Enabling Inclusive Development

Public Finance Quarterly

Issue VI

July 2011

pwc

In this issue

Editorial

Dear Readers,

We present to you another issue of Public Finance Quarterly. We continue to share information, experiences and developments in the public finance domain with the eventual goal of initiating meaningful discussions in the public financial management space.

Our *feature story* in this issue discusses the nature of debt capital flows to developing countries. It presents two composite indices–one for the overall developing region, and the other to gauge the extent of debt burden in Asia. The results underscore the need for putting in place a strategy to manage the debt burden in some regions or countries to avoid situations currently being faced in some of the developed economies.

In the *Pick of the quarter* section, the author has chosen the much-debated topic of our times--oil subsidy. After presenting the overall trends and analysing the extent of fuel subsidy involved, the author examines the impact of this economic policy on varied stakeholders. It questions the very rationale of the practice of passing on less than full oil increases to domestic prices.

Our *Round the corner* section presents in brief recent developments in government finances and policies worldwide. In *Know our work*, we have showcased our experience of executing a business process re-engineering related project for strengthening tax administration and public financial management system for the government of Sri Lanka.

I would like to thank you all for your overwhelming support and response. Your help and suggestions inspire us to continuously enhance this newsletter to ensure effective information sharing.

We would like to invite you to contribute and share your experiences in the public finance space with us. Please write to me at ranen.banerjee@in.pwc.com *or to our editorial team.*

Happy reading!

Sincerely,

Ranen Banerjee

Ranen Banerjee
Executive Director-Public Finance

Feature article

The ABC of 'D': Analysing debt problems of developing countries

The flow of international capital across the border has increased significantly over the years, (Table 1) moving from countries with surplus to where it is scarce. These capital flows constitute portfolio investment, foreign direct investment, international lending and borrowing. As we know, current account balance is the difference between savings and investment (CA = S-I). When national savings are lower than the required domestic investment, the difference is known as current account deficit. Although developing countries have large reserves of natural resources, they lack a sophisticated financial system and the capacity to raise adequate capital domestically. Low capital stock in developing countries means that there are many opportunities for investment. Lower capital to labour ratio means that marginal productivity of the capital is high.

Borrowing from abroad increases domestic investment and helps attain a higher economic growth rate and prosperity. In crude accounting sense, running a current account deficit means inflow of capital into the capital account. Therefore, current account deficit implies that the country is borrowing from abroad and must repay in future with interest. It is expected that the state of the economy will permit developing countries to repay their debt on time. However, in the real world, things do not always fall in place. There are several instances of sovereign default. Countries borrow in excess with no prudential investment strategy and as a result return from capital turns negative. Hence, it is imperative on the part of developing countries to correctly assess their debt needs and manage the temporal debt burden judiciously.

In this article, we discuss the nature of debt capital flows to developing countries and assess the debt burden on the developing regions of the world. We have developed two composite indices–one for the overall developing region and the other to gauge the extent of debt burden in Asia. While constructing the index, we have analysed individual components in greater detail so that policy implications can be drawn to reduce the debt burden.

Nature of debt flows

Net debt flows to developing countries increased considerably between 2006 and 2007 at 193.6%. While there was a net repayment to official creditors during 2005-2007, private credit continued to flow to developing countries. In fact, the credit flow from the private sector in 2007 was close to the cumulative flow in 2005 and 2006.

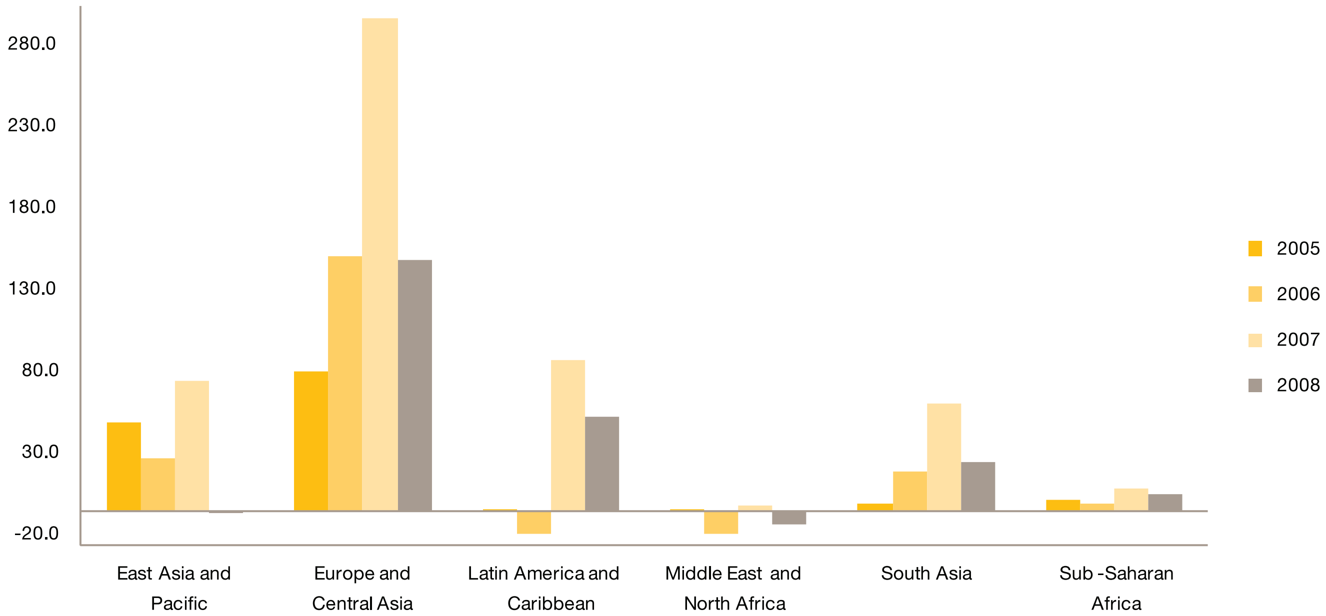
There was a sharp fall in credit flow to developing countries in 2008 due to the global financial crisis. While the official credit flow turned mildly positive, there was a 56% decline in net debt flows primarily due to the risk averseness of private creditors. Short-term credit flows collapsed completely and there was a net outflow of $12.7 bn for the first time since 2000. Figure 1 shows the debt capital flows to different developing regions and the impact of the global crisis in 2008.

