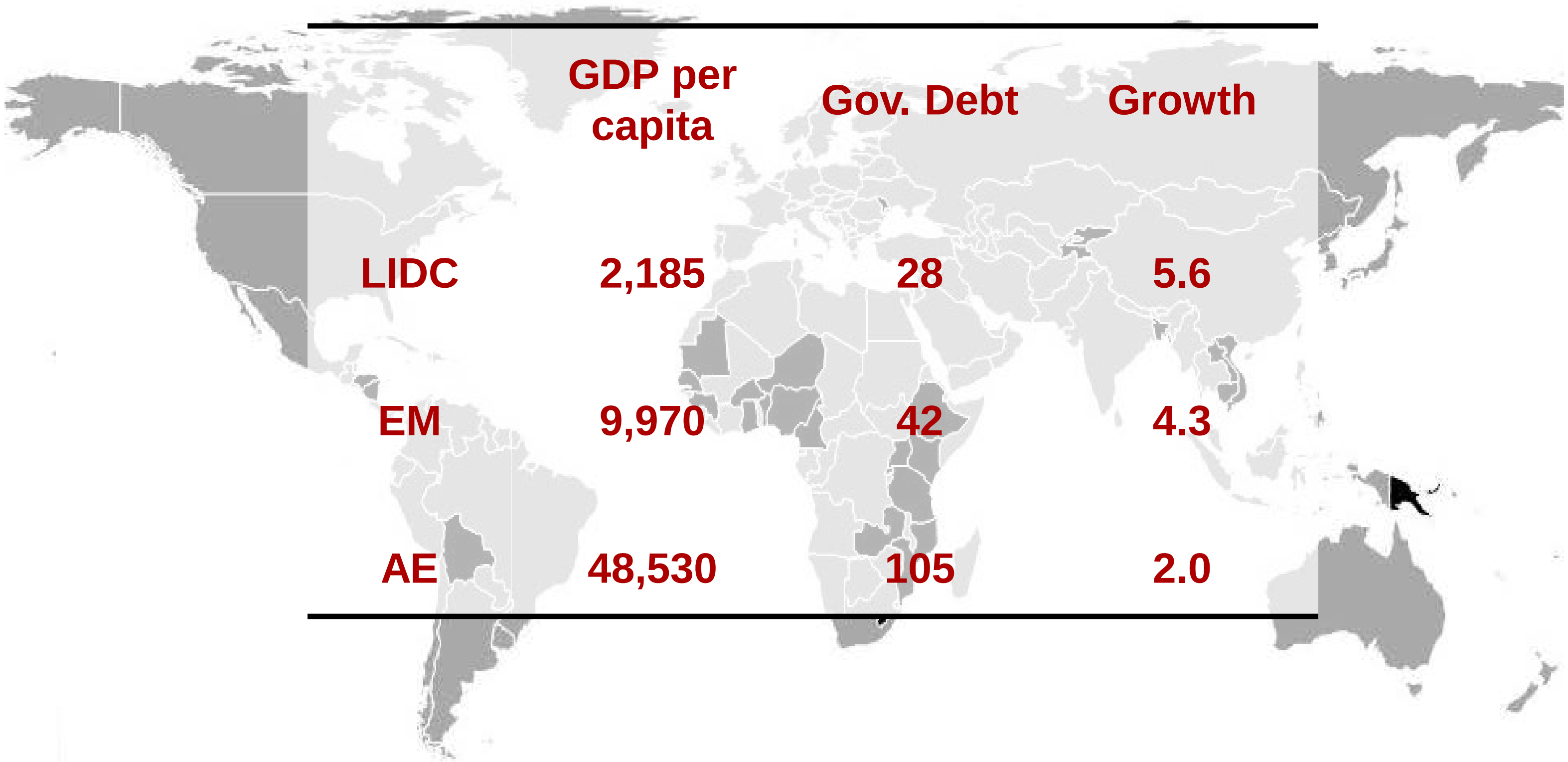
International Monetary Fund
Washington, D.C.

A Play in Three Acts: The Cast



	GDP per capita	Gov. Debt	Growth
LIDC	2,185	28	5.6
EM	9,970	42	4.3
AE	48,530	105	2.0

