Fiscal Risk Statement 2019

Ministry of Finance, Trade, Investment & Economic Planning
November 2018

This document provides an overview of the major fiscal risks facing the Budget for 2019. The Fiscal Risk Statement (FRS) comments on general economic risks and uncertainties, specific fiscal risks related to Budget execution, and presents a risk framework for public enterprises. Combined, this allows for the disclosure of risks to public finances and appreciation of context within which the Government operates. The FRS is compiled and prepared by the Ministry of Finance, Trade, Investment & Economic Planning, with input from the Public Enterprise Monitoring Commission.

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Acronyms and abbreviations

List of acronyms

AFD	Agence Française de Development
AFS	Annual Financial Statements
BADEA	Arab Bank for Economic Development in Africa
CBS	Central Bank of Seychelles
EIB	European Investment Bank
FDI	Foreign Direct Investment
FPCD	Financial Planning and Control Division
GDP	Gross Domestic Product
GDP	Gross Domestic Product
IFRS	International Financial Reporting Standard
IMF	International Monetary Fund
MEECC	Ministry of Environment, Energy and Climate Change
MFAD	Macroeconomic Forecasting and Analysis Division
MHLILT	Ministry of Habitat, Lands, Infrastructure, and Land Transport
MoFTIEP	Ministry of Finance, Trade, Investment and Economic Planning
MTCAPM	Ministry for Tourism , Civil Aviation, Ports and Marine
NBS	National Bureau of Statistics
NISA	National Information Services Agency
PE	Public Enterprise
PEMC	Public Enterprise Monitoring Commission
PFM	Public Finance Management
PIM	Public Investment Management
PPBB	Performance Program Based Budgeting
PSIP	Public Sector Investment Program
QFA	Quasi-Fiscal Activity
ROA	Return on Assets
ROCE	Return on Capital Employed
ROE	Return on Equity
SCI	Statement of Corporate Intent
SRC	Seychelles Revenue Commission

List of Public Enterprises

AS	Air Seychelles Limited
BDRI	Bois de Rose Investment Limited
DBS	Development Bank of Seychelles
FSA	Financial Services Authority
GICC	Green Island Construction Company Limited
GOIC	Green Oak Investment Company Limited
GTIC	Green Tree Investment Company Limited
HFC	Housing Finance Company Limited
IDC	Islands Development Company Limited
L'UE	L'Union Estate Limited
NISA	National Information Services Agency
PS	Petro Seychelles Limited
PDEE	Paradis des Enfants Entertainment Limited
PMC	Property Management Corporation
PUC	Public Utilities Corporation
SCB	Seychelles Commercial Bank
SCAA	Seychelles Civil Aviation Authority
SEYPEC	Seychelles Petroleum Company Limited
SIMBC	Seychelles International Mercantile Banking Corporation Limited
SPA	Seychelles Ports Authority
SPF	Seychelles Pension Fund
SPTC	Seychelles Public Transport Corporation
SPS	Seychelles Postal Services Limited
SSI	Société Seychelloise d'Investissement Limited
SPTC	Seychelles Public Transport Corporation
2020 DC	2020 Development (Seychelles) Limited

1. Introduction

The main objective of the Government over the medium term is to reduce public debt to 50 per cent of GDP by 2021 and ensuring the sustainability of public finances. This document is aimed at identifying macroeconomic and specific Budget risks, as well as that related to Public Enterprises (PEs), all of which can affect the achievement of these objectives with varying impact.

Given the exposures faced by Seychelles and the inherent external vulnerabilities associated with a small, open island economy, macroeconomic risks are seen to be the major source of risk over the medium term. The uncertainty of the global economic landscape and fast changing international developments pose a threat to the Seychelles given the heavy reliance on tourism and imports. To the extent that unanticipated changes in economic conditions occur, their impact will flow through to Government expense and revenue forecasts. Government will have to: either reduce its planned expenditures, limited in scope; undertake additional financing and so increasing the debt stock; or not honour its debt obligations, resulting in crisis.

The risk framework presented in Table 1 below is has four broad categories related to the macroeconomic situation, Budget spending, Public enterprise operations and mitigation strategies. It must be said that, although these categories are clearly defined, fiscal risks are correlated and inter-dependent, with one particular risk, affecting more than one category (especially the case for macroeconomic risks). For example, an increase in fuel price will affect both Government excise tax revenue, assuming a partial demand effect, and dividend from PEs heavily reliant on fuel.

Table 1. Budget Fiscal Risk Framework

Risk Category	Major issues considered
Macroeconomic risks	Shock scenario analysis to evaluate impact of macroeconomic variables on GDP growth, Budget aggregates and Debt target
Budget spending risks	Additional spending pressures as a result of capital project cost overruns Impact of natural disasters on contingency reserves
Public Enterprise risks	Identified risk parameters affecting all Public enterprises
Fiscal Risk Mitigation	Key measures that can be taken to offset the impact of such fiscal risks

2. Macroeconomic Risks

Macroeconomic developments can cause fiscal outcomes to deviate from projections for key macroeconomic variables such as Real GDP growth, oil price, interest rates, exchange rates and commodity prices and are consequently a source of fiscal risk. In this section, we will consider three main macroeconomic risks and have simulated possible impacts through shock scenarios; shocks on inflation and exchange rate, which has a direct effect on the nominal GDP, and shocks on Tourism, which directly affect real GDP.