Table 1: Net debt capital inflows to developing countries ($ billion)

	2001	2005	2006	2007	2008
Net debt flows (A=B+C)	53.3	151.5	190	557.8	243.8
Official creditors (B)	27.3	-71.9	-72.9	-1.9	28.1
Private creditors (C=D+E)	26	223.3	262.9	559.8	215.8
Net medium and long-term debt flows (D)	3.9	137.7	168.1	315.3	228.5
Net short-term debt flows (E)	22.1	85.6	94.8	244.5	-12.7

Source: Global Development Finance, 2010

Figure 1: Net debt capital flows to developing countries ($ billion)

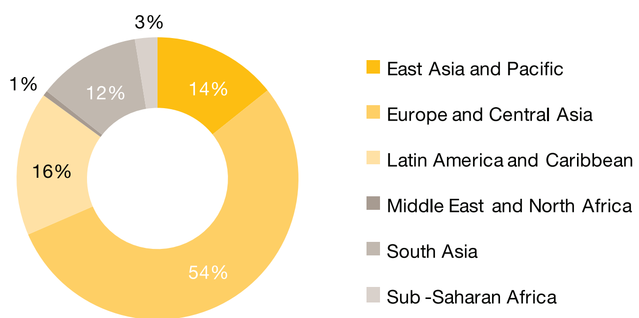


Source: Global Development Finance, 2010

The global economic crisis also affected the flow of external debt. As Figure 1 shows, there was net outflow from East Asia and the Pacific and Middle East and North Africa during 2008. Europe and Central Asia, the largest borrowing region saw its net borrowing halved on a year-to-year basis. South Asia which borrowed $65.8bn in 2007 witnessed a sharp fall in net borrowing (having received only $29.8 bn in 2008). Therefore, the economic recession which originated in advanced geographies, had a severe impact on the capital flows to developing countries.

For countries, debt reduction is a long-term strategy and involuntary reduction due to external forces brings economic instability. The share of different developing regions of the world in total external debt is shown in Figure 2. Europe and Central Asia is the largest borrowing region (54% share in total external lending) followed by Latin America and the Caribbean (16%), East Asia and the Pacific (14%) etc.

Figure 2: Distribution of external debt among regions (2007, %)



Source: Global Development Finance, 2010

Extent of indebtedness

Developing regions are capital-scarce and attract large foreign capital in terms of debt and equity capital. Unlike equity, debt capital is riskier since the country has to make timely payments of principal with interest. Failure to repay foreign debt leads to sovereign default which has strong negative ramifications for the country. Figure 3 shows some of the external debt indicators and their movement over time for developing regions.

On an average, debt pressure on developing regions has substantially moderated over the years (Figure 3). External debt to gross national income (GNI) (Box 1) shows improvement over the years, down from 38% in 1995 to 22% in 2008. The improvement gained momentum between 2000 and 2006, the period in which a majority of developing economies moved to a more liberalised regime. This transition is evident from the debt to exports ratio–a measure of repayment capacity. Till 2000, the ratio of external debt stocks to exports was very high. It was 174% in 1990, 154% in 1995 and 122% in year 2000. Post that, the ratio has gone below 100%, indicating an improvement in the potential of these countries to repay their debt through export earnings. By 2008, export earning was 58.7% of total outstanding external debt. The changing dynamics is also getting reflected by the debt service to exports ratio.

Debt service to exports was 17% during 1995, which means that on a yearly basis, 17% of export revenues was used for repayment of principal and interest of existing debt. However, the economic boom in the earlier years and the increasing outward orientation of these developing countries has enabled them to reduce this ratio to 9.5% by 2008. Similarly, there is a significant improvement in the reserves to external debt. It moved from 24.2% in 1995 to 108% in 2008. The only indicator that reflects the stress is the rising share of short-term debt to total external debt. The share of short-term debt was only 17.5% in 1995, but it went up to 24.8% in 2007 before receding to 22.7% in 2008.

Box 1

Debt indicators

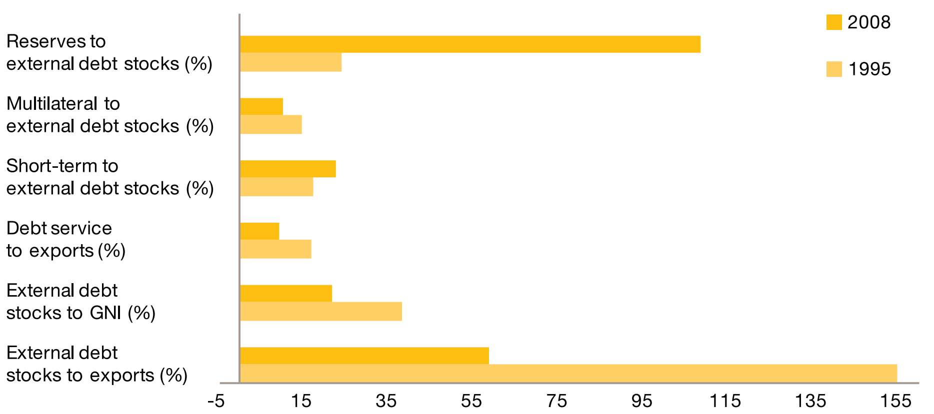
- External debt stocks to exports: Is a ratio of the country's external debt to its export earnings. Export is one of the primary vehicles through which a country earns foreign currency to pay off its debt.
- Reserve to external debt: Shows the reserves the central bank of the debtor country holds to pay off its external debt.
- External debt to GNI: Reflects the burden of total external debt on the country, in other words, the debt-bearing capacity of the country.
- Debt service to exports: Shows the annual burden facing a debtor nation in relation to its export earnings. It measures the public and publicly guaranteed principal and interest repayments the country has to make as a proportion to its export revenues.
- Short-term debt to total external debt: Shows the immediate debt pressure on the debtor nation. Higher the proportion of short-term debt to total external debt, higher is the burden on the nation to accumulate foreign currencies.

Spatial variation in debt pressure

There is a discernible asymmetry in the improvement of debt indicators across developing regions. Some have performed relatively well as compared to others. The uneven pattern of development is shown in Figures 4, 5 and 6.

Figure 4 shows the external debt stock to GNI for two years, 1995 and 2008 for six developing regions. There is a significant improvement in the debt-to-GNI ratio in 2008 over 1995 for all developing regions. Sub-Saharan Africa, which was an outlier in terms of debt to GNI (76%) in 1995, achieved a lot in 2008. Similarly, Middle East and North Africa, the resource-rich regions of the world, were able to reduce their debt-to-GNI ratio from 53.5% in 1995 to 15% in 2008. The only region where the debt indicators worsened is Europe and Central Asia. The debt-to-GNI ratio shot up to 32.5% in 1995 from a benign 13% in 1990. It touched 50% in 2000 before coming down to 37.3%. As evident from Figure 4, the share of external debt to GNI in Europe and Central Asia is higher than in the overall region.

