Fiscal Risks Analysis:
State Owned Enterprises Perspective in Malawi

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Hetherwick Njati

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Outline

- Fiscal Risks
- Financial Risks
- Sources of Fiscal Risks
- Impact of Fiscal Risks
- State of SoEs in Malawi
- Fiscal Risks Indicators
- Factors that have led to increased Fiscal Risks for SoEs
- Fiscal Risks arising from SOEs in Malawi
- Impact of materialized fiscal risks
- Possible Mitigation measures

Fiscal Risks

- The possibility of deviations in fiscal variables (i.e. revenues and expenses) from what was expected at the time of the budget or other forecast.
- Arises from macroeconomic shocks and realization of c ontingent liability;

Financial Risks

- The possibility that shareholders, investors, or other financial stakeholders in a firm or venture will lose money if the company's cash flow proves inadequate to meet its obligations.

Types of Fiscal Risks

- General macroeconomic risks,
- Specific fiscal risks,
- Institutional risks.

Sources of Fiscal Risks

- Forecasting error/risk
  - Due to exogenous macroeconomic volatility, parameter instability, or political interference with budget forecasts;
  - Growth, inflation, exchange rate, oil or other commodity prices, interest rates;
- Long-term or truly exogenous factors
  - Climate change, natural disasters
- Contingent liabilities
  - Guarantees and other stand-behind obligations (from Local governments, SOEs, banking system, ...)
  - Public investment projects and/or PPPs

Impact of Fiscal risks

Once materialized, The deviations created by fiscal risks could impact the following:

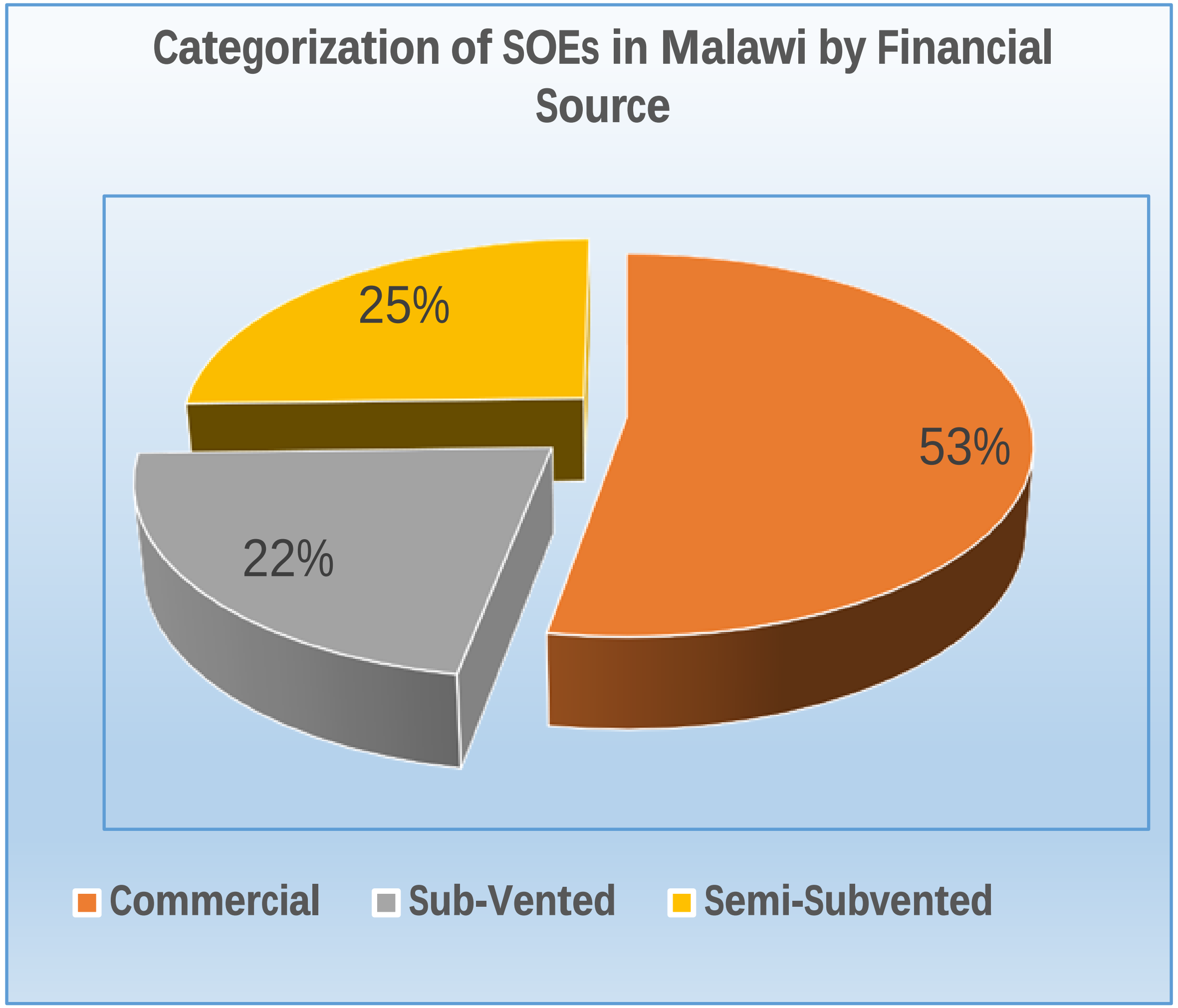
- Macro-economic variables
- Revenues
- Expenditures
- Deficit
- Debt

