SM/09/27
Supplement 1
Correction 2

February 18, 2009

To: Members of the Executive Board

From: The Acting Secretary

Subject: **Companion Paper—The State of Public Finances—Outlook and Medium-Term Policies After the 2008 Crisis**

The attached corrections to SM/09/27, Supplement 1 (1/27/09) have been provided by the staff:

Factual Errors Not Affecting the Presentation of Staff's Analysis or Views

Page 2, last para., line 5: for "the special reasons that may have affected this favorable outcome"
read "the country-specific reasons that may have explained this favorable outcome"

Page 15, para. 12, line 5: "The amounts reported reflect committed funds, not necessarily actual disbursements." added

Pages 67–69: references revised to remove several items and add the following references:

"Barro, Robert, and Xavier Sala-i-Martin, 1990, "World Real Interest Rates," *NBER Macroeconomics Annual*"

"International Monetary Fund, 1986, Manual on Government Finance Statistics (Washington)"

"International Monetary Fund, 2001, Manual on Government Finance Statistics (Washington)"

"International Monetary Fund, 2007, Manual on Fiscal Transparency (Washington)"

Questions may be referred to Mr. Horton (ext. 39850), Mr. Kumar (ext. 37771), and Mr. Mauro (ext. 37712) in FAD.

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

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INTERNATIONAL MONETARY FUND

Companion Paper—The State of Public Finances—Outlook and Medium-Term Policies after the 2008 Crisis

Prepared by the Fiscal Affairs Department

In consultation with other departments

Approved by Carlo Cottarelli

January 26, 2009

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EXECUTIVE SUMMARY

This paper provides data and analysis underpinning the main findings of the Board paper on "The State of Public Finances: Outlook and Medium-Term Policies After the 2008 Crisis."

The first four chapters focus on the fiscal impact of government interventions in the financial sector. Chapter I provides guidance on how financial sector support should be reported in the fiscal accounts. The chapter covers both direct interventions (e.g., loans, recapitalization, and purchase of troubled assets) as well as indirect interventions (e.g., government guarantees or quasi fiscal costs). Chapter II provides a summary of financial sector support operations undertaken through mid-January 2009 in both advanced and selected emerging markets. Chapter III presents an econometric model of "recovery rates" for government interventions (the ratio between amount of receipts recovered from the management and sales of assets acquired through financial support operations and initial budgetary outlays) based on the experience in both advanced and emerging markets during previous banking crises. This is an important input to assessing the net cost of direct government interventions in the financial sector, although estimates are subject to a high degree of uncertainty. Chapter IV illustrates two complementary approaches that can be applied to estimate the likely cost of contingent liabilities from government guarantees to the financial sector.

The next two chapters address the fiscal impact of the economic recession. Chapter V outlines the methodology that has been applied in the main paper to estimate the fiscal impact from automatic stabilizers and other non-discretionary factors (e.g., the revenue effect from exceptional declines in asset prices). Chapter VI summarizes information on fiscal stimulus packages announced in G-20 countries through mid-January 2009 to boost economic activity.

The last two chapters look at the response of interest rates to increases in debt—an issue that will gain prominence as the financing needs of governments will increase sharply in the near term. Chapter VII briefly reviews the existing empirical evidence on the interest rate impact of an increase in debt, while Chapter VIII looks at the case of Japan, where an increase in public debt was not accompanied by a rise in interest rates, and at the country-specific reasons that may have explained this favorable outcome.

II. FINANCIAL SECTOR SUPPORT MEASURES[10]

11. **This chapter provides a detailed summary of the financial sector support measures and their net costs in advanced and emerging market countries.** In addition to the specific measures announced or implemented in each country, it provides information on the magnitude of support, estimates of the upfront fiscal cost, and information on how countries currently propose to treat the different measures in their fiscal accounts (which is not in all cases consistent with the recommended treatment in Chapter I). Based on the analysis in Chapters III and VI, the expected net costs of financial support operations (including recapitalization, purchase of assets, liquidity provision and guarantees) are calculated in Tables 3 and 4.

12. **The data have been compiled jointly with MCM, relying primarily on information from official government sources, such as treasuries and central banks.** These have been supplemented by information from financial market sources, including investment and commercial banks, ratings agencies, and private consultancy companies. Information by country is presented in Table 5. The amounts reported reflect committed funds, not necessarily actual disbursements.