The Plot

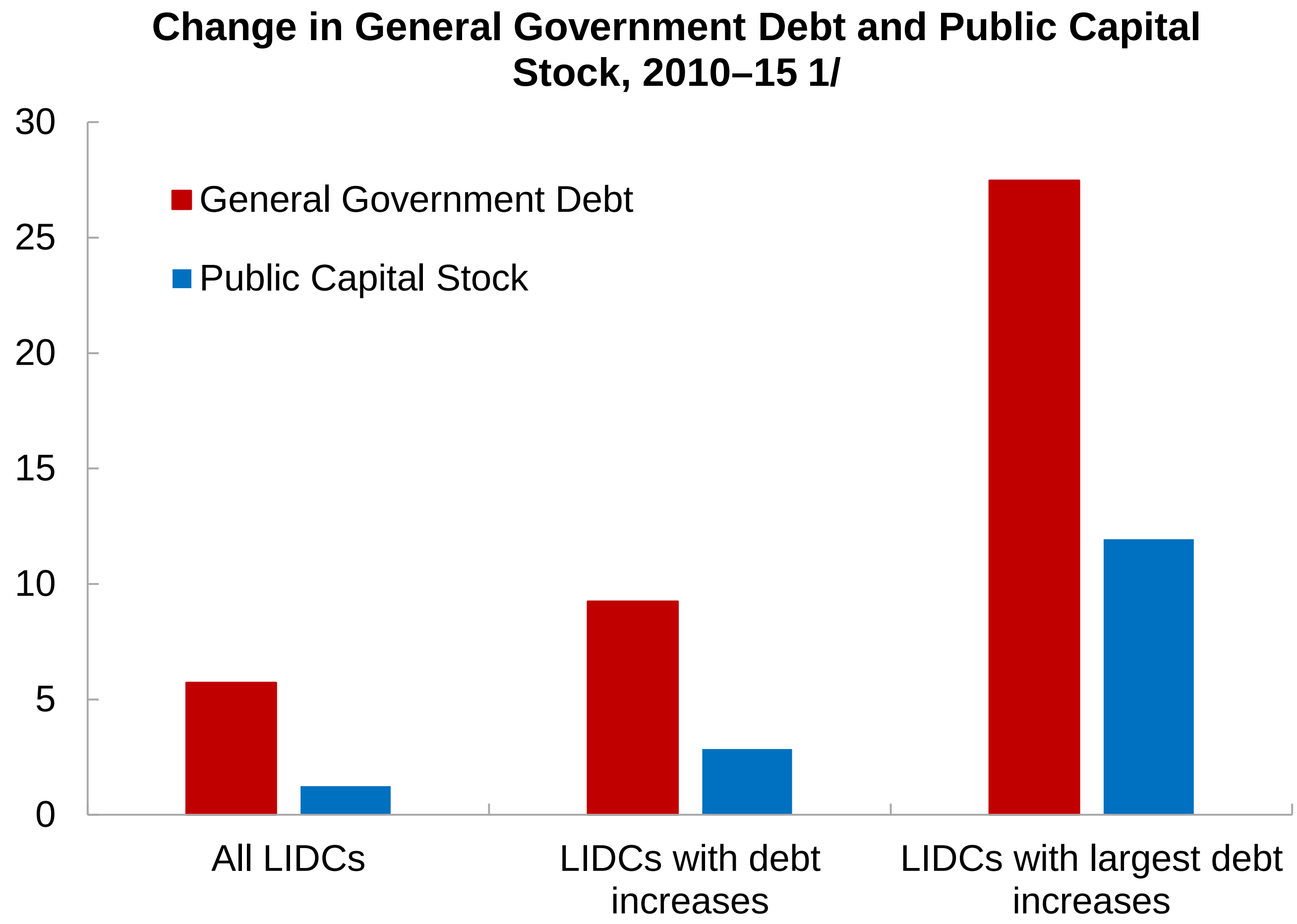
"Decisions to scale up public spending (be it on infrastructure, education, or health) and to what extent, should be made on a case-by-base, country-by-country basis. And with a careful analysis of tradeoffs – public financial sustainability comes first."

\- Christine Lagarde, July 6, 2014 –

"Fiscal space in general refers to room for undertaking discretionary fiscal policy relative to existing plans without undermining fiscal sustainability."

\- Assessing Fiscal Space: An Initial Consistent Set of Considerations -

The Plot



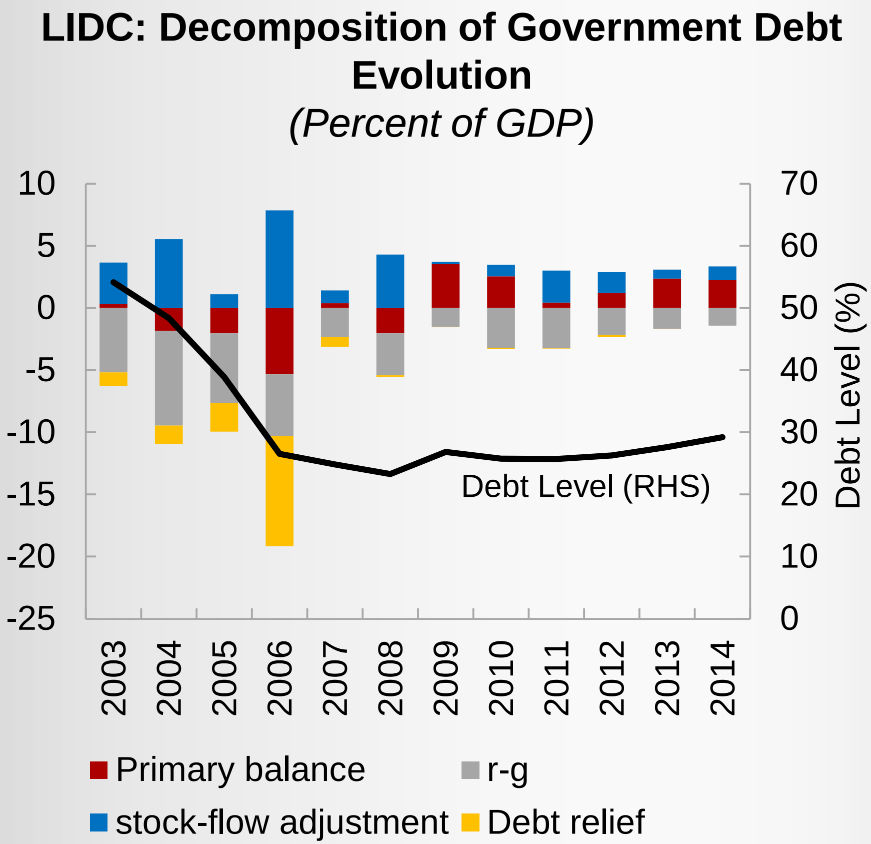
Sources: Bank for International Settlements; Dealogic; IMF, *International Financial Statistics*; IMF, Investment and Capital Stock Dataset; IMF, Standardized Reporting Forms; IMF, *World Economic Outlook*; Organisation for Economic Co-operation and Development; and IMF staff estimates.
1/ Data are for 34 low-income countries. Public debt ratios rose for 25 of these between 2010 and 2015. Those with the largest increases (top quartile) were Cameroon, Central African Republic, The Gambia, Ghana, Lesotho, Mozambique, Republic of Congo, Yemen, and Zambia.