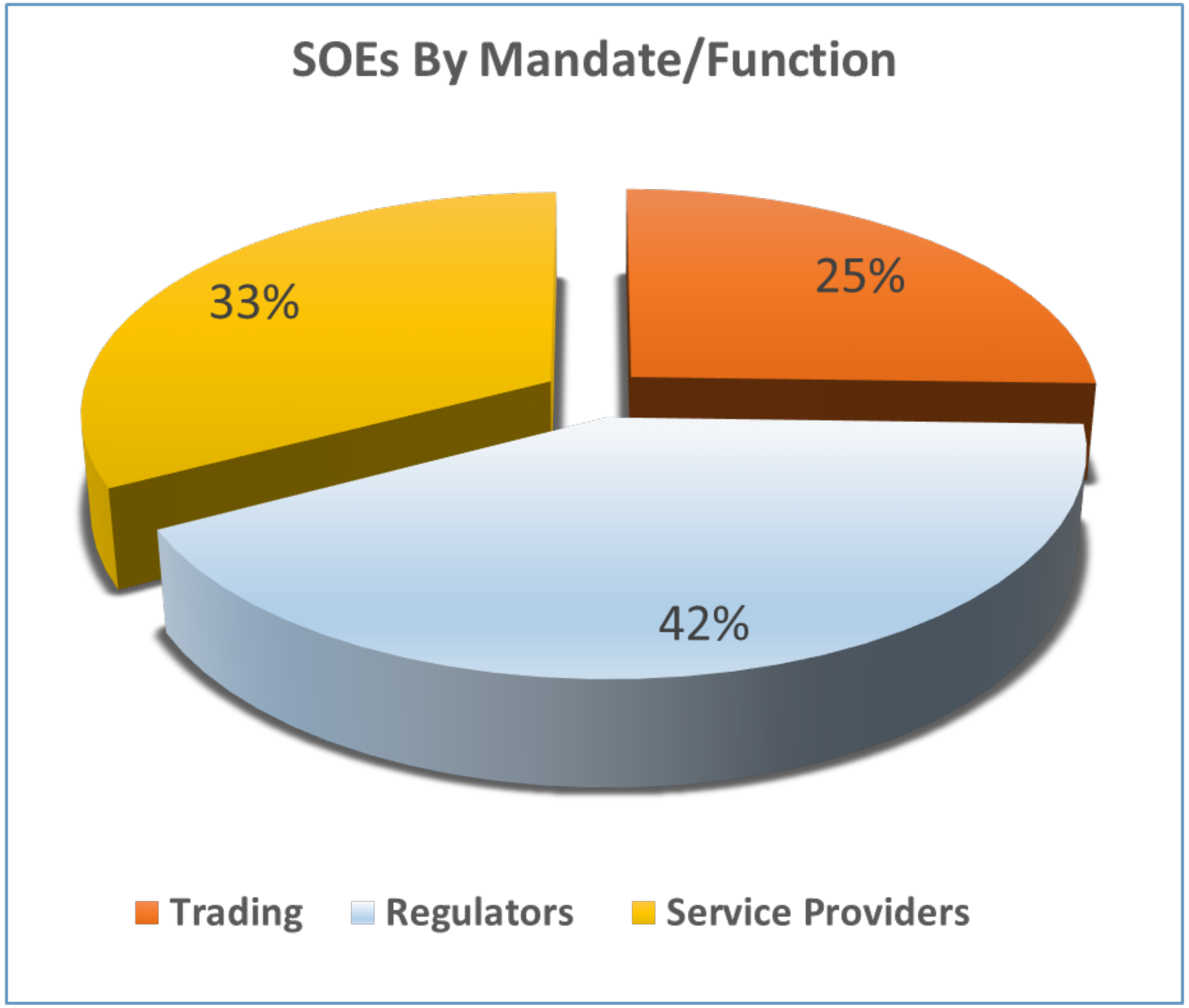
Categorization of State of SoEs in Malawi

Categorization by

1. Function
2. Financing

Overview of SOEs in Malawi





Size of the SoE Sector in Malawi

K' Millions				
	2016 Audited	2017 Audited	2017-18 Mid Year	2018-19 Planned
Total assets	564,960	640,551	662,034	856,058
Total Liabilities	261,719	296,080	245,664	418,352
Total Revenue	194,040	239,991	111,908	379,286
Profit after tax	20,981	2,420	49,472	21,112
As a percentage of GDP				
	2016 Audited	2017 Audited	2017-18 Mid Year	2018-19 Planned
Total assets	14.5%	12.8%	12.8%	14.5%
Total Liabilities	6.7%	5.9%	4.8%	7.1%
Total Revenue	5.0%	4.8%	2.2%	6.4%
Profit after tax	0.5%	0.0%	1.0%	0.4%

Sources of Fiscal Risks from SOEs

- Some SOE debt may be explicitly guaranteed
- All SOE debt are subject to perception of implicit guarantee by SOE managers and creditors etc
- Fluctuations in taxes, royalties, dividends
- Fluctuations in value of equity Requirements for capital from government for new investment (on-lending, or capital inject ions)