Figure 3: Measuring indebtedness of developing regions

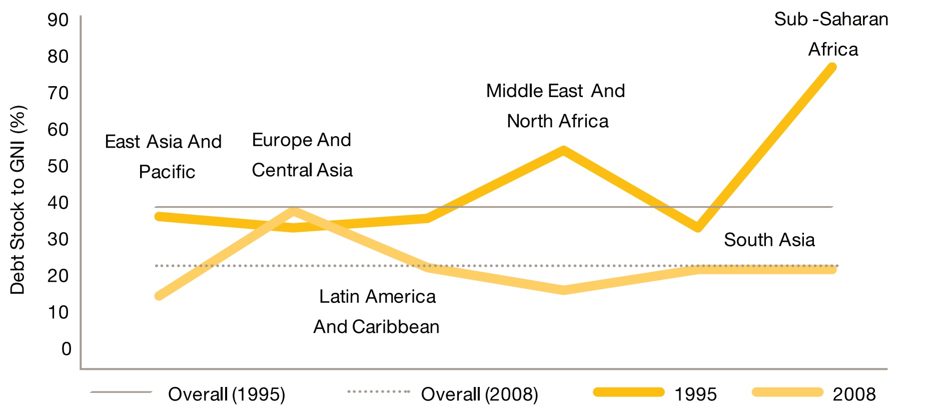


Source: Global Development Finance, 2010

Figure 5 shows the external debt-to-exports ratios for different developing regions of the world. As discussed earlier, 2008 shows a remarkable improvement over 1995 as the world moved from an autarky to an open economy. Regions like Sub-Saharan Africa (254.7%) and South Asia (214.5%) that had higher debt-to-exports ratios in 1995 have brought it down to 48% and 74.7% in 2008 respectively. Europe and Central Asia whose performance score in this indicator was better than the region average in 1995, could not sustain it by 2008. Though on a temporal basis there is a significant improvement in its performance, it still has a debt stock to export ratio of 93.3%, 34% higher than the regional average. East Asia and the Pacific are the group leaders in this parameter, given their higher export orientation.

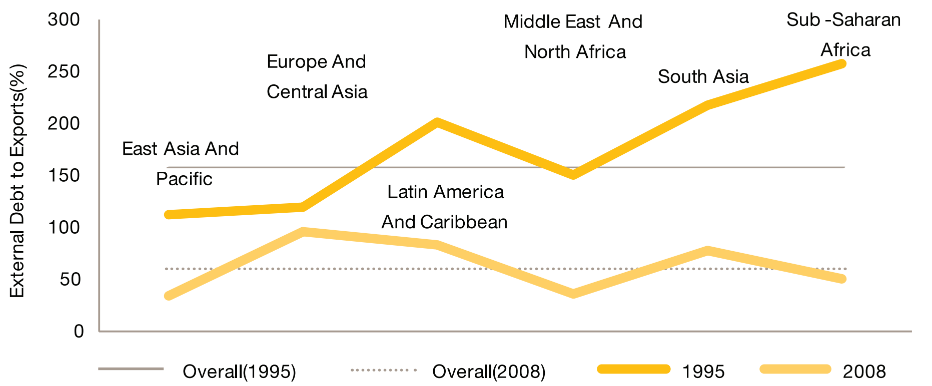
Figure 6 shows the short-term debt to exports for all developing regions. As compared to 1995, all regions have experienced a rise in the share of short-term debt. East Asia and the Pacific appears as an outlier in 2008 with a significant share of short-term debt. This raises concerns about a repeat of the East Asian crisis of the late 90s. Europe and Central Asia, which otherwise showed poor performance in other indicators, have a less-than-average share of short-term debt-to-export earnings. Middle East and North Africa and South Asia have lower shares of short-term debt-to-export earnings.

Figure 4: Debt stock to Gross National Income (%)



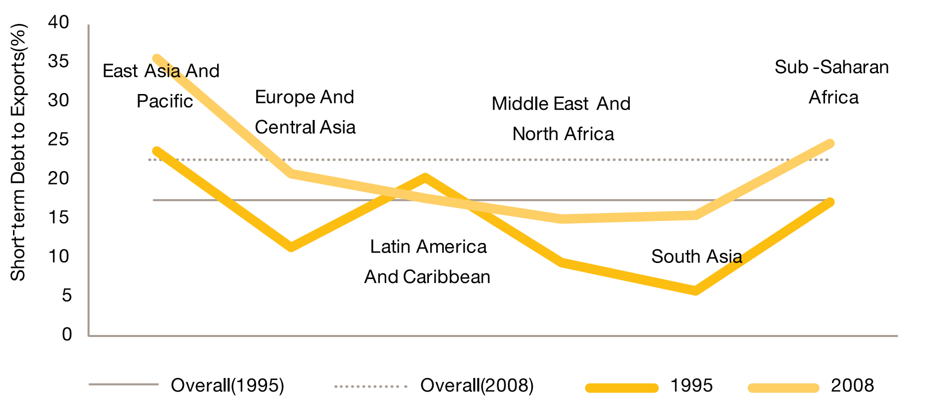
Source: Global Development Finance, 2010

Figure 5: External debt to exports (%)



Source: Global Development Finance, 2010

Figure 6: Short-term debt to exports



Source: Global Development Finance, 2010

Composite index of indebtedness

A composite index of indebtedness has been developed with the help of the range equalisation method:

$$\textit{Index} = \frac{\textit{Actual - Minimum}}{\textit{Maximum - Minimum}}$$

We have considered six variables for the construction of the index:

- External debt stocks to GNI
- External debt stocks to exports
- Short-term debt to external debt stocks
- Debt service to exports
- Reserves to external debt stocks
- Multilateral to external debt stocks

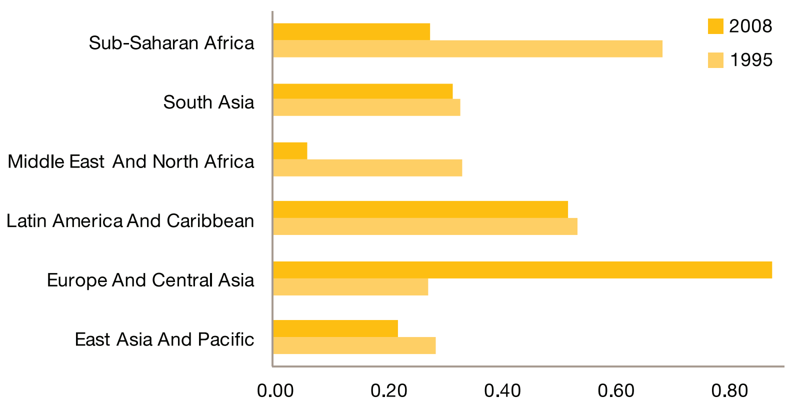
The last two variables are inverted to keep the qualitative interpretation aligned with the other variables.

We have followed two steps to create the index:

1. Individual index for each variable for each country has been generated.
2. The average score of these six parameters for each country has been calculated.

The composite index of indebtedness represents the risk associated with each country. Higher the index value, higher is the debt-related risk. As seen in Figure 7, Sub-Saharan Africa, the riskiest region of the 90s has been replaced by Europe and Central Asia. Between 2000 and 2008, the debt-related risk of Europe and Central Asia has increased manifold. It is evident from the Greece debacle that risks are not confined to this developing region but are spread across Europe including some of the most advanced countries. Latin America and the Caribbean have the same rank as far as debt-related risks are concerned, and it is quite high as compared to other developing regions. Middle East and North Africa and East Asia and the Pacific have emerged to be the developing regions with the least risk. South Asia remained in the moderate category during this period

Figure 7: Composite index of indebtedness



Source: Global Development Finance, 2010

Developing Asia and debt risk

We have ranked the developing Asian countries on the basis of debt-related risks.

Most debt crises can be classified into three types:

- Episodes of insolvency (such as high debt-to-GDP ratio or issues related to debt unsustainability)
- Episodes of illiquidity, where near default is driven by large stocks of short-term liabilities relative to foreign reserves or large debt service over reserves
- Episodes of macro and exchange rate weaknesses (inflation and exchange rate overvaluation).