The budgetary impact of each of the scenarios will also be presented. Based on the identified risks, three scenarios of macroeconomic developments are elaborated: baseline, upside and downside. The Budget is prepared on the baseline scenario, which is the expected outcome incorporating assumptions and judgments based on the best information available at the time of publication. In the latter part of this section, the risks from National accounts GDP rebasing will also be discussed.

2.1 Macroeconomic Assumptions

The below table presents the main macroeconomic assumptions underpinning the Budget estimates and of which all shock scenarios are based upon.

Table 2. Macroeconomic assumptions 2014 to 2022

	Actuals		*Estimates*		*Projections*			
	2015	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**
Nominal GDP (SR' m)	18,340	19,014	20,444	21,905	23,578	25,055	26,761	28,339
Real GDP growth	4.9	4.5	5.3	3.6	3.4	3.3	4.1	4
GDP deflator growth	2.1	-0.8	2.1	3.4	4.1	2.9	2.6	2.5
CPI (annual average)	4	-1	2.9	3.9	4.4	2.8	2.9	2.9
SR/€ (average)	14.76	14.76	15.77	16.89	17.25	17.52	17.66	17.88
SR/US$ (average)	13.32	13.32	13.65	13.92	14.15	14.33	14.47	14.67

Source: Macroeconomic Framework Working Group

2.2 Macroeconomic Shock Scenarios

Exchange Rate Shocks

Nominal GDP refers to the monetary value of all the finished goods and services produced within a country's borders in a specific time period evaluated at current market prices. Nominal differs from real GDP in that it includes changes in prices due to inflation, a rise in the overall price level. It is thus very sensitive to the rate of inflation. Inflation itself is affected by several factors mainly changes in oil prices and commodity prices.

Since the country is highly dependent on imports and revenue inflows, fluctuations in the exchange rate also poses a risk to the Nominal GDP. The risks of exchange rate volatility is augmented given the current freely floating regime, which allows the currency to appreciate or depreciate dependent on market forces.

Sensitivity Analysis

In what follows, a combined effect of unanticipated changes in the estimated inflation rate and fluctuations in both the SR/EUR (affecting earnings) and SR/USD rate (affecting imports) on Nominal GDP is presented. For the purpose of this exercise, 200, 100 and 50 per cent shocks on inflation will be simulated, while for exchange rates, 5, 15 and 25 per cent shocks are considered. In all scenarios, shocks will be both positive and negative. The Exchange rate effect is depicted in Figure 1 and the Nominal and the budgetary effect of these deviations from baseline is portrayed in Figure 2.

On the downside, it is estimated that a,

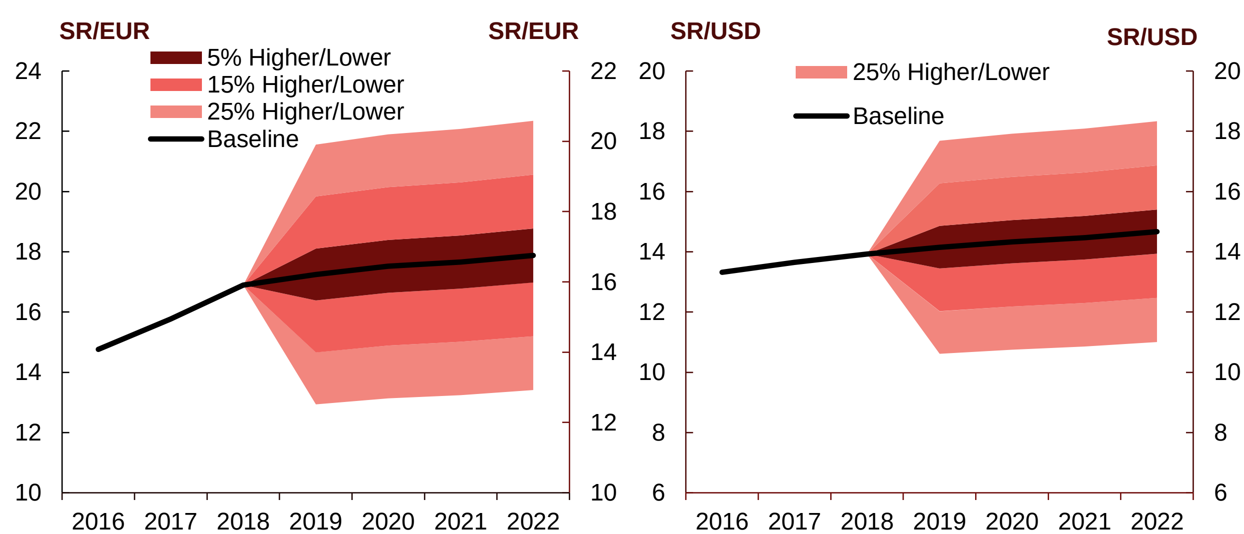
- 25 per cent depreciation in both SR/USD and SR/EUR rate, combined with,
- a 200 per cent fall in the inflation rate,

will result into a SR 1,246m, or 4 per cent, fall in nominal GDP level in 2019.

Given the sensitivity of revenue to nominal GDP (a buoyancy of about 'one' for the majority of taxes), it is estimated that the combined negative shocks will translate into a SR 280m, or 3.9 per cent, reduction in Government tax revenue collection. This would be equivalent to 1 per cent of GDP impact. The negative effect will also impact on Non-tax revenue especially in terms of dividend receipts from PEs, which can be hard to quantify and so not included in this simulation.