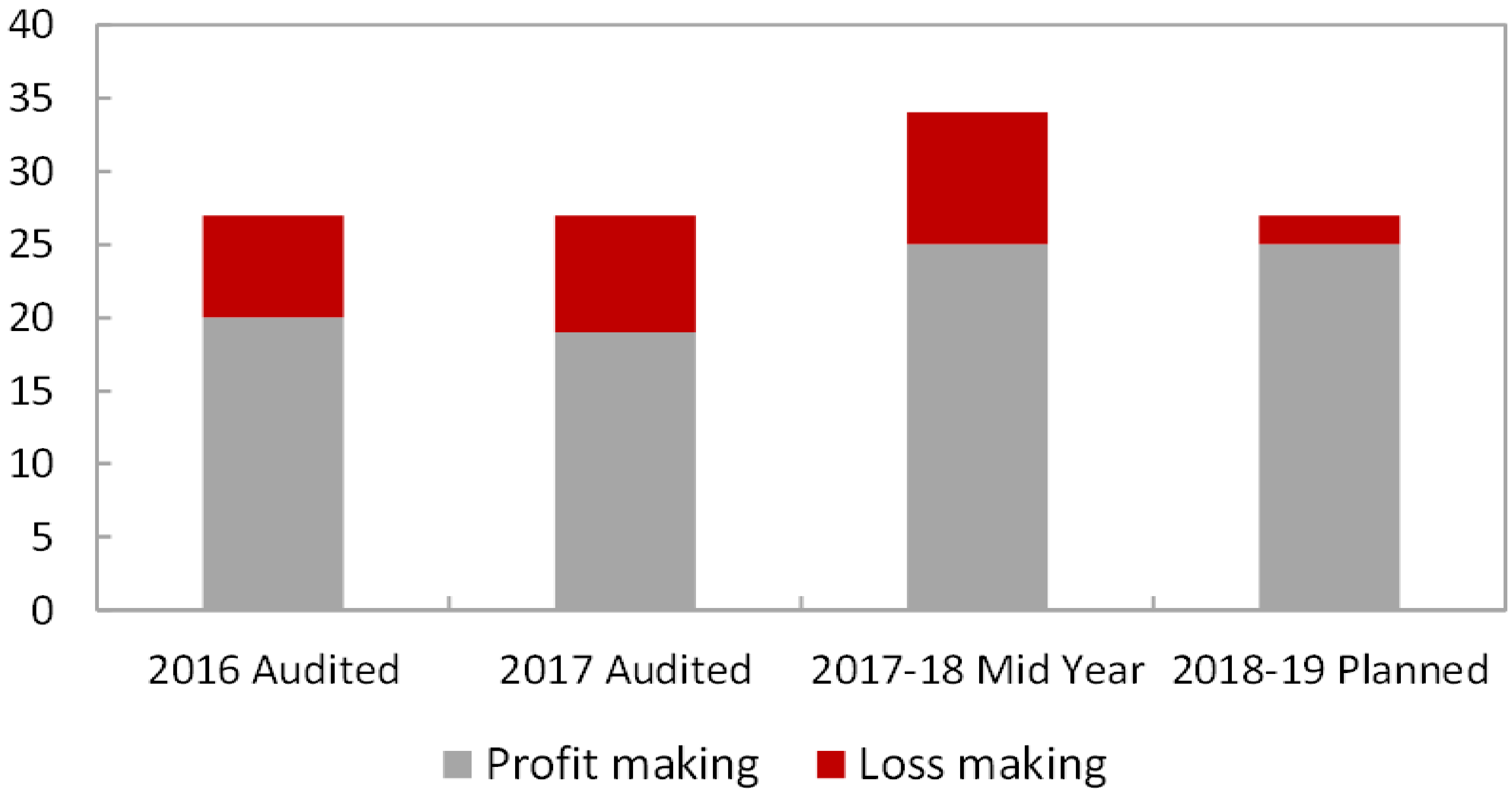
Sources of Fiscal Risks from SOEs..Cont’

- Requirements for operating subsidies
- Requirements for periodic bail-outs, perhaps due to Quasi Fiscal Activities (QFAs)
- Lumpy one-off receipts from privatizations
- Reclassifications of entities
- Opportunities for ‘creative accounting’

Fiscal Risk Indicators for SOEs

1. Profit and loss of each entity, and of the consolidated public corporations sector, as a % of GDP
2. Net equity position of each entity and the consolidated sector as a % of GDP
3. Other indicators:

1-Profit and Loss of each Entity, and of the Consolidated Public Corporations Sector (Number of Commercial SoEs)



2-Net Equity position of each entity and the consolidated sector as a % of GDP

Figure 7: Return on Equity (number of entities)