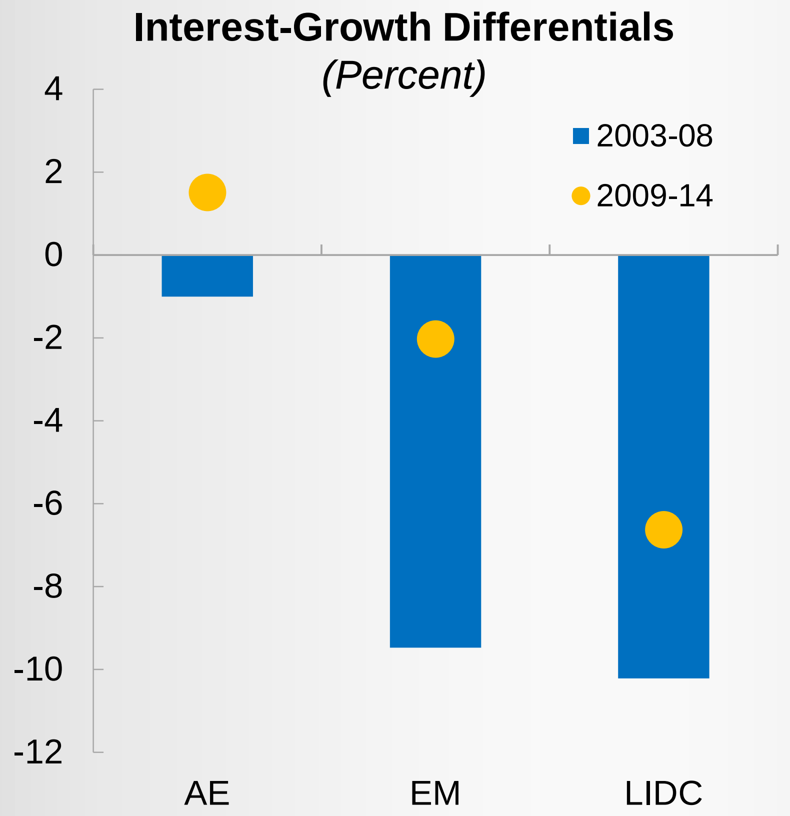
Act I:
A Tale of Three Cities

Act I: A Tale of Three Cities

Good Deeds?

Or Tailwinds?

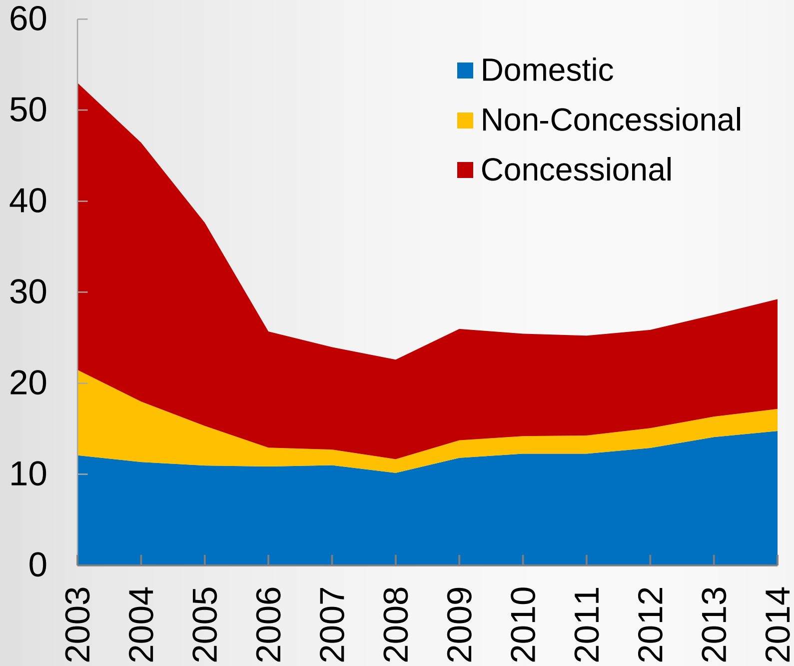




Act I: A Tale of Three Cities

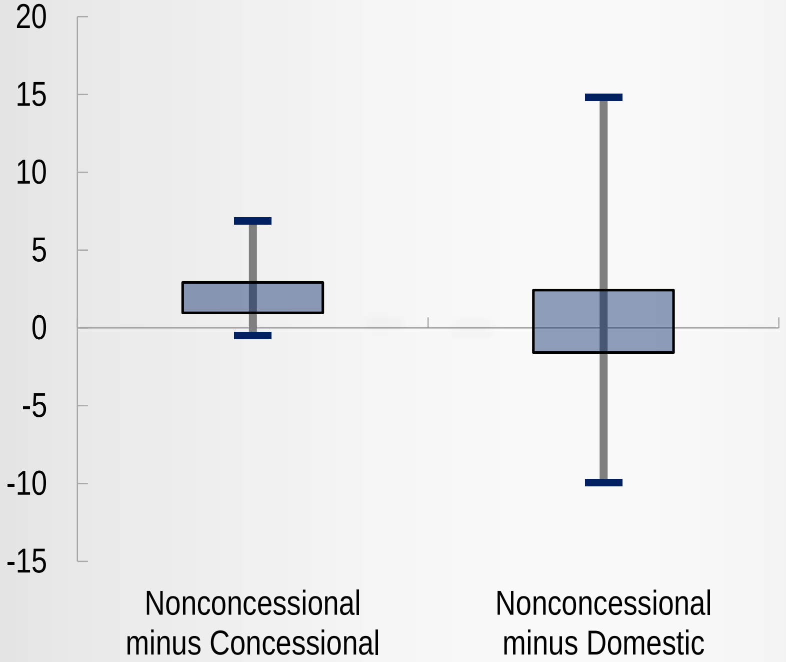
Concessional, still at Center Stage

LIDC: Financing Mix
(Percent of GDP)