In the following section, we categorise the countries of developing Asia based on fiscal stress. Three major types of risks have been identified:

- Solvency or debt unsustainability risk
- Illiquidity risk
- Macro-Exchange rate risks

We have used different indicators to capture each of these risks as discussed in Box 2. Table 2 gives the risk-scoring on each of these variables. For example, if external debt-to-GNI ratio is less than 40%, then the associated risk score is one which is low risk. Data for the current empirical exercise is taken from the *World Development Indicators - 2011* database for the year 2009. The final score for each of the risk parameters has been calculated in two stages. Initially a risk score is assigned to each variable associated with the risk parameter and then an average score for that risk parameter is calculated.

Box 2

Measures of risk

- Solvency risk is measured by external debt to GNI, reserves to external debt, current account balance to GDP ratio.
- Illiquidity risk is measured by debt service payment to GNI and short-term debt to total reserves.
- Exchange rate volatility (standard deviation of exchange rate over the last five years) and inflation volatility (standard deviation of consumer price index over the last five years) is considered to measure the macro-exchange rate risks.

Table 2: Threshold measure for risk calculation

	1 (Low risk)	*2 (Moderate risk)*	*3 (High risk)*
External debt (% of GNI)	< 40	40 to 80	> 80
Total reserves (% of total external debt)	> 90	50 to 90	< 50
Current account balance (% of GDP)	> 0	-3 to 0	< -3
Total debt service (% of GNI)	< 1	1 to 5	> 5
Short-term debt (% of total reserves)	< 15	15 to 30	> 30
Exchange rate volatility (last 5 years)	< 5	5 to 20	> 20
Inflation volatility (last 5 years)	< 10	10 to 20	> 20

Table 3 shows the risk score for each of the parameters for developing Asian countries. 1 to 1.67 indicates lower risk, 1.68 to 2.33 indicates moderate risk and 2.34 to 3 indicates higher risk. The categorisation is done on the basis of distribution of the respective data series.

Table 3: Scores under the three parameters

Country	*Solvency risk*	*Illiquidity risk*	*Macro-exchange rate risk*
Bangladesh	1.7	2.0	1.5
Cambodia	2.3	1.0	3.0
China	1.3	1.0	1.0
Fiji	1.7	1.0	1.0
India	1.3	2.0	1.5
Indonesia	1.7	2.5	2.5
Lao PDR	3.0	1.5	2.0
Malaysia	1.3	2.5	1.0
Maldives	3.0	2.5	1.5
Pakistan	2.7	1.5	2.5
Papua New Guinea	1.7	2.0	1.0
Philippines	1.3	2.0	1.0
Samoa	2	1.5	1.5
Solomon Islands	1.7	1.5	2.0
Sri Lanka	2.3	2.5	2.5
Thailand	1.0	2.5	1.0
Tonga	1.7	1.5	1.5
Vanuatu	1.3	1.5	1.0
Vietnam	2.0	2.5	3.0

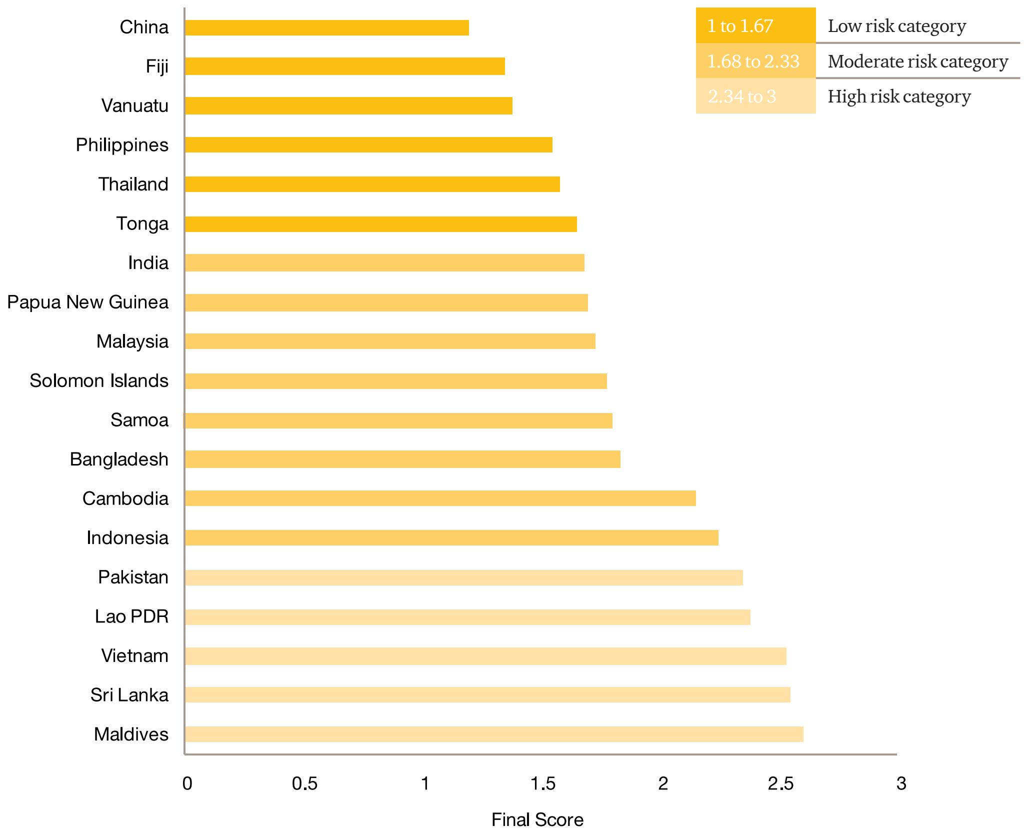
To calculate the composite index of debt-related risk, the individual scores given to the three parameters are multiplied with their allocated weights:

- Solvency risk: 45%
- Illiquidity risk: 35%
- Macro-exchange rate risk: 20%.

Weights are assigned to different parameters on the basis of their importance.

Figure 8 shows the classification of countries into different debt-risk zones.

Figure 8: Risk profile of countries



Source: Global Development Finance, 2010

Not surprisingly, China is the lowest risk country in developing Asia primarily due to its high economic growth, higher export orientation and stable macroeconomic policies. Out of six countries in the low-risk category Fiji, Tonga and Vanuatu are located in the South Pacific Ocean, east of Australia, an economically stable region. India falls in the moderate risk category though it has lower risk score in two parameters–solvency risk and macro-exchange risk. Due to higher debt service payment to GNI and short-term debt-to-reserve ratios, India slipped into the moderate risk category. Three South Asian countries, Pakistan, Sri Lanka and Maldives, belong to the high-risk category. Maldives leads the pack of high-risk countries, because of its high solvency risk which is deteriorating over the past decade as can be seen in Table 3.