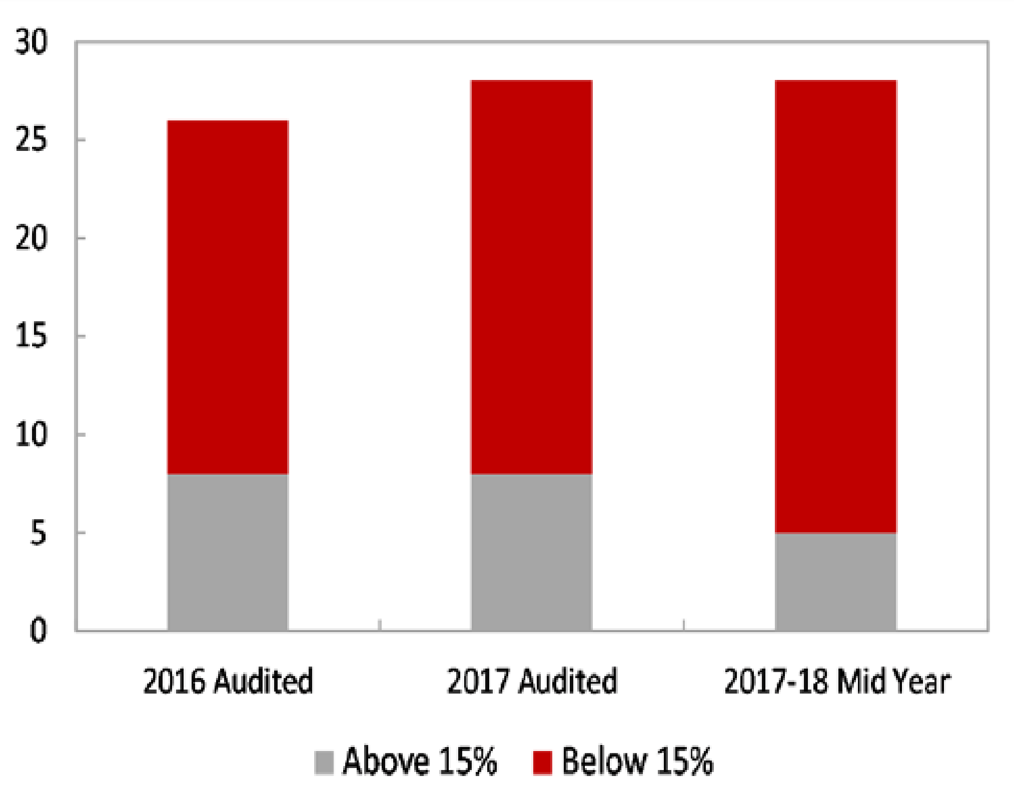
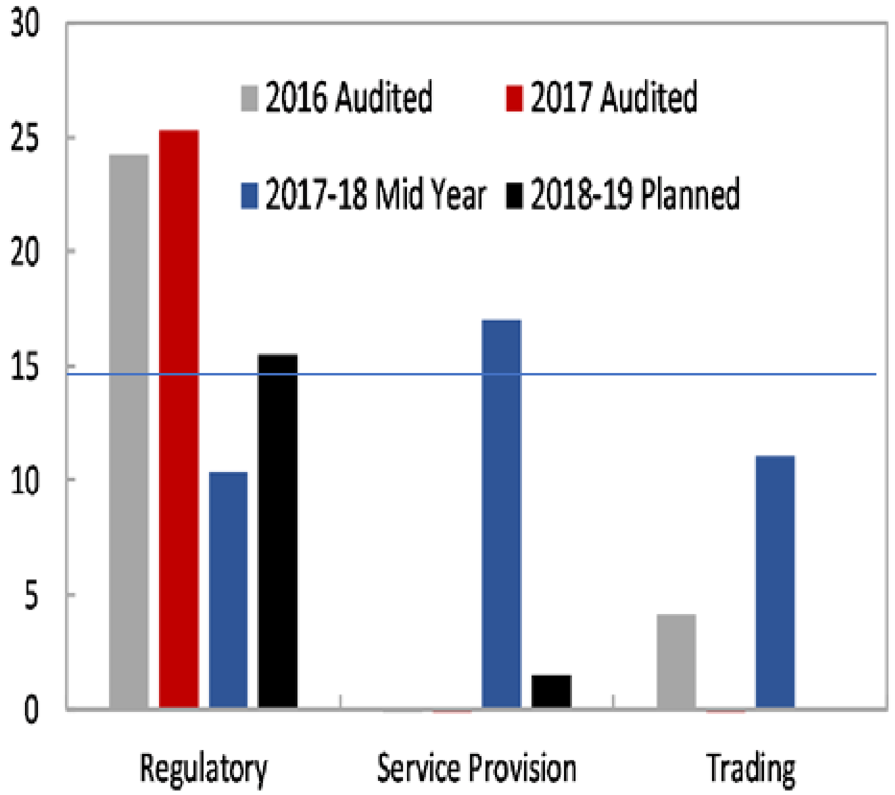


Figure 8: Return on Equity (Percent)



Other Indicators

A. Accumulation of SOEs debt: Contingent Liabilities
B. b-Sensitivity to market issues: Cost recovery
C. C-Payment Arrears by Government
D. d-Liquidity
   Non performing loans
E. Fiscal Flows between SoEs and the National Budget

A-Accumulation of SOEs debt: Contingent Liabilities

Debt to Equity and the Debt Servicing Ratio

Figure 10: Debt to Equity, 2016 (percent)

