GOVERNMENT OF GRENADA

Fiscal Risk Statement

Submitted To

The Parliament

By

The Minister of Finance, Planning, Economic & Physical Development

November 2019

PURPOSE

This Fiscal Risk Statement is being prepared in fulfilment of Section 12 (1) (e) of the Fiscal Responsibility Law No. 29 of 2015, as amended (FRL), which stipulates that:

> "*The Minister of Finance shall prepare and submit to Parliament, with the annual Budget Bill, a fiscal risk statement that shall reflect all decisions by Cabinet and the Minister and circumstances that may have a material effect on the economic and fiscal outlook. This statement must contain the following information:*
>
> *i.* *the sensitivity of economic and fiscal forecasts to changes in the economic outlook and economic shocks;*
>
> *ii.* *the exposure of the Government to contingent liabilities, including guarantees and obligations arising from judicial proceedings in progress;*
>
> *iii.* *fiscal risks arising from the financial sector, statutory bodies, state-owned enterprises, public-private partnerships, and any other institutions;*
>
> *iv.* *any commitment unaccounted for in the economic and fiscal forecasts;*
>
> *v.* *any other circumstance that may have a material effect on the economic and fiscal forecasts and is unaccounted for in the economic and fiscal forecasts; and*
>
> *vi.* *any measures implemented by Cabinet, or the Minister, to manage fiscal risks."*

INTRODUCTION

This Fiscal Risk Statement outlines the Government's assessment of key risks that can affect the achievement of its development priorities in the short-to-medium term. The categories of risks discussed are: (i) Macroeconomic Risks; (ii) Budget Risks; (iii) Public Enterprises Risks; and Climate Risks.

Macroeconomic Risks

As indicated by the International Monetary Fund in its World Economic Outlook Report released in October 2019, global risks are tilted to the downside over the medium-term. The projected softening in global economic activity particularly in the economies of Grenada's main trading partners, can negatively affect tourist arrivals, remittances, and foreign direct investments. Uncertainties regarding Brexit outcomes also pose downside risks to Grenada; depending on the outcome, trade in both goods and services to/from the UK can be negatively impacted. Geo-political uncertainties portend volatile international fuel prices, which also pose a downside risk.

Table 1 presents the main baseline economic assumptions underpinning the Medium-Term Fiscal Framework (2020-2022); and of which shock scenarios are analysed.

Table 1: Baseline Macroeconomic Assumptions

	2020	2021	2022
Real GDP (%)	4.2	3.6	3.4
Total Revenue (% of GDP)	22.6	22.6	22.6
Total Expenditure (% of GDP)	24.7	22.7	20.5
Overall Fiscal Balance (after grants) (% of GDP)	4.2	4.6	5.8
Primary Balance (after grants) (% of GDP)	6.1	6.3	7.4
Public Debt (% of GDP)	53.7	52.2	50.6