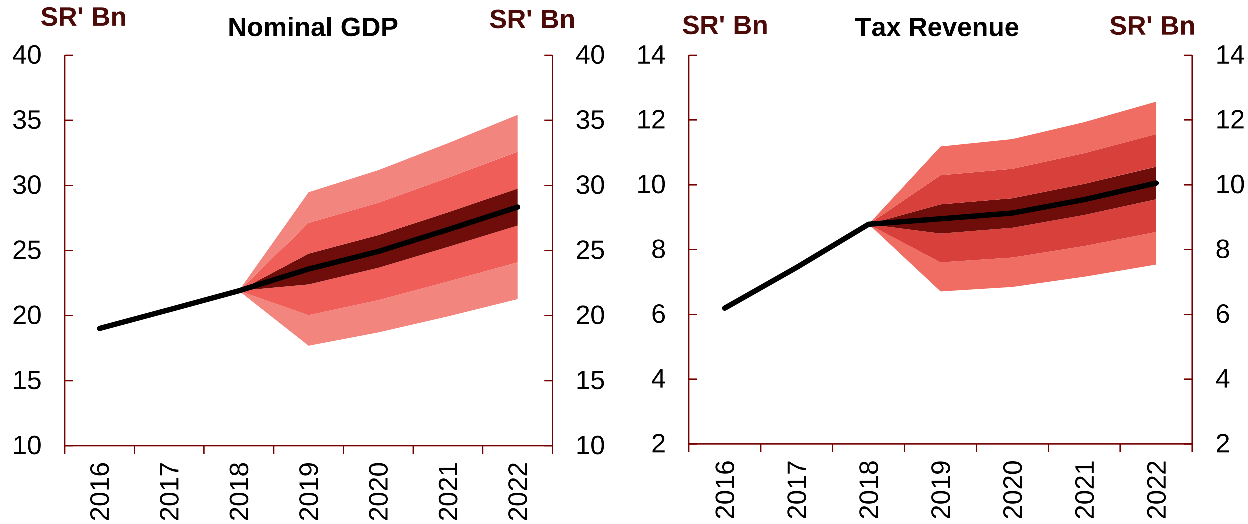
The inverse scenario is also considered for the positive shock. The simulation is estimated to lead to SR 1,457m increase in nominal GDP. Nominal GDP growth will increase from 7.6 per cent to 14.3 per cent. This will be translated into a SR 280m increase in Government revenue plus additional revenue from Non-tax revenue.

Figure 1: Shocks scenario on Exchange rates and Inflation



Source: MFTIEP, Macroeconomic Forecasting and Analysis Division Estimates

Figure 2: Effect of Exchange rate shocks on Nominal GDP and Tax Revenue



Source: MFTIEP, Macroeconomic Forecasting and Analysis Division Estimates

<u>Shocks on Tourism arrivals to Real GDP Growth</u>

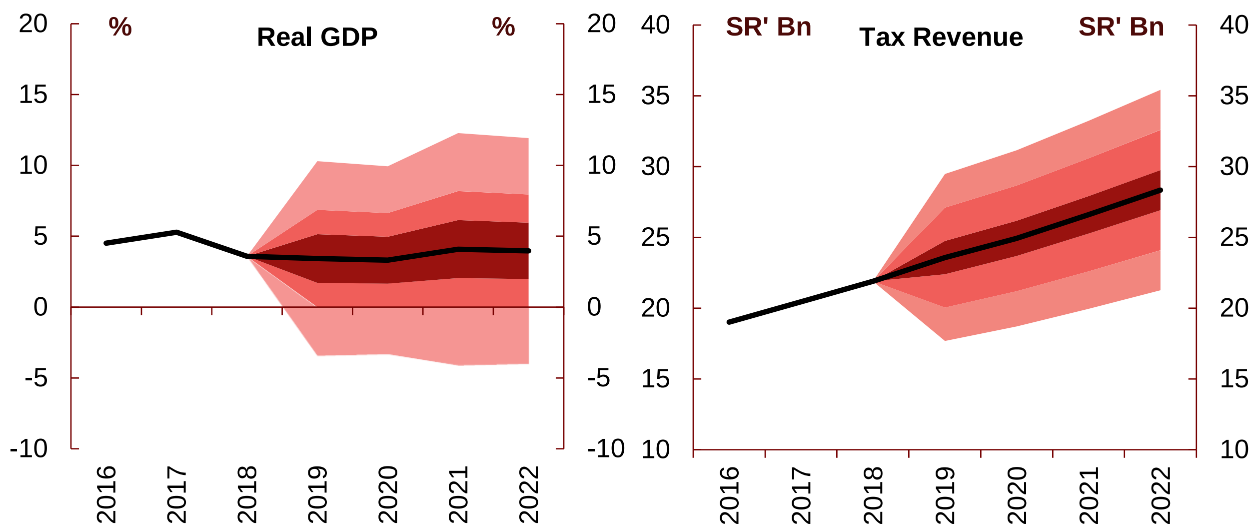
In this section we shall look at shocks to real GDP growth. Real GDP growth is affected directly by activities in the economy. Tourism remains the main activity in Seychelles economy, contributing to around 30 per cent of GDP. Any changes in visitor arrivals and average length of stay will have a direct impact on real GDP growth. The effect on revenue will, however, be lower as compared to the nominal GDP since only a few tax lines grow in line with real GDP. These are related to some specific taxes on imports.

Sensitivity Analysis

On the downside, we consider a 200 per cent fall in Real GDP growth as a result of an extreme shock on tourism arrivals. This is to say, instead of the forecasted 3.4 per cent growth in real GDP, the country faces a 3.4 per cent contraction in 2018 (or a growth of -3.4 per cent).