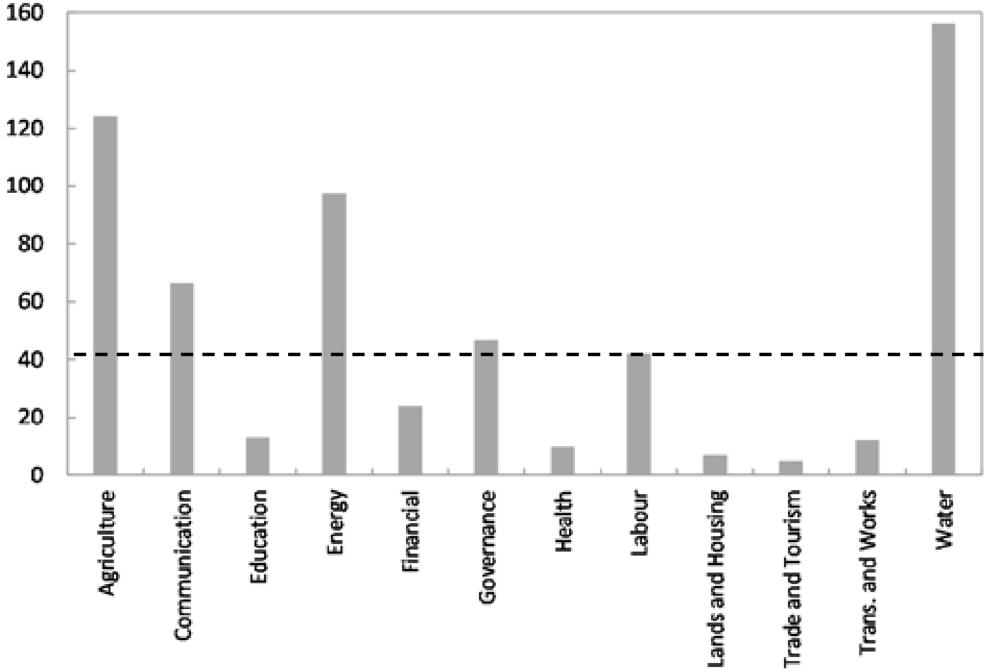
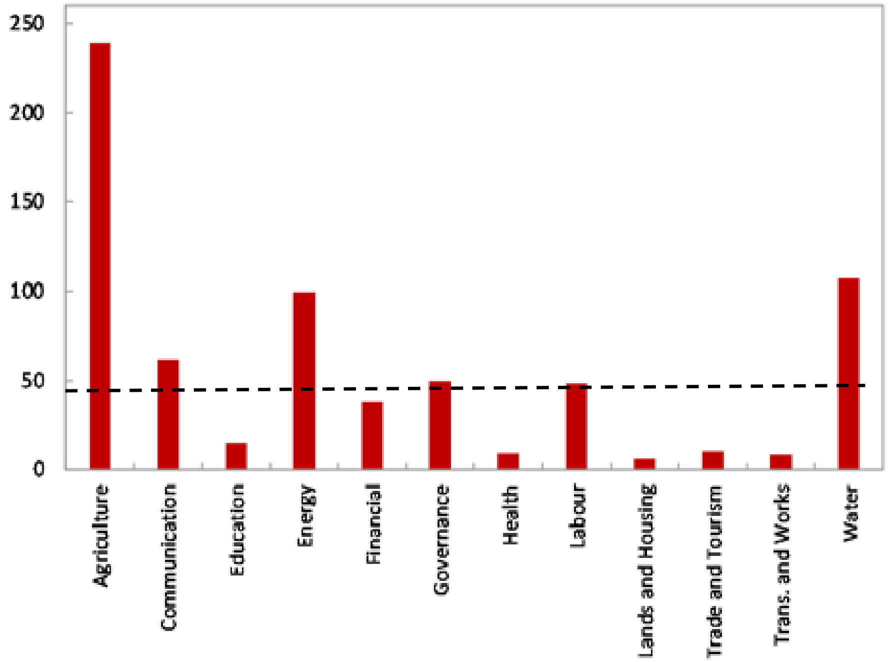
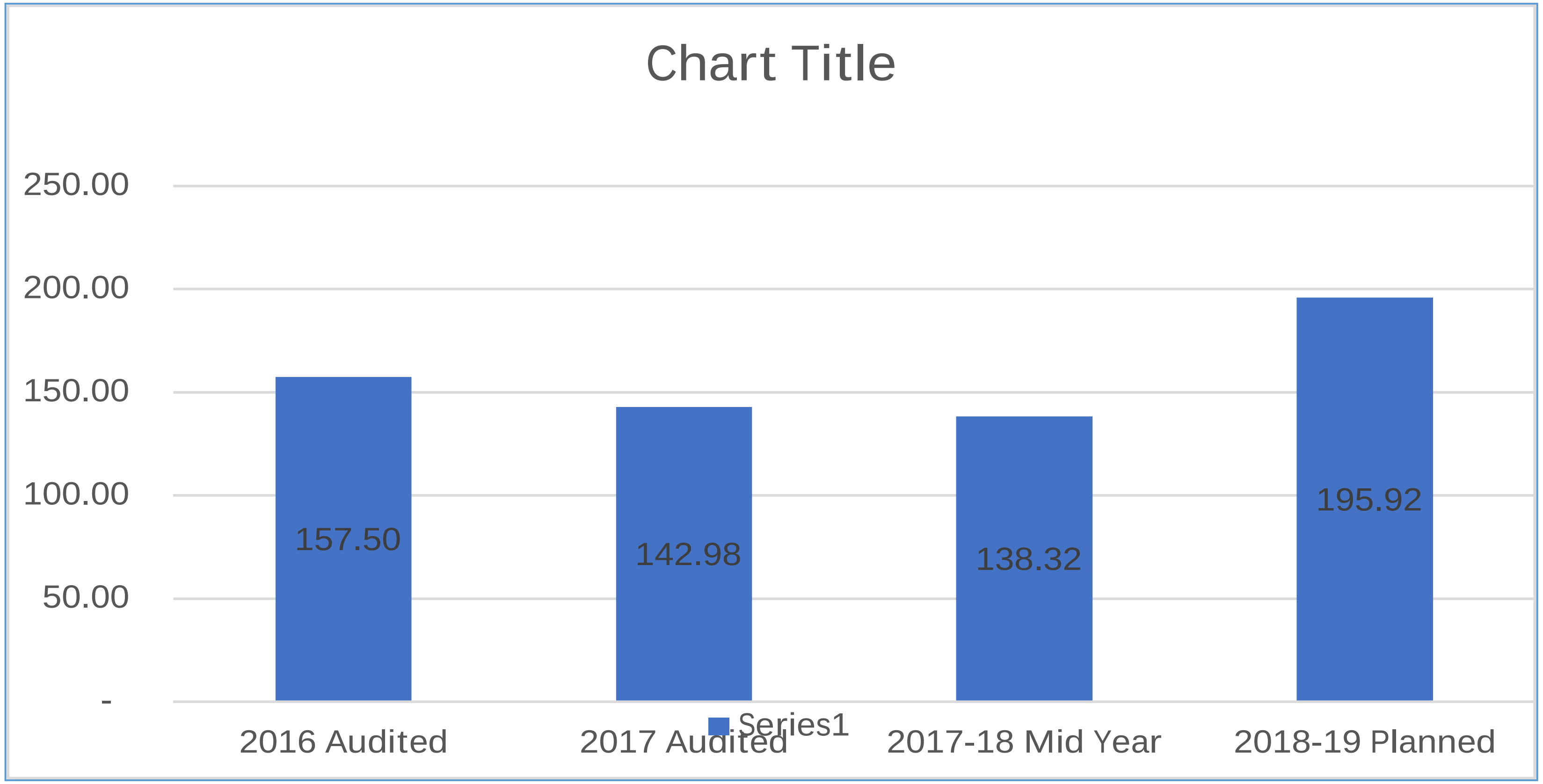