Conclusion

The emerging theme of this article is the transition of a few developing regions from a safer zone to a risky zone with reference to their debt burden. For example, Europe and Central Asia traditionally seen as a conservative region has become riskier. At the same time, Sub-Saharan Africa which was perceived to be in the danger zone has reduced its debt burden over a period of time. In Asia, Maldives has resorted to excessive external borrowing. This is much riskier on its part given the volatile nature of its national income. Unlike large economies, its revenue is excessively reliant on the service sector (tourism, trade, hotels, etc.). Similarly, Pakistan and Sri Lanka suffer from solvency and illiquidity risk. With the increasing scrutiny and debate on the risks of sovereign defaults, regions or countries have to be more sensitive towards monitoring these indicators and fine-tuning their fiscal policies. This will help them avoid a situation like Greece, where all tough choices were to be made all at once.

Pick of the quarter

Fuel subsidy: Is it a subsidy?

International fuel prices have shown considerable volatility in recent years. Between end2003 and mid-2008, fuel prices increased more than fourfold, with most of the increase coming in during 2007 and the first half of 2008 (Figure 9). However, many governments in developing countries including India were reluctant to fully pass on these price increases to domestic consumers, resulting in substantial fiscal costs. After a sharp decline in fuel prices in the second half of 2008, prices have again increased substantially, renewing concerns about the fiscal risk associated with not passing on the complete increase to domestic prices.

The reasons cited by the Indian government for this policy is to protect poor consumers from fuel price volatility (mostly increase in prices). It is argued that high fuel prices especially that of diesel would stoke inflation as it would increase the production and transportation cost of agricultural and industrial produce. Another objective of government intervention is to enable lower income households to afford kerosene and also subsidise LPG for middle-income households.

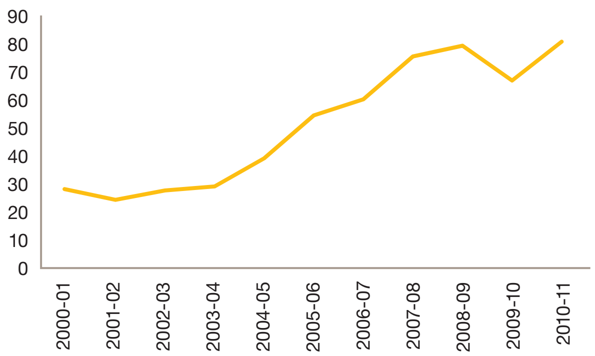
Questions are frequently raised regarding whether the government is justified in following an economic policy of fuel subsidy in the larger interest of the economy and lower- and middle-income households. Are these subsidies really helping the targeted beneficiaries and is there a larger hidden price that is paid by these households? We attempt to answer these questions and understand the economics and impact of the subsidy policy on the major stakeholders.

Subsidy burden: A snapshot

India's crude consumption has grown at a CAGR of around 4% from 2002 to 2010. The consumption was at 193 MMT of crude and 139 MMT of petroleum products in 2009-2010. More than 80% of crude was imported and accounted for 30.5% of the country's total imports. Crude was mainly imported from the Middle East (67%) and African (20%) countries. Figure 10 shows the net import of crude and petroleum products during 2006 to 2011.

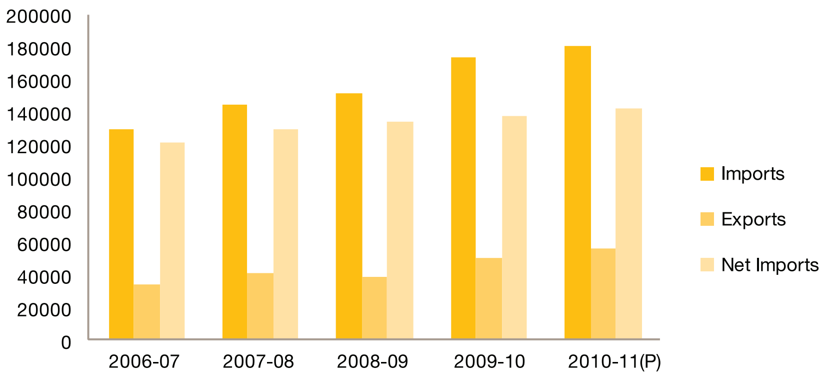
Out of the total consumption, 66% comprises sensitive products, such as petrol, kerosene, diesel and LPG. The government intervenes in the markets through price control. It fixes the prices of LPG, diesel and kerosene (petrol was deregulated in 2010). These prices are lower than market prices. Since they are revised by the government on an ad hoc basis, this results in under-recoveries (losses) to the government oil marketing companies (OMCs) which supply them in the market. The government compensates the oil marketing companies for this loss.

Figure 9: Trend of crude oil prices (Indian basket) $/bbl.



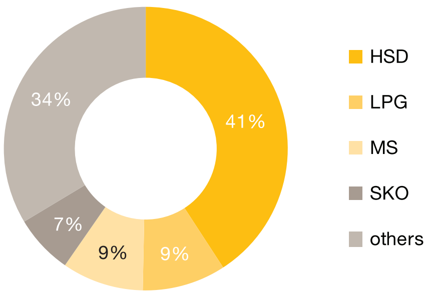
Source: Petroleum Planning and Analysis Cell, Ministry of Petroleum and Natural Gas, GoI

Figure 10: Net import of crude and petroleum products during 2006-11 (MMT)



Source: Petroleum Planning and Analysis Cell, Ministry of Petroleum and Natural Gas, GoI

Figure 11: Consumption 2009-10 (MMT)



Note: SKO= superior kerosene oil, HSD= high speed diesel, MS= motor sprit, LPG= liquefied petroleum gas

Figure 12: Under-recoveries during 2005-2010 (crore INR)

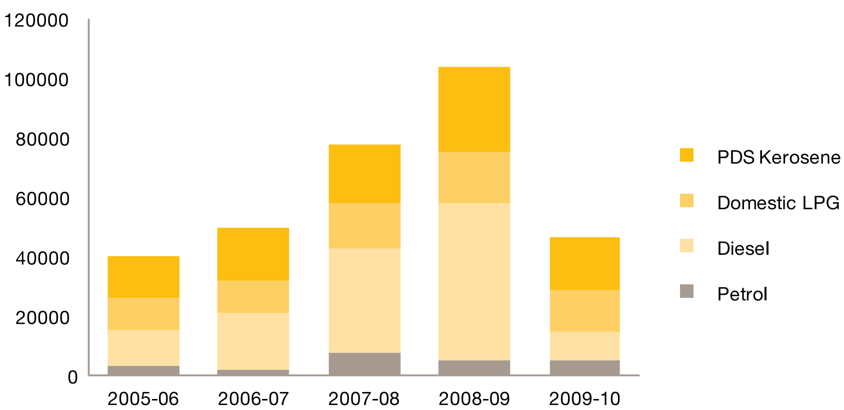


Figure 12 shows the overall under-recoveries incurred by the OMCs due to price fixation by the government. The under-recoveries were at 1,03,292 crore INR in 2008-09 and 46,051 crore INR in 2009-10. The losses were lower in 2009-10 due to lower crude prices. But the losses are expected to increase in 2010-11 due to sustained high crude prices.