The negative growth is estimated to lead to SR 506m fall in tax revenue, or 6 per cent fall. This accounts for about 2.1 per cent of GDP and will almost cancel out the surplus target of 2.5 per cent over the medium term. The reverse scenario is observed if real GDP growth was 10.2 per cent instead of the 3.3 per cent baseline. The 200 per cent, 100 per cent and 50 per cent deviations from baseline on real GDP, both positive and negative, and the revenue are depicted in the charts below.

Figure 3: Effect of Tourism shocks on Real GDP and Tax Revenue



Source: MFTIEP, Macroeconomic Forecasting and Analysis Division Estimates

Apart from the direct impact on GDP, shocks in exchange rate and inflation will have an impact on the **Debt Management**. The current Fiscal target of the country is to attain a 50 per cent debt-to-GDP ratio by 2021. Changes in exchange rate will affect the country's external debt repayment. Likewise, any changes to the nominal GDP will affect the ratio thus jeopardizing the country's fiscal target.

*In this very first Fiscal Risk Statement for Seychelles, Debt shocks were not considered specifically given certain constraints and given that these are presented in the **Debt Strategy 2019 to 2021** attached with the Budget*.

2.3 GDP Rebasing

Given the importance of having up-to-date data, rebasing the GDP is a step in the right direction. With this, planning and investment decisions will be more robust and informed and better reflect the current economic situation. NBS will soon be conducting an exercise towards rebasing the GDP, currently set at 2006 prices. This represents a potential risk to the Budget.

When looking at other country's recent experience who has undertaken this exercise, there is potential upside risk to GDP rebasing. In Nigeria, the revision increased the GDP by 90 per cent, whereas in Ghana there was a 60 per cent increase to the GDP number. The impact of an increase in the Nominal GDP will have a positive effect on the debt-to-GDP ratio and could allow the 50 per cent target to be reached even before 2021 given the base effect on the denominator.

3. Other Budget Risks

Capital projects

Capital Budget execution is one of the areas of risk on Budget. Government has seen a number of projects over the years with significant cost overruns which puts a strain on the current Budget. Cost overruns on a project also means that the respective implementing agency have to re-allocate funds from other projects. The Budget for Capital expenditure in 2019 is SR 885m, equivalent to about 4 per cent of GDP. A 10 per cent increase in this outlay, as a result of cost overruns amounts to about 0.4 per cent of GDP and so will lower the primary balance target in GDP terms from 2.5 to 2.1 per cent.

Another challenge faced with regards to capital project is delays in project implementation largely due to human resource capacity and delays in procurement process. This distort the outer year's Budget where re-allocation is needed to cater for funds for the delayed project. Delays in public infrastructure investment also remains poses a downside risk to economic growth.

The Government will continue to strengthen the Public investment management system to address delays in project execution and cost overruns.

Risks Due to Uncertainty of Foreign Aid

Expectations about foreign aid poses another source of risk to the Budget. Foreign aid, which comes in the form of grants, is estimated to be around 0.9 per cent of GDP for the 2019 Budget and is assumed to remain constant over the medium term. Any international threat, such as financial crisis, may affect revenues of our donor countries and thus affect their ability to give foreign aid. Furthermore, as Seychelles has been re-classified to a high-income country from upper-middle income, this could have a negative impact on the aid given. However, these may be countered by Seychelles presence on the international scene as a proponent for Small Island Developing States requiring funds for sustainable environmental projects.

Natural disasters

Natural disasters can have a significant impact on the Budget. Whilst a contingency fund is in place to cater for such unforeseen events, it might not be enough depending on the magnitude of the disaster. The current Contingency fund for the 2019 is set at SR 50m, more than double the amount of 2017.

4. Public Enterprise Risks

Public enterprises can be a major source of fiscal risk to public finances if they do not perform well financially. The fiscal risk analysis identifies, quantifies and discloses the fiscal risk exposure of the Government of Seychelles (GOS) arising from the Public Enterprises (PEs). Given the size of the PE sector as part of the economy, it is important to monitor PEs to ensure they are performing well financially and are sustainable.

Fiscal risks arise from a variety of sources, which affect the financial and fiscal performance of the PEs. A PE operating inefficiently could see its financial returns decline, its debt increase and its solvency could be at risk. This may result in lower financial returns from SOEs and additional fiscal costs to the Budget and an unsustainable level of debt for that PE.

There are substantial fiscal risks emanating from the PEs in Seychelles. The key fiscal risks in Seychelles includes:

1. **Macroeconomic shocks** for instance, the fluctuations in commodity prices particularly for oil, interest and exchange rates, real estate prices and tourism growth rates.

2. Fiscal risks emanating from other **expenditure and revenue developments** for example higher increases in salaries or in QFAs or lower sales of PEs which reduces the net profit or increases losses.

3. **Contingent liabilities** of which the Government either have legal or no legal obligations to intervene in cases where PE faces liquidity problems.

4. **Arrears**, whereby debts continue to accumulate, become uncollectible, are written off, resulting in profitability and liquidity problems.

5. **Deficiencies in the institutional framework** such as the significant non-compliance of PEs to the PEMC Act and other governing legislations.

4.1 PE Macroeconomic risks

As highlighted in the previous sections, macroeconomic developments can cause fiscal outcomes to deviate from projections for key macroeconomic variables such as oil price, interest rates, exchange rates and commodity prices and are consequently a major source of fiscal risk for PEs. Macroeconomic developments can impact the financial performance of PEs which would have a consequence on Government finances, such as the amount of taxes or dividends being paid into the Budget.