Figure 11: Debt to Equity, 2017 (Percent)



B-Sensitivity to market issues: Cost recovery

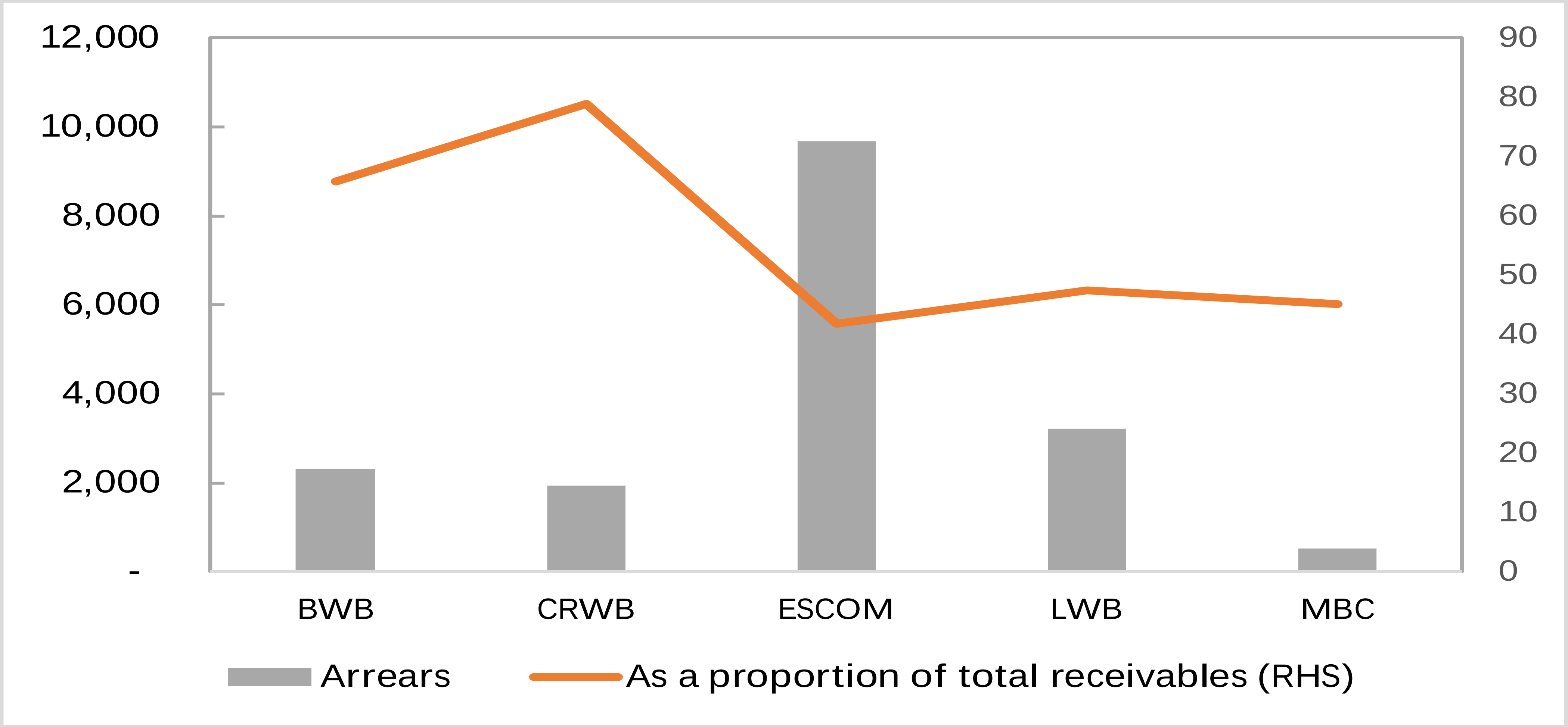


C-Payment Arrears by Government

- Utility SOEs face challenges to collect from Government institutions
- As of December 2018, Cumulative Govt. arrears was at around $37m.

- Related to this:
- Bail-out for Struggling SOEs resulting from challenges to service debt