Impact on oil demand and prices

Emerging economies that use subsidies to keep domestic fuel prices far below the world price see a higher consumption of fuels as compared to economies that offer no subsidies. According to one estimate, countries with fuel subsidies accounted for virtually the entire increase in global oil consumption last year. Without this artificial demand stimulus, world oil prices were expected to be significantly lower. Since the prices are not passed on to consumers, it does not reduce consumption when the prices are high. This distorts demand and prevents correction in oil prices.

Impact on targeted households

The impact of fuel price increase and subsidies is studied in detail in an IMF working paper[1]. The study covers most of the developing countries including India.

The paper studies the impact of increasing domestic fuel prices on the welfare of households through two channels. First, there is a direct impact on households faced with higher prices for fuels consumed for cooking, heating, lighting and private transport. Second, there is an indirect impact through higher prices for other goods and services consumed by households as higher fuel costs are reflected in increased production costs and consumer prices. The impact of these increases will depend on the share of cooking, lighting, heating, and private transport costs in total household consumption, as well as on the fuel intensity of other goods and services. The summary of the impact of $0.25 increase in fuel prices on household consumption is provided in Table 4.

The paper concludes that the distribution of the total, direct and indirect welfare impact are approximately neutral, with the welfare loss being similar across income groups. However, in the case of direct impact, this hides substantial differences across fuel products. The impact of gasoline and electricity price increases is progressive while that of kerosene price increases is regressive. But clearly low-income groups incur a substantial welfare loss, which they will find more difficult to absorb given their low initial consumption levels. However, the benefits of maintaining low prices are captured mostly by higher income groups, reflecting their large share in total income and consumption. This makes fuel subsidies a very inefficient policy instrument for protecting poor households from fuel price increases.

[1] The Unequal Benefits of Fuel Subsidies: A Review of Evidence for Developing Countries by Javier Arze del Granado, David Coady, and Robert Gillingham

Table 4: Composition of total impact by consumption quintile (% of household consumption)

Consumption quintiles	*Bottom*	*2*	*3*	*4*	*Top*	*All households*
Total impact	6.4	6.2	6.2	6.3	6.4	6.2
Direct impact	2.8	2.7	2.7	2.8	2.9	2.8
Gasoline	0.1	0.2	0.3	0.4	0.7	0.3
Kerosene	1.7	1.3	1.2	1.0	0.6	1.1
LPG	0.3	0.3	0.3	0.3	0.4	0.3
Electricity	0.8	0.9	1.0	1.1	1.2	1.1
Indirect impact	3.6	3.5	3.5	3.5	3.5	3.3

Source: IMF working paper 'The Unequal Benefits of Fuel Subsidies: A Review of Evidence for Developing Countries'- authors' computations based on country reviews

Impact on upstream companies, OMCs and the oil sector

Since the subsidy burden is shared by OMCs and upstream oil companies, the companies have to book losses due to under-recoveries as well as forego cash as they are paid for by government oil bonds. This results in reduced cash flow, thereby forcing companies to borrow from the market to meet working capital needs. The higher borrowing and eroded profitability of companies impacts their performance and further investments in upstream, refining capacities and efficiency measures. Though the losses are absorbed by these companies, the government being a major shareholder is also affected by reduced profits, dividends and capital destruction.

The lack of profit incentives also forces private companies not to operate in oil marketing and distribution. Since the price intervention is calculated based on cost and methodology, there is little incentive for companies to invest in efficient distribution and technology.

It is also estimated that around 35% of the PDS kerosene[2] is diverted and does not reach the targeted population.

Impact on environment and green technology

By subsidising consumption, the government indirectly encourages the use of fossil fuels which has a serious impact on the environment through depletion of natural resources, pollution leading to the greenhouse effect and associated adverse impact like flash floods, global warming, etc. Though the cost of environment impact is not measurable, it is irreversible and has a direct impact on the quality of life. Artificially keeping crude costs down does not incentivise producers and consumers to adopt cleaner technologies. Additionally, there are no incentives for increased investments in newer innovations in environmental-friendly technologies.

Impact on government finances

The government subsidises only kerosene and LPG through budgetary support while it issues oil bonds for diesel subsidy. Though kerosene and LPG subsidies from the government have remained constant, the under-recoveries to the OMCs have increased over the years.

Considering the under-recoveries are a part of the fiscal deficit of the government, the fiscal deficit as a percentage of GDP rises by at least a couple of points (2008 to 10). The issuing of oil bonds creates future liability for the government as it has to pay interest and the principal on the maturity of these bonds. This increases the debt service liabilities of the government leading to adverse effects on sovereign ratings. S&P rated India BBB- (minus) in the long term and A-3 for the short term. Lower ratings further increase the cost of borrowing for the government.

This cycle of increasing subsidy, issuing of oil bonds, rising fiscal deficits and cost of borrowings may crowd out important interventions that have a direct impact on the poor in the country.

So, is it a subsidy?

Considering the current form of subsidy encourages the use of fossil fuels and has an adverse impact on the environment and government finances and is subject to issues in targeting, it is less of a subsidy for the poor and more of a burden for the citizens. The major beneficiaries of the subsidy are the rich oil-producing countries since there is artificial demand keeping the prices of oil high.

Against this perspective, while the prices of diesel, kerosene and LPG should be freed from government pricing to encourage better competition, cleaner technology and better government finances, targeted subsidies to the poor for kerosene and LPG can be continued to shield poor households. The government is taking steps in the right direction through announcements on direct transfer of subsidy for better targeting.

[2] Source: Report of the Kirit S. Parikh Committee 'The Expert Group on a viable and sustainable system of pricing of petroleum products', February 2010

Round the corner

News bytes

Conference on 'Fiscal Policy, Stabilisation, and Sustainability'

Jointly hosted by the European University Institute and IMF in Florence, Italy, 6—7 June 2011

The European University Institute (EUI), the International Monetary Fund (IMF) and the IMF Economic Review organised a conference on 'Fiscal Policy, Stabilisation, and Sustainability'. The conference provided a forum to discuss innovative research on fiscal policy issues and to facilitate the exchange of views among researchers and policymakers. The conference was hosted by the European University Institute in Florence, Italy on 6–7 June, 2011.

http://www.imf.org/external/np/seminars/eng/2010/eui/index.htm

RBI launches the 24th round of 'Inflation Expectations Survey of Households (IESH)'

Reserve Bank of India on 1 June 2011

The Reserve Bank of India launched the 24th round of the Inflation Expectations Survey with April-June 2011 as the reference period on 1 June, 2011. The Survey seeks qualitative responses from households on price changes (general prices and prices of specific product groups) in the next three months as well as in the next one year. Quantitative responses on current, three-month-ahead and one-year-ahead inflation rates are also surveyed. The Reserve Bank will use results of this survey as an important input to the monetary policy formulation. Inflation expectations are subjective assessments of around 4000 households across 12 cities and are based on households' individual consumption baskets. The Reserve Bank has been conducting IESH on a quarterly basis since September 2005.

http://www.rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=24491

ADB-IMF Panel urges Asia to build new engines of growth to offset weak global demand