13. **The information reported here can be also found in the FAD-MCM database on public intervention.** The database will be posted on the crisis group website for the Fund's internal use. Given the ongoing nature of government intervention, the announcement of financial sector support packages will be monitored on a continuous basis, and the list of measures will be updated accordingly.

[10] Prepared by Daehaeng Kim with contributions by Edouard Martin.

Table 3. Upfront Gross Fiscal Cost and Recovery Rate
(in percent of GDP, unless otherwise indicated)

	Upfront Government Financing	Recovery Rate 1/		**Medium-term Net Cost of Direct Support**	
		Point Estimate 2/	95% Interval	**Point Estimate**	95% Interval
Advanced North America					
Canada	**4.9**	59.7	[37.9, 81.5]	**0.3**	[0.1, 0.4]
United States	**6.3**	49.1	[26.8, 71.4]	**3.2**	[1.8, 4.6]
Advanced Europe					
Austria	**5.3**	54.2	[34.3, 74]	**2.4**	[1.3, 3.4]
Belgium	**4.7**	55.5	[34.7, 76.2]	**2.1**	[1.1, 3.0]
France	**1.5**	48.5	[29.1, 67.9]	**0.8**	[0.4, 1.0]
Germany	**3.7**	54.7	[34.8, 74.4]	**1.7**	[0.9, 2.3]
Greece	**5.4**	47.5	[30.4, 64.5]	**2.8**	[1.9, 3.7]
Ireland	**5.3**	51.9	[28.6, 75.1]	**2.6**	[1.3, 3.7]
Italy	**1.3**	50.4	[31, 69.7]	**0.6**	[0.3, 0.8]
Netherlands	**6.2**	57.7	[37.8, 77.4]	**2.6**	[1.3, 3.8]
Norway	**13.8**	97.7	[53.6, 100]	**0.3**	[0, 6.4]
Portugal	**2.4**	46.6	[30.1, 62.9]	**1.3**	[0.8, 1.6]
Spain	**4.6**	49.9	[31.5, 68.2]	**2.3**	[1.4, 3.1]
Sweden	**5.8**	62.4	[39.1, 85.6]	**2.2**	[0.8, 3.5]
Switzerland	**1.1**	61.4	[39.1, 83.5]	**0.4**	[0.1, 0.6]
United Kingdom	**17.4**	42.9	[25.3, 60.3]	**9.9**	[6.8, 12.9]
Advanced Asia and Pacific					
Australia	**0.7**	62.5	[39.8, 85.1]	**0.3**	[0.1, 0.4]
Japan	**0.2**	50.5	[29.6, 71.2]	**0.1**	[0.0, 0.1]
Korea	**0.2**	58.4	[37.8, 79]	**0.1**	[0.0, 0.1]
Emerging Economies					
Argentina	**0.0**	N/A	N/A	**0.0**	N/A
Brazil	**0.0**	N/A	N/A	**0.0**	N/A
China	**0.0**	30.0	N/A	**0.0**	N/A
India	**0.0**	N/A	N/A	**0.0**	N/A
Indonesia	**0.1**	30.0	N/A	**0.1**	N/A
Hungary	**1.1**	19.4	[7.97, 30.7]	**0.9**	[0.7, 1.0]
Poland	**0.2**	30.0	N/A	**0.1**	N/A
Russia	**0.6**	40.8	[22.9, 58.8]	**0.4**	[0.2, 0.4]
Saudi Arabia	**1.2**	100.0	[51.6, 100]	**0.0**	[0, 0.5]
Turkey	**0.0**	30.0	N/A	**0.0**	N/A
Average for: 3/					
G-20	**3.1**	50.7	[29.5, 71.1]	**1.6**	[0.9, 2.2]
Advanced Economies	**4.9**	50.5	[29.5, 71.4]	**2.5**	[1.5, 3.5]
Emerging Economies	**0.1**	53.2	[28.9, 67.4]	**0.0**	[0.0, 0.1]

Source: FAD-MCM database on public interventions and Staff estimates. See Chapter III for details.
1/ In percent of upfront outlays.
2/ The recovery rate for China, Indonesia, and Poland is assumed to be 30 percent.
3/ Weighted by PPP GDP of 2007.

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