Payment Arrears by Government



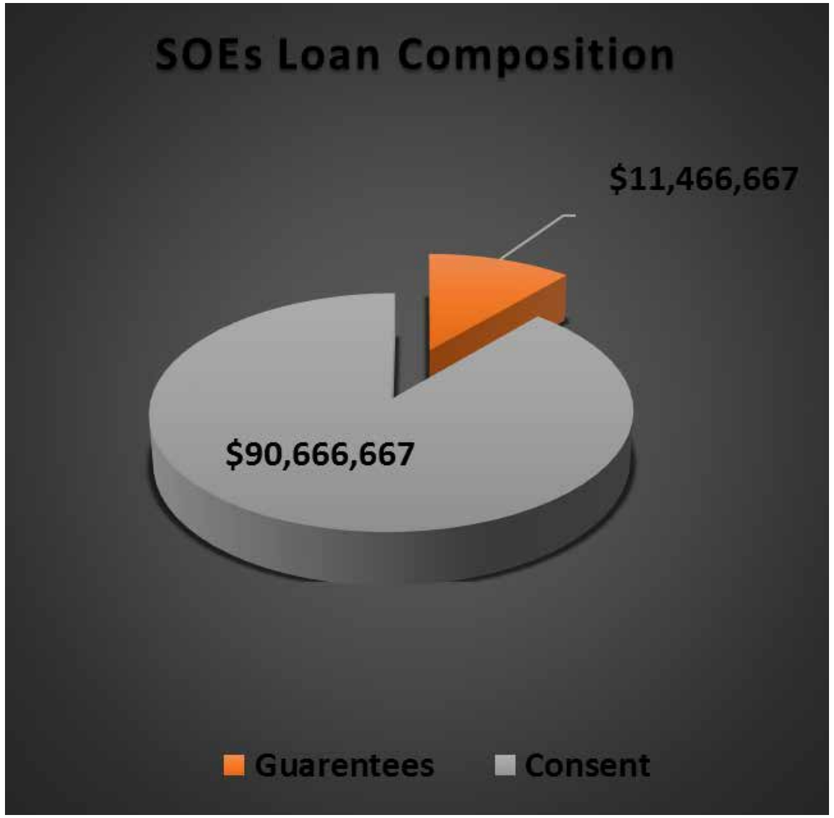
D-Liquidity

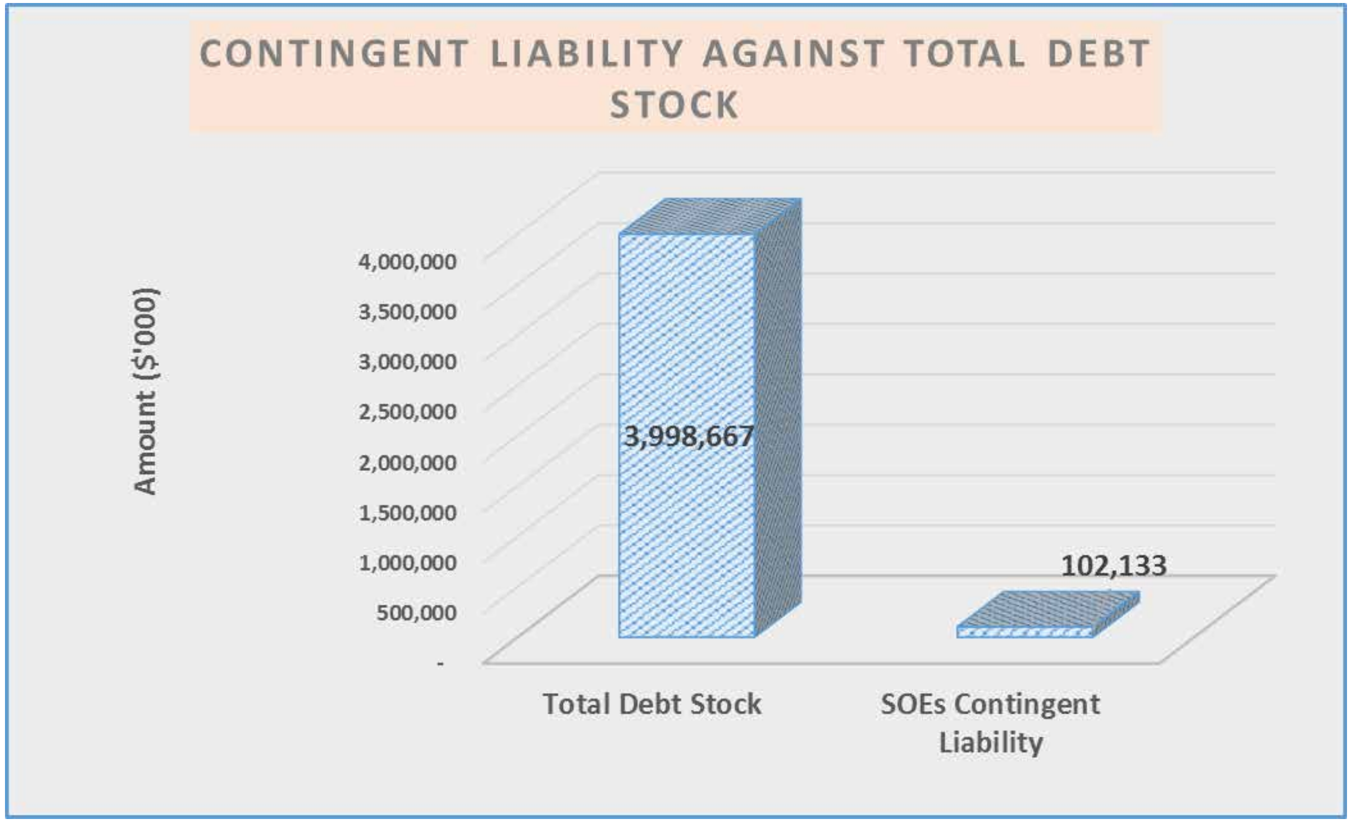
- Increased levels of short term borrowing through Overdrafts
  - Costly financing of operations
  - Trading SOEs perpetually maintain Overdrafts

E-Non performing loans

- There has been instances of default on some loans
- This has led to materialization of contingent liability