Large Dispersion in Rates

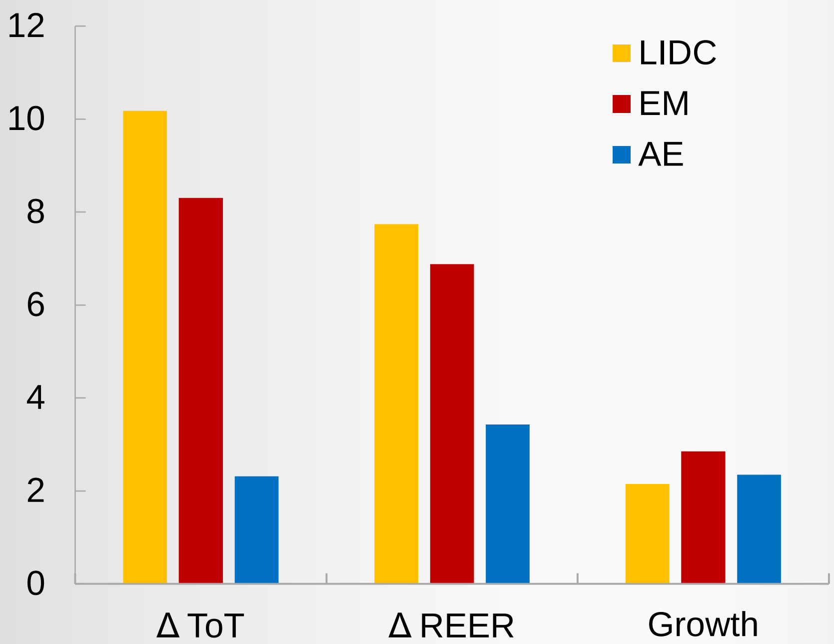
LIDC: Real Interest Rate Differentials
(Percent)



Act I: A Tale of Three Cities

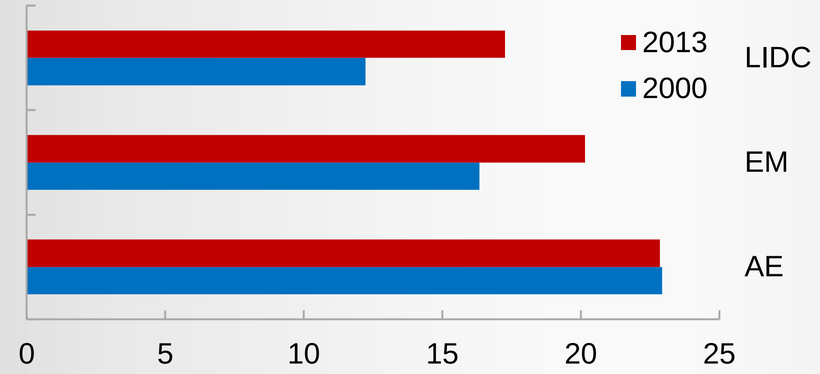
The Higher They Go…

Volatilities of Macroeconomic Variables: SD, 2000–15
(Sample Median Observation)

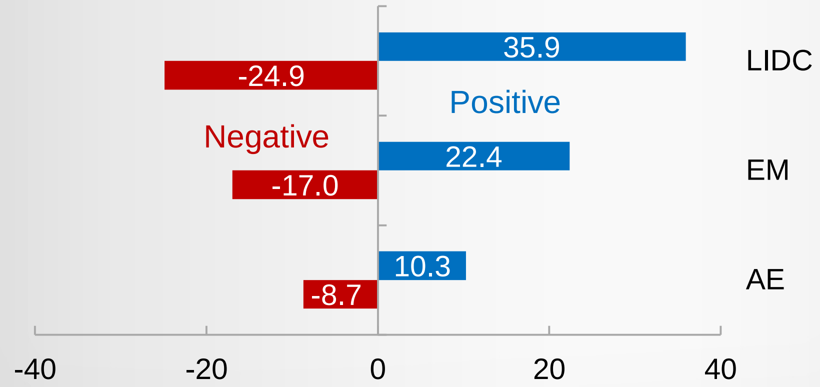


…The Harder They Fall

Weighted Average Tax Revenues
(Percent of GDP)



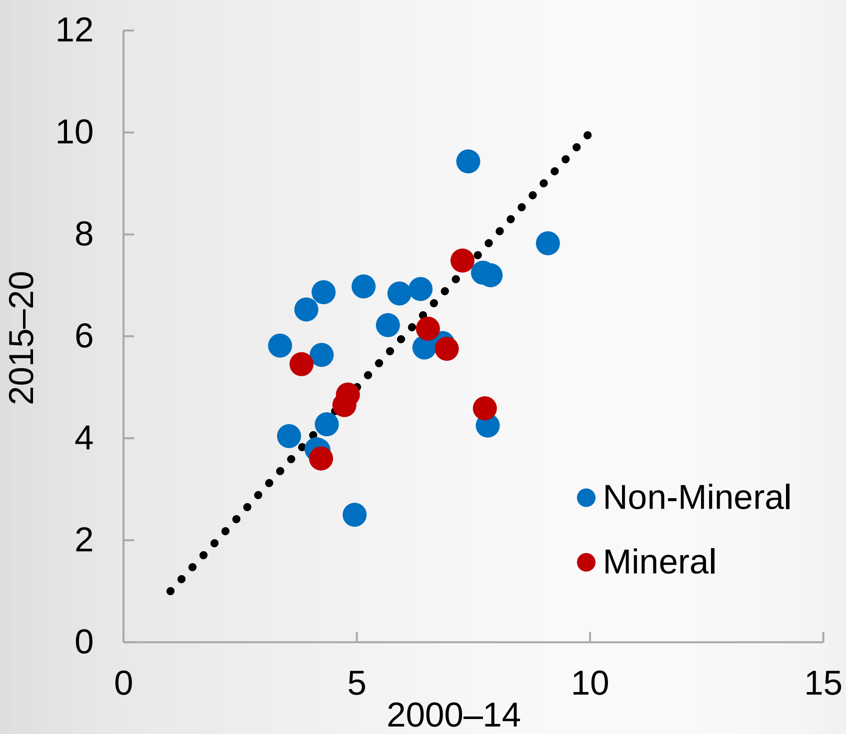
Largest Annual Positive and Negative Changes on Tax Revenue, Median Observation, 1971–14
(Percent Change of Tax Revenues as a Share of GDP)