The risk matrix below shows the vulnerability of each PE to different types macroeconomic risks. Some macroeconomic risks would have a substantial impact on all PEs, such as inflation, whereas other macroeconomic risks are more specific to the sector in which the PEs operate, such as oil price risk. The matrix also indicates that all PEs are vulnerable to at least one type of macroeconomic risk.

Table 3: Risk Matrix illustrating the Macroeconomic Risks of PEs

	Risk Parameters							
PE	Oil price	Other commodity prices	Exchange rate	Interest rate	Credit availability	Tourism	Housing prices	Inflation
AS	x	x	x	x	x	x		x
BDRI		x		x	x			x
DBS		x	x	x	x	x	x	x
FSA		x	x	x	x			x
GICC	x	x	x	x	x		x	x
GOIC	x	x		x	x		x	x
GTIC	x	x		x	x		x	x
HFC		x		x	x		x	x
IDC	x	x	x	x	x	x	x	x
l'UE	x	x	x			x		x
NISA	x	x		x	x			x
PS	x		x	x				x
PDEE								x
PMC				x	x		x	x
PUC	x	x	x	x	x	x		x
SCB			x	x	x	x	x	x
SCAA	x	x	x	x	x	x		x
SEYPEC	x		x	x	x	x		x
SIMBC			x	x	x	x	x	x
SPA	x		x			x		x
SPF			x	x			x	x
SPTC	x		x	x				x
SPS	x		x					x
SSI	x	x	x	x	x			x
SPTC	x	x	x	x	x			x
2020 DC		x	x	x	x		x	x

Source: PEMC

Oil price, other commodity prices, exchange rates, interest rates, credit availability and inflation are the macroeconomic variables to which more than 50 per cent of PEs were exposed. Important fluctuations in the macroeconomic variables would have varying impact on the PEs, depending on the nature of their activity and their ability to absorb these fluctuations. For example, a significant spike in the oil price could affect the PEs which are heavily dependent on oil products, such as Air Seychelles, SEYPEC, PUC and SPTC, as they will have greater costs to absorb. For example, Air Seychelles is exposed to oil price risk given that it is dependent on jet fuel for its air crafts. A 32 per cent increase in oil price (as was the case from 2010 to 2011) of the year 2017 would have resulted in an increase in fuel and oil expense in the range of SR 160m and this could mean that the company's net loss of SR 190m would have turned into a loss of approximately SR 350m, if all other variables remained constant. Similarly, a rise in interest rates would negatively impact PEs that have borrowings or those that had planned to borrow, as they may have greater interest payment.

4.2 Risks from Other Expenditure and Revenue Development

All PEs across the public sector are at risk of expenditure and revenue deviating from the plans on their respective financial performance. A selection of risks to the financial performance of the PE were identified and listed in Table 4 below.

The risk matrix below shows the vulnerability of PEs to risks associated to fluctuating revenue and expenditure. Some expenditure and revenue risks would have substantial impacts on all PEs, such as natural disasters and/or lower sales. The matrix also indicates that all PEs are vulnerable to at least one type of expenditure or revenue risk.

Table 4: Risk Matrix of PEs affected by Risks from Expenditure and Revenue Development

PE	Higher expenditure because of:							Lower revenue because of:				
	Risk Parameters											
	higher wages/salaries	other current cost	cost overruns investment projects	new or increased QFAs	unexpected maintenance, new investment	natural disaster	Government policies and regulations	lower sales	lower taxes paid in terms Government	lower dividends received	QFA's	lower loan repayment
AS	x	x	x	x	x	x	x	x			x	
BDRI		x			x	x		x				
DBS						x		x				x
FSA						x	x	x				
GICC						x		x				
GOIC						x		x				
GTIC						x		x				
HFC						x	x	x				x
IDC						x		x		x		
l'UE						x		x				
NISA						x	x	x				
PS						x		x				
PDEE						x		x				
PMC						x	x	x				

PUC						x	x	x				
SCB						x	x	x				x
SCAA						x	x	x				
SEYPEC						x	x	x		x		
SIMBC						x	x	x				x
SPA	x		x		x	x	x	x	x	x		
SPF	x		x		x	x	x	x		x		
SPTC	x	x	x	x	x	x	x	x			x	
SPS		x				x		x				
SSI			x			x	x	x	x	x		
STC	x	x	x	x	x	x	x	x			x	
2020 DC		x	x		x	x		x				
OICL		x	x			x		x				

Source: PEMC

4.3 Contingent Liabilities

Contingent liabilities can be defined as "any obligations, either explicit or implicit, triggered by an uncertain event (e.g. a loan guarantee dependent on future default)." In the event these contingent liabilities materialize, there is a high risk that GOVERNMENT will be liable to provide fiscal support to PEs.

The risk matrix overleaf shows the vulnerability of PEs to different types contingent liabilities. Risk factors for contingent liabilities are classified into two main categories; explicit and implicit contingent liabilities.

Explicit Contingent Liabilities

Explicit contingent liabilities refer to the legal obligation or announced policy that Government will be responsible to provide fiscal support in specific circumstances. Table 5 refers to four of the potential explicit contingent liabilities for the Government of Seychelles for the period 2013-2017.