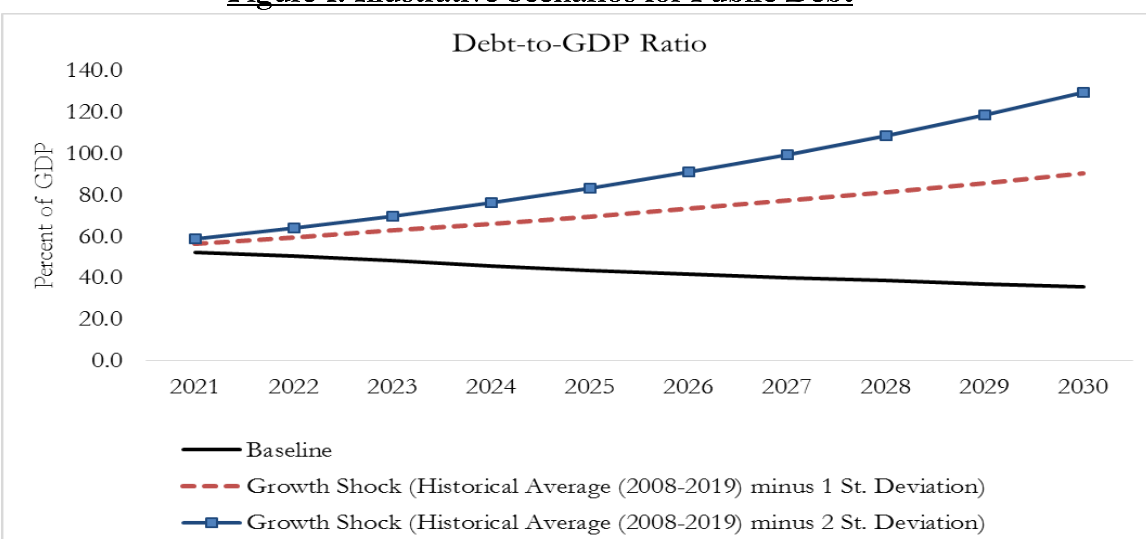
Source: Ministry of Finance

Macroeconomic Shocks:

GDP Shock

Figure 1 shows how vulnerable the baseline debt-to-GDP ratio is to two illustrative stylised shocks. The first assumes a negative shock to tourist arrivals that occurs in 2020 resulting in a decline in GDP equivalent to its 10-year historical average (2008-2019) minus one standard deviation. Under this illustrative scenario, the ratio of public debt-to-GDP increases to 56.6 percent in 2021, which is above the FRL's target and 4.4 percentage points higher than the baseline projection in 2021. The debt dynamics worsen over time, with the ratio increasing to 90.4 percent in 2030, well above the baseline projection of 35.7 percent. Under a more extreme shock of an assumed natural disaster occurring in 2020 causing a contraction in GDP equivalent to its historical 10-year average minus two standard deviation, the ratio of public debt-to-GDP increases to 58.6 percent in 2021, 6.5 percentage points above the baseline projection. By 2030, public debt as a ratio of GDP expands to 129.6 percent, almost four times the baseline projection. These vulnerabilities necessitate that the Government continues to accord high priority to entrenching fiscal and debt sustainability and building resilience to economic, environmental, and other shocks. The Government will also continue to strengthen its debt management operations and systems.

Figure 1: Illustrative Scenarios for Public Debt



Source: Ministry of Finance

Budget Risks

The execution of the capital budget carries fiscal risks. On the one hand, challenges with project implementation, such as weak assumptions about project execution, lack of readiness to implement projects, administrative bottlenecks, and cash flow management issues result in delays in the Public Sector Investment Programme, which pose downside risks to economic growth and revenue collection. On the other hand, cost overruns on projects that result in expenditure re-allocations put a strain on the Budget. The Government will continue to strengthen the public investment management systems to improve the execution of its capital budget.

Expectations about external receipts also pose downside fiscal risks. The fiscal outlook can be negatively affected should the anticipated inflows to the National Transformation Fund (NTF), as well as external grants from development partners not be as strong as anticipated over the short to- medium term.

Furthermore, pension reform, as well as the implementation of the National Health Insurance, if not carried out in a phased and fiscally–prudent and sustainable manner, can also pose significant fiscal risks. Therefore, the groundwork for these two initiatives is being carefully executed in a manner that supports fiscal sustainability. Cost estimates for the two initiatives have not been completed, and as such, assessment of fiscal implications can only be qualitative at this stage.

Public Enterprises Risks

The key fiscal risks that arise from SOEs are summarised as follows:

- *Large-scale future capital commitments* - Some SOEs have significant future capital expenditure plans, the funding for which in some cases, is beyond the financial capacity of the entities concerned. This gives rise to potential fiscal risks for Government, either through direct funding or guaranteed lending.

- *Commercial risks* - Some SOEs have a large fixed-cost base and are leveraged to the success of their commercial operations. Negative external shocks could have a significant impact on the viability of these enterprises.

- *Unfunded liabilities* - There are unfunded pension liabilities in some of the SOEs, which may require funding assistance from the Central Government. However, the organizations where these exist are taking steps to create funds to meet these future obligations. This was a mandate given in the Letter of Expectations issued in 2015.

- *Guaranteed debts* **-** Where Government provides explicit or de facto guarantees of debts, this provides a potential cause of short/medium-term calls on the budget where SOEs cannot service these debts.

- *Insufficient subvention funding / unfunded mandates* **-** Where SOEs fail to remain within their funding constraints, either through deliberate action or because of obligations imposed on them, the shortfall will ultimately fall on Central Government.