Act I: A Tale of Three Cities

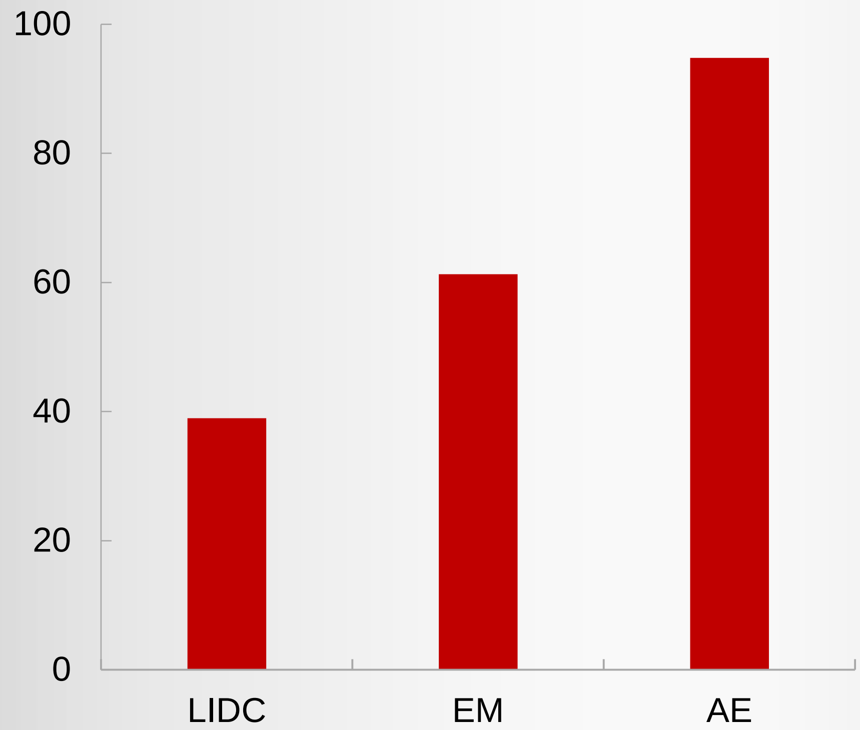
Looking Good…

Average Growth Rates for the 2009–14 and 2015–20 (forecast) Periods
(Percent)



…But No Money!

Financial Depth
(Ratio of M2 to GDP, Percent)



Act II:
The Method

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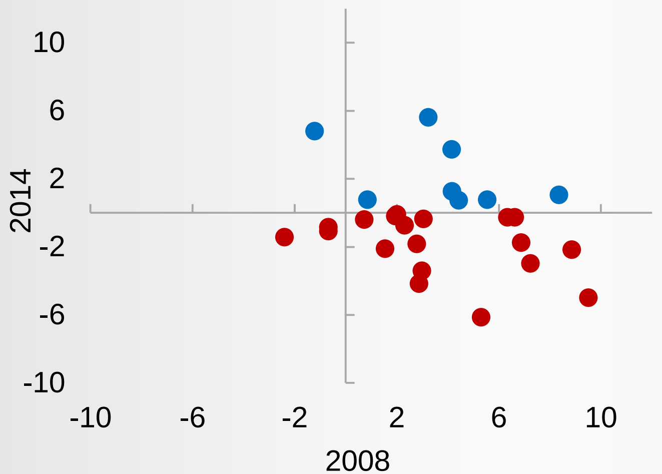
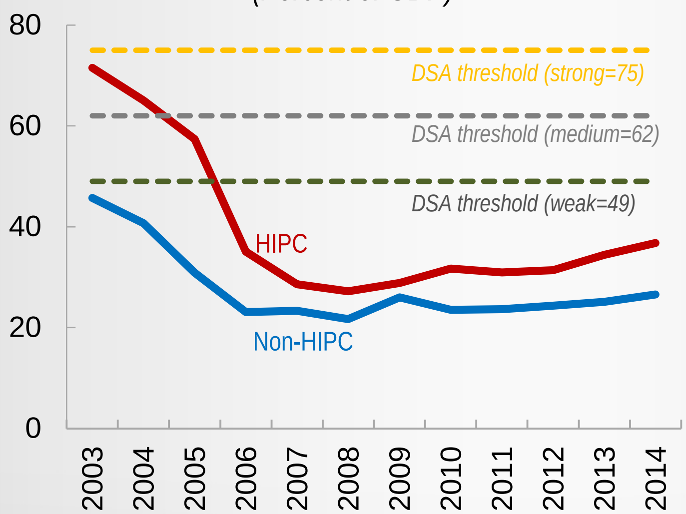
LIDC: Primary Balance Gap
(Percent of GDP)



LIDC: DSA Thresholds and Government Debt
(Percent of GDP)



What's the anchor?