Table 5: Risk Matrix of PEs substantially affected by Explicit Contingent Liabilities Risks

<table>
<tr><th rowspan="2">PE</th><th colspan="4">Risk Parameters</th></tr>
<tr><th>Loans granted by Government to PEs</th><th>Government guarantees granted to PPPs undertaken by PEs</th><th>Other Government guarantees granted to PEs</th><th>Bailouts of PEs/capital injections because of explicit contingent liabilities emanating from PEs</th></tr>
<tr><td>2020 DC</td><td></td><td rowspan="23">PEMC did not obtain data relating to GOS guarantees granted to PPPs undertaken by PEs</td><td></td><td></td></tr>
<tr><td>AS</td><td>x</td><td>x</td><td>x</td></tr>
<tr><td>BDRI</td><td></td><td></td><td></td></tr>
<tr><td>DBS</td><td>x</td><td>x</td><td></td></tr>
<tr><td>FSA</td><td></td><td></td><td></td></tr>
<tr><td>HFC</td><td></td><td>x</td><td></td></tr>
<tr><td>IDC</td><td></td><td></td><td></td></tr>
<tr><td>LUE</td><td></td><td></td><td></td></tr>
<tr><td>NISA</td><td></td><td>x</td><td></td></tr>
<tr><td>PDEE</td><td></td><td></td><td></td></tr>
<tr><td>PMC</td><td></td><td>x</td><td></td></tr>
<tr><td>PS</td><td></td><td></td><td></td></tr>
<tr><td>PUC</td><td></td><td>x</td><td></td></tr>
<tr><td>SCAA</td><td></td><td>x</td><td></td></tr>
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<tr><td>SPTC</td><td></td><td></td><td></td></tr>
<tr><td>SSI</td><td></td><td>x</td><td></td></tr>
<tr><td>STC</td><td>x</td><td></td><td></td></tr>
</table>

Source: PEMC

Implicit Contingent Liabilities

Implicit contingent liabilities refer to cases where there is no legal responsibility or announced obligation, but there is possibility/likelihood of Government intervention in cases where a PE faces liquidity problems (e.g. possible need for Government to bail out a PE). This section focuses on identified implicit contingent liabilities based on information collected from PEs as shown in Table 6 overleaf.

Table 6: Risk Matrix of PEs substantially affected by Implicit Contingent Liabilities Risks

PE	***Risk Parameters*** Loans granted by PE to other PEs	Loans granted by PE to third parties	Legal against PEs claims
AS			*PEMC had no data pertaining to legal claims at the time of writing this report*
SPF	x		
SPTC			
SSI	x		
SPA			
SEYPEC			
PUC			
SCB	x	x	
PMC	x		
SPS			
SIMBC	x	x	
BDRI	x		
DBS	x	x	
FSA	x		
IDC	x		
LUE			
NISA	x		
PS			
HFC	x	x	
PDEE			
SCAA	x		
STC			
2020 DC			

Source: PEMC

Implicit contingent liabilities consist of mainly loans amongst PEs and loans provided by financial institutions to third parties. Table 6 refers to the potential implicit contingent liabilities for Government. PEMC currently does not have data on legal claims against PEs and therefore have not included this as part of the contingent liabilities for this year. For future reports, the Commission plans to incorporate legal claims as part of contingent liabilities. As can be noted in Table 6 above, 12 PEs had been impacted by loan transactions. This is mainly related to a PE providing loans to another PE as can be seen in Table 7.

Table 7: Details of loans between PEs

Lending Institutions/PE	Beneficiary	Currency	Legal end date	Maximum Exposure 2017 (SR' m)
SSI	BDRI	SCR	7th Jan 2022	125
SCB	GTIC	SCR	31st March 2019	28.8
	HFC	SCR	30th Jan 2024	148
SIMBC	NISA	SCR	29th Feb 2024	16
	DBS	EUR	2nd July 2018	5
		EUR	12th April 2020	3
		SCR	16th March 2023	39.5
	PUC	EUR	28th Oct 2018	3
	GTIC	SCR	7th April 2025	92
	GTIC	SCR	13th June 2024	3.5
	IDC	USD	31st Dec 2019	1.1
	GICC	SCR	11th July 2019	5.3
	GICC	SCR	31st March 2019	6.5
	GICC	USD	31st March 2019	0.4

Source: PEMC

4.4 Arrears

Arrears are financial obligations, which are due and have not yet been paid. They are recognized as a further source of fiscal risks, which may create liquidity problems and reduce profitability if debts are not collectible. This section identifies and determines arrears due in the following categories:

- from Government to PEs
- from PEs to Government and
- between PEs.

Arrears that are not identified and quantified can disguise the true size of the Government's or the PEs' arrears. As in many countries like the Seychelles, payments of arrears owing to PEs are recognised as having a lower priority than paying other creditors. The risk matrix below identifies four PEs with the issue of payments of arrears for the year 2017.

Table 8: Risk Matrix of PEs substantially affected by Arrears Risks

PE	***Risk Parameter***		
	Government in arrears to PEs	PE in arrears to Government	Arrears to or from other PE(s)
AS	x	x	x
PS	x	x	x
PUC	x		
SEYPEC			x
STC	x		x

Source: PEMC

Arrears from Government to PEs

Table 9: Showing Arrears from Government to PEs (SR' m)

PE	SR' m
AS	119
PS	0.01
PUC	30.2
STC	1.4
Total	**150.7**

Source: PEMC

Arrears from Government to PEs can create liquity and profitability problems for the PE if debts continuously acumulate and become incolectible and may even have to be written off.

- PUC has large receivables composing of outstanding utility invoices from Government organization customers reducing its cash flow.
- In the case of Petro Seychelles, the SR 10,000 is the remaining share capital of 1 per cent share for PS of Finance still outstanding.
- The STC Government arrear is related to the purchase of items from its outlets.