Asian Development Bank on 6 May 2011

"Developing Asia must adapt its export-driven model and develop new engines of growth if the region is to sustain the robust economic expansion it has enjoyed in recent decades," Haruhiko Kuroda, president, Asian Development Bank (ADB), said during a seminar at ADB's 44th Annual Meeting, held jointly with the IMF in Hanoi, Vietnam. IMF Deputy Managing Director Naoyuki Shinohara added that Asia's extraordinary economic gains in recent decades stemmed largely from manufacturing exports to advanced economies. But the global economic crisis and slow growth in most G7 economies underscore the need for Asia to develop domestic markets and stimulate intra-regional trade. Growth in Asia should lead to the creation of enough private sector jobs to absorb the currently unemployed and a fast-growing labour force. It needs to promote equal access to economic opportunity for citizens to realise their potential and provide social protection for the vulnerable.

http://beta.adb.org/news/adb-imf-panel-urges-asia-build-new-engines-growth-offset-weak-global-demand

Conference on promoting fiscal sustainability through strengthening fiscal institutions and medium-term budget frameworks

Jointly hosted by IMF and NIPFP at India Habitat Centre, New Delhi, India on 21-22 April 2011

The IMF's Fiscal Affairs Department (FAD) and the Indian National Institute of Public Finance and Policy (NIPFP) hosted a joint conference on fiscal consolidation and the strengthening of budget institutions in South Asian countries. The main issues discussed were fiscal responsibility frameworks, fiscal councils and medium-term budget frameworks. The conference took place in New Delhi from 21-22 April, 2011. Apart from senior officials and policymakers from the central and state governments of India, representatives from Bangladesh, Sri Lanka, Nepal, Bhutan, Afghanistan and Maldives participated in the conference.

http://blog-pfm.imf.org/pfmblog/2011/05/conference-on-fiscal-consolidation-and-budget-institutions-in-south-asian-countries.html#more *and* ***http://www.nipfp.org.in/newweb/content/eve***

Conference on Revenue Mobilisation and Development

Hosted by IMF in Washington DC, 17-19 April, 2011

The core challenge for many developing countries is to improve their domestic revenue mobilisation to raise more, in ways that are more efficient, fairer and promote better governance. The conference marked the launch of two trust funds to support the fund's technical assistance in this area. The aim of this conference was to bring together leading policymakers and academics, business and civil society to improve decisions and advise, learning from successes and failures of the past and from the most recent academic advances.

http://www.imf.org/external/np/seminars/eng/2011/revenue/index.htm

Presentation videos are available at ***http://www.imf.org/external/mmedia/index.aspx***

Paper releases

'Measuring Fiscal Decentralisation- Exploring the IMF's Databases'

Working paper of IMF, June 2011

Authors: Claudia Dziobek, Carlos Gutierrez Mangas and Phebby Kufa

Conventional wisdom postulates that there are benefits from decentralising government finances but there is little empirical evidence about actual country practices. This paper presents data on fiscal decentralisation for about 80 countries over a 20-year period (1990-2008) from the IMF's Government Finance Statistics Yearbook (GFSY), the only global database with fiscal data for several levels of government. The data shows that in many countries, revenue collection remains relatively more centralised than expenditures and that employment tends to be concentrated in lower levels of government. Except for transition economies, the levels of decentralisation are relatively stable over this time period. The findings are shown by degree of economic development, constitutional power arrangements and geographic area, which have been identified as key factors determining the extent of fiscal decentralisation in the literature.

http://www.imf.org/external/pubs/ft/wp/2011/wp11126.pdf

'Reforming the Tax System to Promote Environmental Objectives: An Application to Mauritius'

Working paper of IMF, June 2011

Author: Ian WH Parry

Fiscal instruments are potentially among the most cost-effective options for addressing externalities related to poor air quality, urban road congestion and greenhouse gases. This paper takes a case study, based in Mauritius (a pioneer in the use of green taxes) to illustrate how existing taxes, especially on fuels and vehicles, can be reformed to better address these externalities. It discusses the following:

- An explicit carbon tax,
- A variety of options for reforming vehicle taxes to meet environmental, equity and revenue objectives
- Progressive transition to usage-based vehicle taxes to address congestion.

http://www.imf.org/external/pubs/ft/wp/2011/wp11124.pdf

'Assessing Fiscal Stress'

Working paper of IMF, May 2011

Authors: Emanuele Baldacci, Iva Petrova, Nazim Belhocine, Gabriela Dobrescu and Samah Mazraani

This paper develops a new index which provides early warning signals of fiscal sustainability problems for advanced and emerging economies. Unlike previous studies, the index assesses the determinants of fiscal stress periods, covering public debt default as well as near-default events. The fiscal stress index depends on a parsimonious set of fiscal indicators, aggregated using the approach proposed by Kaminsky, Lizondo and Reinhart (1998). The index is used to assess the build-up of fiscal stress over time since the mid- 1990s in advanced and emerging economies. Fiscal stress has increased recently to record high levels in advanced countries, reflecting raising solvency risks and financing needs. In emerging economies, risks are lower than in mature economies owing to more sound fiscal fundamentals. However, fiscal stress remains higher than before the crisis.

http://www.imf.org/external/pubs/ft/wp/2011/wp11100.pdf

Does donor support to public financial management reforms in developing countries work? An analytical study of quantitative cross-country evidence

Working paper of Overseas Development Institute, April 2011

Authors: Paolo de Renzio, Matt Andrews and Zac Mills

This paper is part of a broader evaluation of donor support to public financial management (PFM) reforms in developing countries. It brings together available quantitative evidence on the quality of PFM systems. It assesses the factors that are associated with a particular focus on the impact of donor support to PFM reforms. Findings show that economic factors are the most important in explaining differences in the quality of PFM systems. Aid-related factors on the other hand, have more limited explanatory power. As a consequence, PFM systems are more likely to improve in response to changing economic circumstances rather than to donor efforts. More specifically, countries with higher levels of per capita income, with larger populations and better recent economic growth records are characterised by better quality PFM systems. On the other hand, state fragility, defined as being in a conflict or post-conflict situation, has a negative effect on the quality of PFM systems. Evaluating the effectiveness of donor support to PFM reforms in developing countries is still largely unfinished business. While this study has used existing quantitative data to identify some preliminary trends and interesting associations, further work is needed. Qualitative case studies will complement and address the many shortcomings of quantitative analysis. Most notably, these will be the difficulties in explaining not only if and when donor PFM support has had an impact on PFM systems, but also why and how it has, taking into account the differences in the context of countries in which PFM reforms take place.

http://www.odi.org.uk/resources/download/5719.pdf

'Fiscal Decentralisation in Asia: Challenges and Opportunities'

Report by Asian Development Bank, April 2011

Author: Jorge Martinez-Vasquez

As has happened in other countries around the world, the roles and expectations for sub-national governments have increased substantially in most Asian countries since the 1990s. Although decentralisation reform has been an evolving process, this process has not been linear, and it has often been subject to moves toward recentralisation. For example, in 2009 Pakistan dissolved local governments and elected mayors, replacing them with appointed officials. This publication discusses the decentralisation issues faced by countries of Asia and the Pacific. It includes practical suggestions on how to proceed in this area to achieve economic growth, macroeconomic stability, poverty and income distribution, services delivery improvements, and political accountability. This note elaborates on adequacy of local revenues and autonomy, expenditure management and clear service delivery mandates. It identifies horizontal imbalances and limited use of incentives in inter-governmental transfers, financing needs and local government borrowing and local management capacities as the major challenges in a decentralized fiscal architecture. The recommendations to address the above challenges also note the long- term nature of these reforms.

http://www.adb.org/documents/reports/fiscal-decentralization/fiscal-decentralization.pdf

PwC updates

Know our work

PwC is engaged on a Fiscal Management Efficiency Project (FMEP) for the government of Sri Lanka. The aim is to implement fiscal reforms for achieving wider economic benefits, improve revenues and put in place effective controls and monitoring measures concerning government revenues and expenditure.