- Too restrictive
  or
- Little guidance on safety margin

No account of trade-offs
Return vs. Risks

Act II: The Method

Back to Basics

$$d_t = \frac{1}{1+g_t}\left[d_{t-1} + (\alpha^d r_t^d + \alpha^f r_t^f) d_{t-1} + \Delta\varepsilon_t (1 + r_t^f)\alpha^f d_{t-1}\right]$$

$$-pb_t$$

(a) $FRF: pb_t = f(X_t) + \varepsilon_t$

$X_t \sim ToT\ gap, foreign\ financing$

(b) Deterministic scenarios

$$+SFA$$

While Adding Uncertainty

Past debt

Fiscal behavior

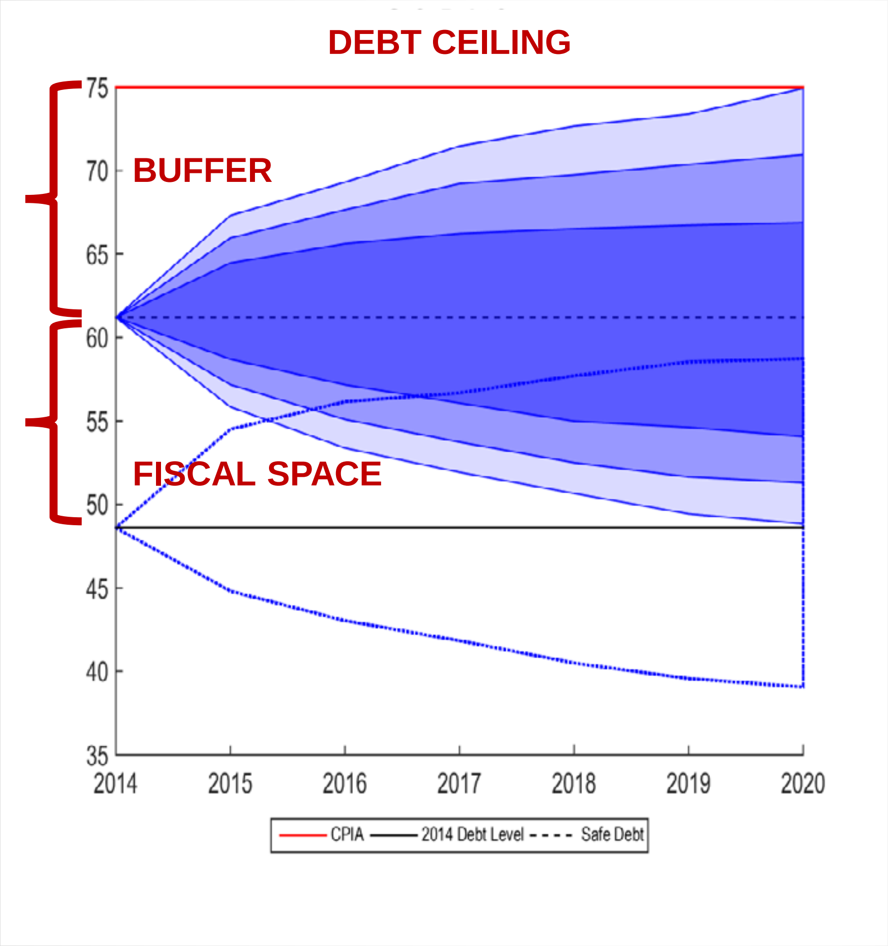
Contingent liabilities

Act II: The Method

Putting It All Together:

- Safe Debt
- Fiscal Space
- Buffer Zone

Safe Debt: An Illustration
(Percent of GDP)



Act III:
How Much Room?

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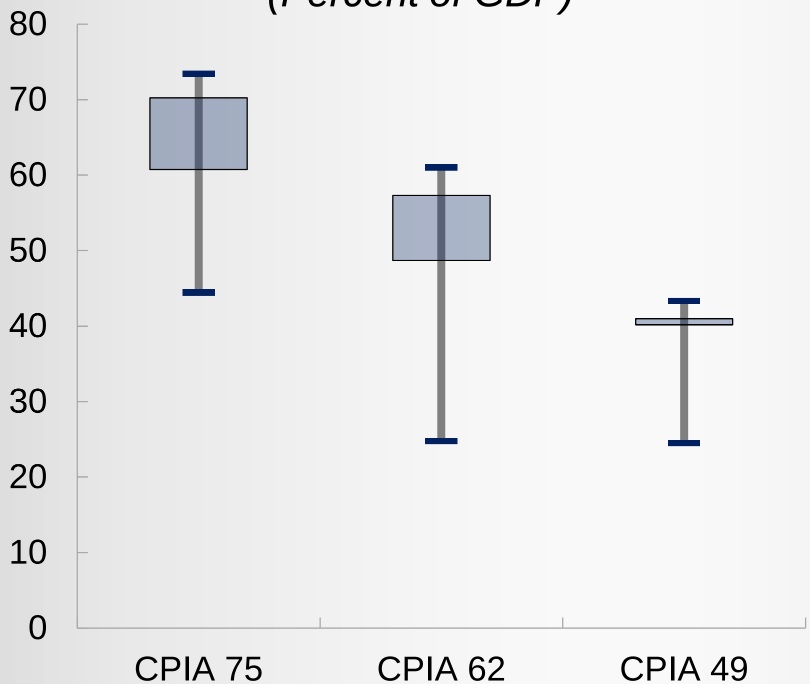
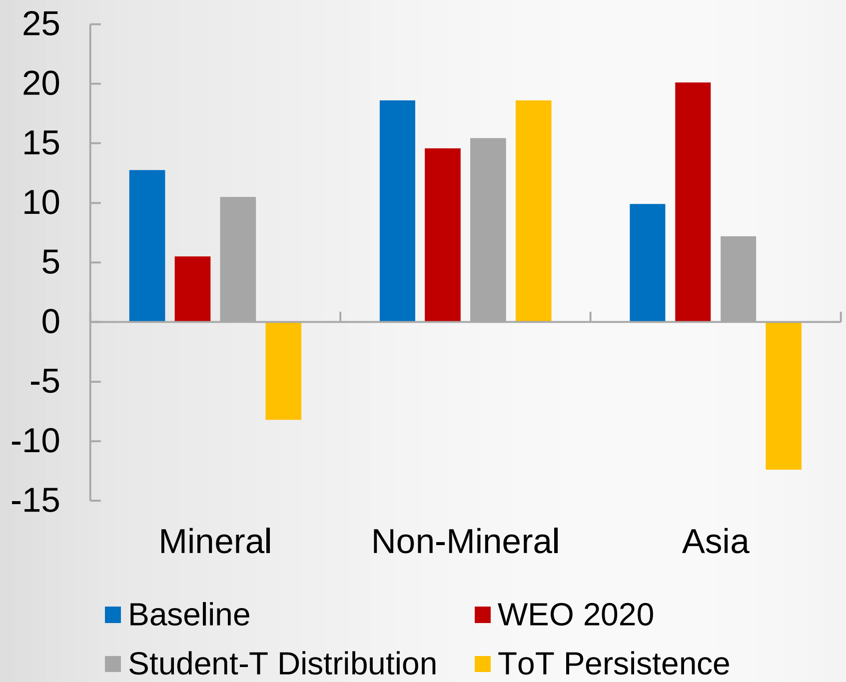
Fiscal Behavior Matters a Lot