Arrears from PEs to Government

Table 10: Showing Arrears from PEs to Government (SR' m)

PE	SR' m
PS	0.012
AS	22.3
Total	**22.3**

Source: PEMC

Arrears from PEs to Government can also create financial problems for the public department or concerned ministry, may exert more fiscal burdens on the Budget and may affect the availability of public finance if the PE cannot pay the amounts owing to Government.

- The Petro Seychelles arrears are in regards to the Audit Journal for year-end 2016 being adjustment of PIT under paid for 13th Month salary.
- Air Seychelles' arrears to Government for 2017 correspond to processing lag and lack of Budget.

Arrears between PEs

Similarly, arrears between PEs reciprocally affects their profitability and may lead to cash flow problems if not managed accordingly. Uncertainty of arrears may also cause PEs to limit their investments by being more conservative in their operation approach, thereby limiting growth in the public sector and the economy as a whole. This uncertainty can also deepen fiscal risks if both PEs and Government do not have clear and quantifiable data on the extent of their arrears whilst they continue to invest or accumulate their dues. In this way the monitoring of arrears is critical and needs to be addressed.

Table 11: Showing Arrears from PE to PE(s) (SR' m)

Debtor PE	Creditor PE	Amount Outstanding as at December 31, 2017 (SR' m)
Air Seychelles	Seychelles Civil Aviation Authority	2.08
Air Seychelles	SEYPEC	2.31
Air Seychelles	Public Utilities Corporation	0.36
PEs	STC	0.01
PEs[1]	SEYPEC	12.92
SEYPEC	Petro Seychelles Ltd	15.00
SEYPEC	PEs	0.15
Seychelles Civil Aviation Authority	Air Seychelles Ltd	0.33
Public Utilities Corporation	Air Seychelles Ltd	0.13
Seychelles Petroleum Company	Air Seychelles Ltd	0.11
Seychelles Trading Company	Air Seychelles Ltd	0.77
Seychelles Ports Authority	Air Seychelles Ltd	0.07
Petro Seychelles	Air Seychelles Ltd	0.02

Source: PEMC

It was recommended that MoFTIEP state a clear policy requiring the prompt payment of amounts owing by Government bodies to PEs. In addition, the PEMC could start to analyze information on the amount and age of PE receivables to determine the extent of any arrears problem and whether any action is necessary. (Oversight of Fiscal Risks of the SOE Sector Report, 2016)[2].

PEMC could play an active role in determining whether there is any issue of payment arrears concerning PEs and if so draw MoTIEP and PE attention to the need to rectify this.

[1] Awaiting breakdown from SEYPEC
[2] Shand. D., Gokgur. N., & Aziz. I. (2016). *Oversight of Fiscal Risks of the SOE Sector*. International Monetary Fund IMF Afritac South

4.5 Institutional Risks

The institutional risks, which arise from the gaps in the oversight framework, inadequate capabilities to deal with the increasing number of PEs and the lack of compliance to the relevant legislations by PEs, may lead to fiscal risks if not mitigated. A weak oversight framework may have a substantial impact on their financial performance whereas non-compliance with the submission of relevant documents such as audited financial statements prevent the proper analysis and forecast of the financial performance of PEs. This in turn may have an effect on the executive decision-making and the policy formulation for their effective control and management.

Oversight Framework

The absence of Ownership policy indicates that there is inadequate guidance being provided to the PEs towards achieving their goals and objectives. The Ownership Policy, which defines the mandates and objectives of the Government of Seychelles as the owner of PEs with the aim of improving efficiency and competitiveness of the economy, has been drafted and is yet to be implemented.

Presently, no Public Policy Objective (Public policy) has been formulated for each PE, which indicates that their responsible ministry has not set the policy target. The Public policy outlines the mandate and purpose of the PEs which also includes defining, identifying and quantifying and disclosing the costs associated with the Public Service Obligations (PSOs) currently being undertaken by PEs. PSOs lead to Quasi-Fiscal Activities (QFAs) where PEs are not reimbursed for performing these obligations. QFAs can affect the financial performance of a PE, such as in the case of STC whereby it is charging prices below market prices for 14 commodities. As STC is not being compensated for the provision of the reduced prices, it is cross subsidizing the reduced price by increasing the prices of its other goods. As the parent ministry is not setting the policy target, it may lead to financial consequences, which in turn affects the setting of financial targets.

The PEMC does not partake in the setting of these financial targets despite its responsibility to monitor and evaluate the financial performance of PEs. As per the PEMC Act[3], the setting of financial targets falls under the mandate of their respective board. In line with international good practice, the ownership and oversight unit set financial targets to ensure that there is alignment between these targets and the objectives outlined in its policy targets.

There is fragmentation across the oversight framework whereby PEs are mandated to report to numerous oversight bodies and ministries in respect of its financial, governance and sectorial performance. This leads to duplication of effort and impedes the effectiveness of the oversight framework.

[3] PEMC Act, 2013, Section 35

Lack of Compliance (PEMC Act/Companies Act)

There is an overall non-compliance to the time frame for submission of the Annual Financial Statements, Budgets, Statements of Corporate Intent, monthly financial statements and Annual Reports for the year 2017. Table 12 below presents the main compliance risk parameters.