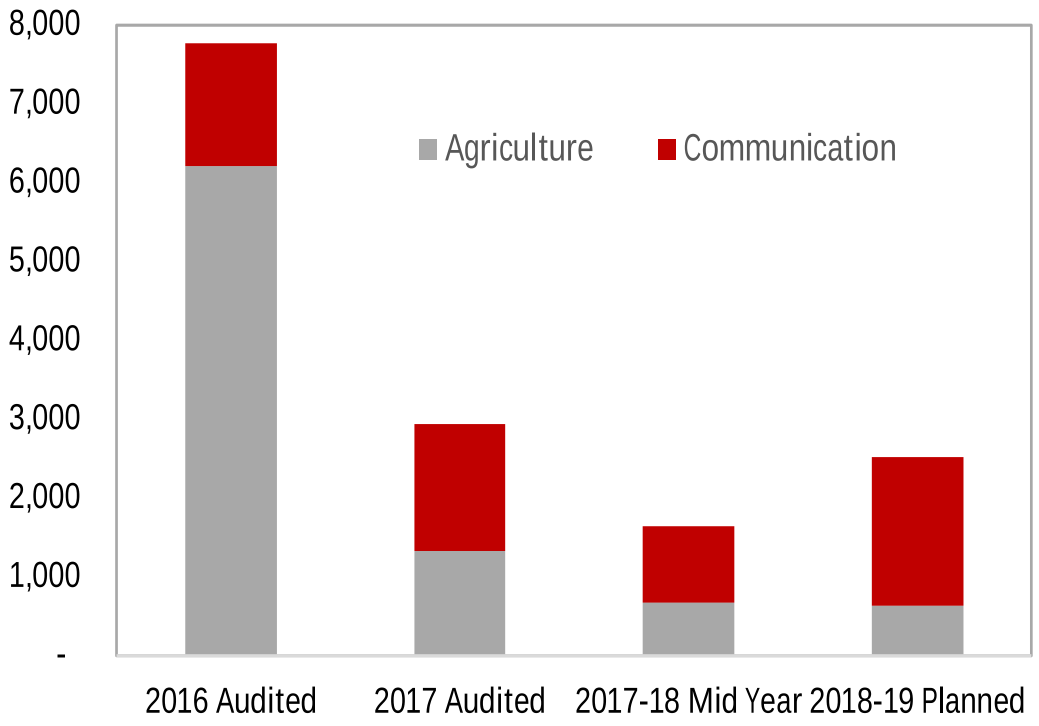
SOEs debt Stock: Contingent Liabilities



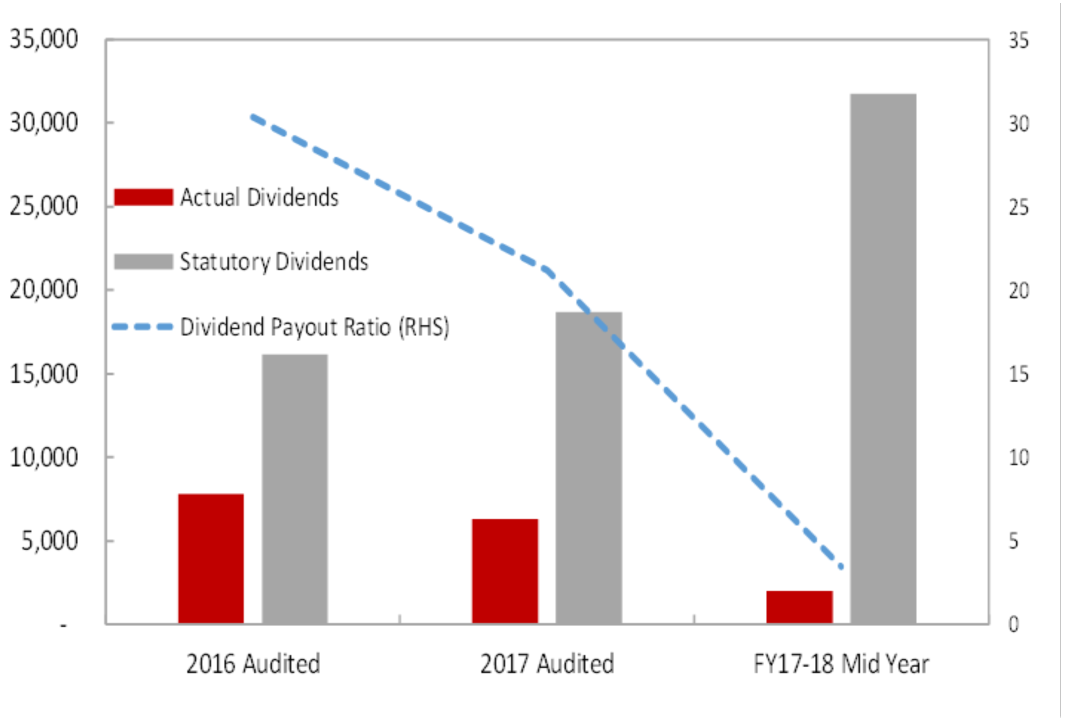


F-Fiscal Flows between SoEs and the National Budget

Transfers from Government to SOEs (millions of Kwacha)



Actual vs. Statutory Dividends and the pay out Ratio



Impact of Fiscal risks

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Factors that increase risks from SoEs

Fiscal risks from SOEs tend to be greatest when:

- The need to improve public services is great
- Financial sector is underdeveloped
- The central government is trying to reduce its own deb t and deficit
- Used to deliver political patronage and rents
- They operate with little government oversight

Strategies for reducing the risks from SOEs

- A variety of strategies:
  - Limit size of SOE sector – privatization, partial privatization, or shrink over time
  - Corporatization
  - Sound corporate governance
  - Prudent regulation of FPCs
  - Progressively reduce QFAs
  - Systematic monitoring and reporting of entity performance
  - Intervening before problems become severe e.g. control risk-taking directly by limiting entity borrowing
  - Establishing a credible no-bailout policy
- Governments should pursue a mixed strategy—reduce exposure, active monitoring, some controls, and attempt to avoid bailouts
- But combining controls and monitoring may increase expectations of bailouts

Managing Fiscal Risks

1. Identifying and monitoring

- Risk assessment framework
- Central coordination unit
- Information collection/consolidation

2. Analyzing

- Economic sensitivity analysis
- Asset-liability assessment
- Valuing contingent liabilities

3. Mitigating

- Risk allocation strategy
- Institutional responsibility

4. Incorporating in budget

- Debt level
- Budget margins/reserves
- Budget for contingent liabilities
- Stabilization funds

5. Reporting

- Economic sensitivity analysis
- Public sector balance sheet
- Fiscal risk statement


Thank
you !!