Safe Debt Level
(Percent of GDP)



Under Benign Conditions: Sizable Space

Fiscal Space, 2003 Onwards 1/
(Percent of GDP, Median)

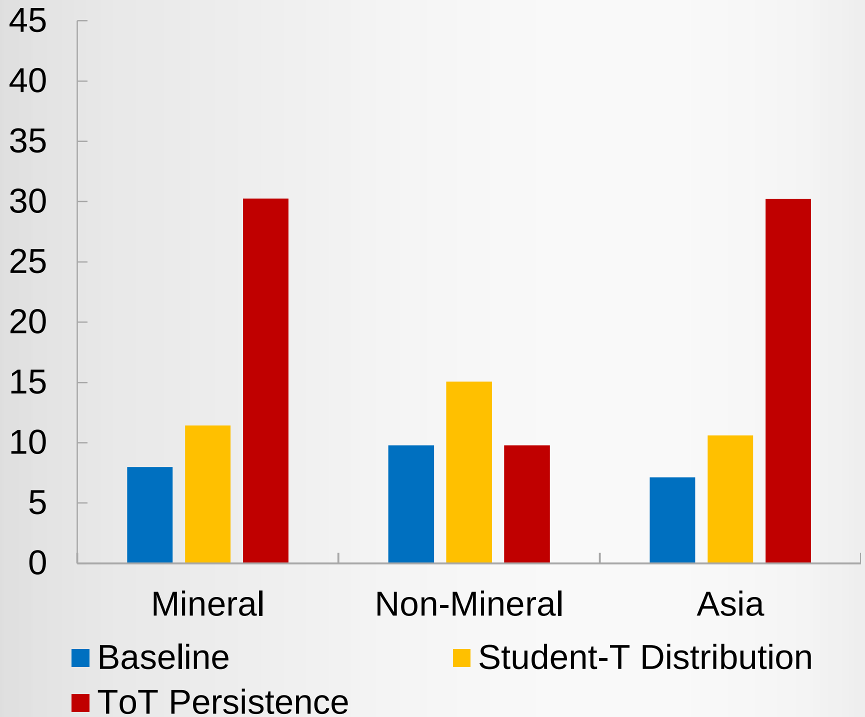


1/ Distance between (i) the country-specific 2014 actual debt level (the 2020 WEO debt projection for "WEO 2020") and (ii) the calibrated country-specific initial debt level that does breach the CPIA threshold under shocks over a six-year time horizon with a 95 percent probability.

Act III: How Much Room?

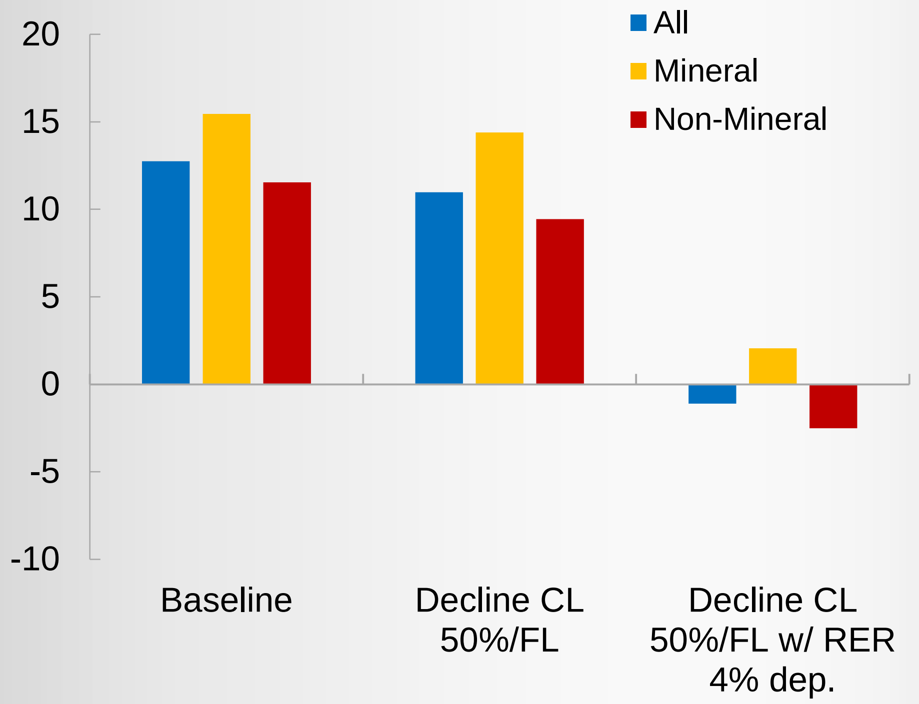
But you need buffers to avoid the cliff

Prudent Debt Buffer, 2003 Onwards 1/
(Percent of GDP, Median)



1/ Distance between (i) the CPIA public debt threshold and (ii) the calibrated country-specific initial debt level that does breach the CPIA threshold under shocks over a six-year time horizon with a 95 percent probability.