Table 12: Risk Matrix of PEs substantially affected by Risks stemming from Lack of Compliance

	Risk Parameter					
PE	Delayed submission of Annual Financial Statement	Delayed submission of Budget	Delayed submission of Statement of Corporate Intent	Delayed submission of monthly financial statements	Delayed submission of other data requested by PEMC /Annual Reports	Lack of Compliance with the IFRS-standards
AS	x	x	x	x	x	
SPF		x		x		
SPTC	x			x	x	
SSI	x	x		x	x	
SPA	x	x		x	x	x
SEYPEC	x		x	x	x	
PMC	x		x	x	x	
PUC	x	x		x	x	
SPS	x		x	x	x	
SIMBC	x			x	x	
NISA	x		x	x	x	x[4]
SCB	x	x	x	x	x	
FSA	x			x	x	
2020 DC	x	x	x	x	x	x
L'UE	x			x	x	x
IDC				x	x	x
PS	x			x	x	
STC	x		x	x	x	
DBS	x				x	
HFC	x			x	x	
SCAA	x			x	x	x

Source: PEMC

The PEMC Act lacks the enforcement powers as it does not allow for sanctions to be taken in the case where PEs are not complying with its reporting obligations. The lack of data and inadequate legal provisions contributes to the delay in conducting an effective and efficient analysis which in turn hinders the timely provision of information to stakeholders for decision making.

[4] NISA uses IFRS for Small and Medium-Sized Entities (SMEs)

5. Mitigating Fiscal Risks

Necessary in the identification, evaluation and analysis of fiscal risks, are strategies and methods to mitigate the possible impact of such risks. As the risks discussed in this document will all affect the fiscal position of the country and impact upon fiscal targets and fiscal sustainability, risk mitigation is major priority for the Government.

Below are several strategies and initiatives that can be undertaken to help in mitigating fiscal risks. The Government remains committed towards further expanding its options towards this cause.

- Establish a Budget contingency provision for fiscal risks that are likely to materialize. This is expensed in the Budget to cover for any unforeseen expenditures that may arise, which were initially not predicted during Budget preparation. The Budget already includes this.

- Make provisions in the Budget to cater for the evaluation of risks materializing.

- Transferring risks through hedging and insurance instruments. The mentioned would help in mitigating the macroeconomic risks associated to the PEs in particular.

- Imposing caps and limits on the liabilities public entities can accumulate.

- Improve upon reporting requirements of PEs. This is currently being undertaken by PEMC.

- Make provision for the appropriate subsidization to PEs in case the institutional risks were to materialize into the fiscal risks and for the proper planning for the cost associated to QFAs so as to ensure that the compensation is incorporated in the Government Budget which will in turn avoid the risk of distorting the Government's fiscal position.

- Implementing a coordinated framework of reporting between MoFTIEP, the responsible ministries, regulators and the PEs concerning any decisions that would affect key stakeholders negatively. This framework would also allow risks to be identified and tackled early.

6. Conclusion

The Fiscal Risk Statement covers potential fiscal risks that threaten the Government's Budget in the period ahead. Macroeconomic risks are considered as the source of fiscal risk with most likelihood and with far reaching effects. The most significant fiscal risks over the next three years are lower-than-expected economic growth which threatens revenue forecast, higher-than-expected inflationary and exchange rate pressures, international fuel and commodity price movements, the parlous finances of public enterprises, as well as uncertainty in terms of foreign aid.

Shock scenarios were simulated on tourism, exchange rates, and inflation, to illustrate the potential impact of these variables when in a downside and upside situation. The shocks presented a combined effect of changes in the estimated inflation rate, and fluctuations in both the SR/EUR (affecting earnings) and SR/USD rate (affecting imports) on the Nominal GDP baseline. Similarly, given the countries high dependence on tourism, shocks on visitor arrivals are expected to have a significant impact on the GDP. These risks can also translate into upside and downside risks to the Government Budget in terms of tax revenue collections and expenditure. Consequently, this poses a threat to the Government's commitment towards debt management.

Risks from PEs have also been presented. Fiscal risks emanating from PEs represent a substantial risk on public finances. Shocks particularly from oil prices, interest rates, exchange rates, commodity prices and inflation affects significantly PEs such as Air Seychelles, SEYPEC and STC. PE to Government arrears, as has been present in Air Seychelles and Petro Seychelles since 2016, increases the fiscal burden on the Budget and limits the availability of public finances.

In addition, PEs are exposed to revenue and expenditure risks. All PEs are affected by at least one revenue or expenditure change, which worsens their financial position and hence the position of Government. Other factors, such as contingent liabilities and calls on Government guarantees across PEs, also have potential negative impact. Calls on Government guarantees could add pressure to the Government Budget and increase Seychelles public debt. For instance, from 2013-2017, Government injected a total of SR 154m into Air Seychelles to assume liability for borrowings.

Risks deriving from the Government's institutional capacity could also take a toll on Seychelles' fiscal aggregates. Risks emerge from deficiencies in the institutional framework. Such discrepancies produce uncertainty and inadequate guidance undermining compliance transparency and accountability. Considering for instance that only 2 out of 21 PEs submitted their Annual Financial Statement 2017 within the specified period.

Finally, certain Government strategies are necessary to help mitigate overall fiscal risk and to better manage, exposure to risks associated with PEs. In most cases, additional provisions in the Budget are necessary to act as a buffer against shocks, provide resources in evaluating fiscal risk likelihood and to aid PEs counter costs arising from QFAs. Hedging against potential risks is another strategy that can be employed, while developing a coordinated approach with all stakeholders in reporting on potential risks will help in early identification.

The current fiscal policies in place are designed to reduce these risks and to ensure that Government targets are achieved, although more could be done to safeguard the future. The Government remains committed towards this.