PwC had earlier assisted the government in the first level of reforms through the Fiscal Management Reforms Programme (FMRP) wherein specific policy, systems and structural improvements for effective financial management in the country were identified. The ministry has been working towards its implementation.

Post FMRP, the Ministry of Finance and Planning (MoFP), government of Sri Lanka initiated FMEP with a goal to strengthen the public financial management and tax administration in the country. They aimed to achieve this by enabling an environment to foster mobilisation of greater tax revenues, improve effectiveness of public expenditures and ultimately place public finances on a sustainable path through the expansion of fiscal space.

Adoption of Information and Communication Technologies (ICT) for improving the efficiency and effectiveness of public financial management and tax administration in the country is among the key focus areas under FMEP. It has three key components:

- The implementation of Revenue Administration Management Information System (RAMIS) for Inland Revenue Department (IRD) for the automation of functions and services surrounding tax administration in the country
- The implementation of Integrated Treasury Management Information System (ITMIS) for the automation of the entire lifecycle of public financial management in the country including budgeting, revenue and expenditure management, debt management, auditing and accounting of public revenue and expenditure of all government agencies
- Capacity-building and training government employees in relevant areas to strengthen the public administration and service delivery

As part of the engagement, some of the specific analyses undertaken by PwC for MoFP were as follows:

Pre-implementation phase:

- Identification of process improvement opportunities related to treasuries, financial management and tax administration
- Finalisation of requirements for ITMIS and RAMIS implementation
- Preparation of functional, technical architecture and requirements specifications
- Recommendations on implementations approach and planning
- Support for MoFP in preparation of bidding documents for selection of implementation partners
- Support in evaluation of bids and vendor selection

Implementation phase:

- Quality assurance for ITMIS and RAMIS implementation and deliverables
- Programme management support
- Risk and issue management
- Support in change management, etc.

Know our people

Chaithanya Chava
Senior Manager,
Public Finance, GRID

Profile at a glance

Age:
33 years

Designation:
Senior Manager, Public Finance, GRID

Professional experience:
More than 12 years

Worked in:
India, USA, Australia, Tanzania, Mauritius, Indonesia, Sri Lanka, Nepal

Chaithanya is a Senior Manager with the public finance team of the Government Reforms and Infrastructure Development (GRID) group at PwC India. With over 12 years of experience, Chaithanya has spent significant time in providing strategy, performance improvement and IT advisory services for government and public sector clients across central, state and local government levels in India and other countries. He has been associated with engagements in various countries including India, USA, Australia, Tanzania, Mauritius, Indonesia, Sri Lanka, Nepal. He has rich experience in working with development agencies such as Asian Development Bank and World Bank.

His key expertise is in providing advisory services in the modernisation of government administration and service delivery with specific emphasis on using ICT. He has participated and led government service delivery modernisation engagements, in the following areas:

- Vision and strategy development
- Business process reengineering
- Requirements definition and procurement support
- Project and programme management, people change management and capacity-building.

He has in-depth skills and domain understanding in tax administration, public procurement and government treasuries and financial management and has led several engagements in these spheres successfully.

He is currently leading engagements such as supporting the Ministry of Finance and Planning (MoFP), government of Sri Lanka in modernisation of government financial management and tax administration in the country (funded by Asian Development Bank) and providing regional technical assistance to Asian Development Bank. As internal project manager for PwC, he has helped identify strategic intervention areas for ADB in Central Asia in domains such as public financial management, public procurement, e-governance, etc.

Prior to these engagements, Chaithanya led and played a crucial role in public procurement modernisation and e-procurement initiatives for the governments of India, Mauritius, Tanzania, Nepal, the modernisation of tax administration in Andhra Pradesh, Orissa, ministry of urban development, government of India, etc. He also led the capacity-building programme design for the National E-Governance Plan (NeGP) from PwC India, which involved the following:

- Identifying training programmes for building capacities across central, state and local government agencies in conceptualisation, design, implementation and management of e-governance projects.
- Defining scope of these training programmes, developing training content and creating evaluation tools for measuring the effectiveness of the training programmes.

Chaithanya is also a regular speaker at e-governance capacity-building programmes conducted for various state governments in India. He has delivered similar lectures in Mauritius and Brunei.

About us

The public finance practice of Government Reforms and Infrastructure Development (GRID) SBU of PwC in India has been closely working with clients in the public sector and at all levels of the government as well as key donors such as DfID, JBIC, World Bank and ADB.

A large team of full-time dedicated professionals and associates provide services in areas that include public expenditure management, revenue administration, budgetary policy development, financial restructuring, performance improvement, institutional strengthening and capacity-building, accounting and financial management systems and human resource development.

PwC has been providing advisory services to governments, multilateral and private sector clients in the area of public finance. The work has broadly included budget reform, revenue augmentation strategies, automation or computerisation and debt management. Most of these projects included training and capacity-building of government counterparts working with the public finance team on specific modules. In addition, the team has gained a lot of traction in the Public Expenditure and Financial Accountability (PEFA)/Fiduciary Risk Assessment (FRA) areas with many assignments across South Asia.

Workshop on Revenue Administration Management Information System for the Ministry of Finance and Planning (MoFP) and Inland Revenue Department (IRD) officials, government of Sri Lanka

About PwC

PwC firms provide industry-focused assurance, tax and advisory services to enhance value for their clients. More than 161,000 people in 154 countries in firms across the PwC network share their thinking, experience and solutions to develop fresh perspectives and practical advice. See pwc.com for more information.

In India, PwC (www.pwc.com/India) offers a comprehensive portfolio of Advisory and Tax & Regulatory services; each, in turn, presents a basket of finely defined deliverables. Network firms of PwC in India also provide services in Assurance as per the relevant rules and regulations in India.

Complementing our depth of industry expertise and breadth of skills is our sound knowledge of the local business environment in India. We are committed to working with our clients in India and beyond to deliver the solutions that help them take on the challenges of the ever-changing business environment.

PwC has offices in Ahmedabad, Bangalore, Bhubaneshwar, Chennai, Delhi NCR, Hyderabad, Kolkata, Mumbai and Pune.

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NJ 214 September 2011 PF Newsletter.indd
Designed by: PwC Brand & Communications, India