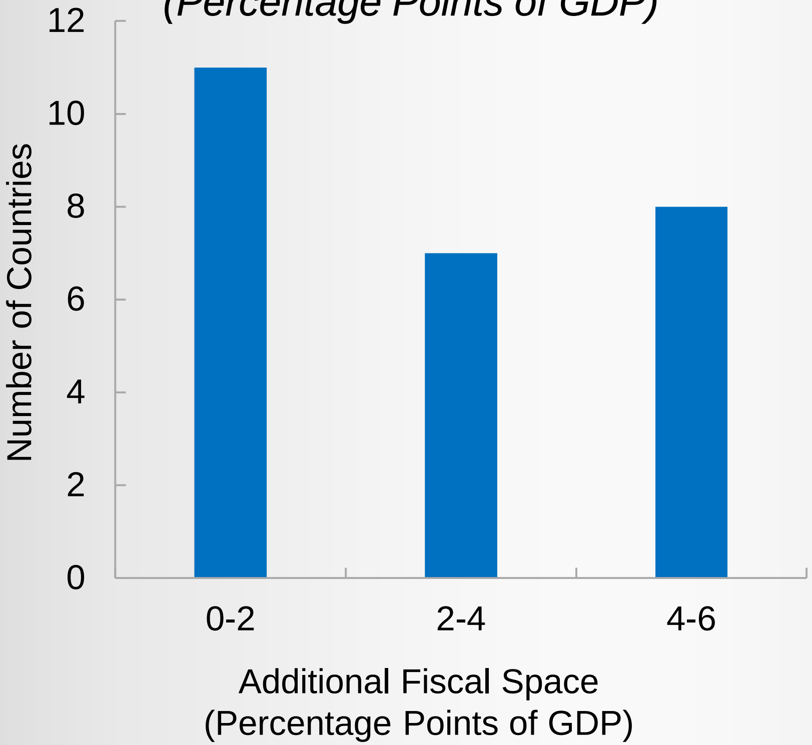
Fiscal Space under Different Financing Mix and FX, 2003 Onwards
(Percent of GDP, Average)



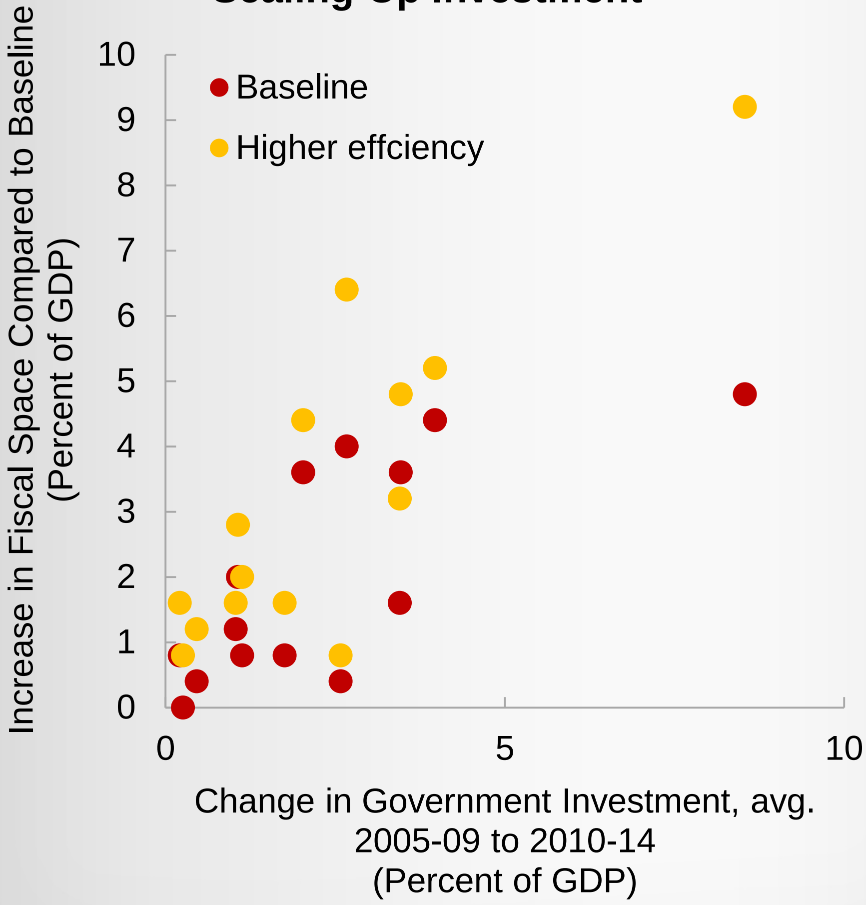
Epilogue

Fiscal Space Can Be Created

Additional Fiscal Space under DRM Scenario
(Percentage Points of GDP)



Increase in Fiscal Space under Scaling-Up Investment



The End

Scaling up spending

DSA provides debt limits

Under benign conditions

But volatility matters a great deal

Bottom Line

Enhancing the ability to achieve SDGs

Return vs. Risks

But little guidance on safety margins

Sizable space

Buffers up to 30 percent of GDP!

The Three Arrows

- Domestic revenue mobilization
- Spending efficiency
- Fiscal institutions

ありがとうございました
Thank you