Governance Arrangements

The current quarterly reporting mechanism seeks to reduce these risks as Government is better able to monitor the operations of SOEs. As the monitoring system improves, The slowdown to quantify and provision for contingent liabilities arising from SOEs. Additionally, stricter enforcement with regards to the requirement to provide audited financial statements is being implemented. However, limited auditing servicing and, in some cases, lack of capacity in some statutory bodies have delayed the preparation of audited financials. Therefore, unaudited reports are currently being used to quantify fiscal risks.

Illustrative calculations of estimated loss arising from Statutory Bodies and State-Owned Enterprises show that in 2020, contingent liabilities amounting to $120.8 million or 3.5 percent of GDP. If these liabilities were ever to be realized the financial obligations will be that of the Central Government, hence the reason for the Government's continued focus on monitoring fiscal risk of SOEs.

Climate Risks

Grenada's vulnerability to natural disasters is an inherent risk; adverse effects of climate change negatively affect infrastructure, tourism, and agriculture in particular. Building resilience to climate change remains a pressing development priority. The Contingency Fund stipulated in Section 11 of the National Transformation Fund Regulations as amended in 2019 (approved by Parliament in October 2019), will become operational in 2020. The accumulation of the Fund over time will provide a buffer to cushion the effects of climate and economic shocks. Additionally, a Line of Credit has been approved by the World Bank, for which the drawdown trigger is an unforeseen natural event.

Furthermore, coverage by CCRIF also adds to the Government's risk-layering approach to disaster rehabilitation financing.

Other Potential Sources of Risks:

Financial Sector

The outlook for the financial sector is to remain stable and sound. Grenada's banking sector has not been significantly affected by Corresponding Banking challenges and based on the AML/CTF measures in place, it is not envisaged that Corresponding Banking Relationship (CBR) issues will become a challenge for banks in Grenada. In 2019, the ECCB approved the transfer of the assets and liabilities of the Bank of Nova Scotia (BNS) to Republic Financial Holding Limited (RBFHL) in eight ECCU countries (including Grenada). Though the sale of BNS to RBFHL heightens concentration risks, on balance, the impact on financial sector stability is not considered to be adverse, and as such, not a source of economic/fiscal risk, at least in the short term. However, enhanced financial sector surveillance would be required given that one financial institution would have become systematically important.

Public-Private Partnerships

With respect to Public-Private Partnerships (PPPs), there was only one such existing arrangement in place in 2019. In 2018, the Government entered into a 15-year PPP agreement with Digicel. The PPP agreement is part of the Caribbean Regional Communication Program, which is a World Bank-funded regional project between the Governments of Grenada, St. Lucia and St. Vincent and the Grenadines and Digicel to support the countries' digital transformation agenda. Grenada's contribution to the regional projects is a current liability (i.e. concessional loan financed) and as such, there are no explicit related contingent liabilities associated with the PPP arrangement.

Table 2 provides a Risk Summary.

Table 2: Risk Assessment Summary

Risk Description	Source of Risk	Risk Rating	Measures to Manage/Mitigate Risks
Macroeconomic	• A slowdown of global economic growth. • Geo-political uncertainties. • Brexit uncertainties.		Continue to implement structural reforms to diversify the economy with the aim of boosting economic resilience. Contingency Fund will be operationalized in 2020, which will provide financial resources to facilitate counter-cyclical fiscal policy in the event of an economic recession or crisis.
Budget	Lower-than expected external inflows and Grants.		Continue to strengthen expenditure management and revenue administration, as well as improve prioritisation of the Public Sector Investment Programme.
	Capacity and institutional constraints affecting project implementation.		Continue to strengthen the Public investment management system to improve the execution of its capital budget. Continuous capacity building in project management and greater coordination among implementing ministries should help mitigate this risk.
	The cost associated with pension reform and NHI.		The respective ongoing processes are being guided by the parameters of the FRL to be consistent with preserving fiscal sustainability.
Public Enterprises	Fiscal risks from SOEs		Ensure that up-to-date audited financial statements are submitted in a timely manner and closely monitor management performance within the SOEs to ensure that they pursue their respective stipulated mandates in the most cost-efficient and cost-effective manner.
Climate	Adverse effects of climate change		A comprehensive disaster risk financing strategy has been developed that includes: a Contingency Fund; a Line of Credit (approved by the World Bank in 2019) for which the drawdown trigger is an unforeseen natural event; and CCRIF.

Key	
	High Risk
	Medium Risk