INTERNATIONAL MONETARY FUND

Mitigating Fiscal Risks in Oman

OMAN

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SIP/2024/017

***IMF Selected Issues Papers* are prepared by IMF staff as background documentation for periodic consultations with member countries.** It is based on the information available at the time it was completed on December 14, 2023. This paper is also published separately as IMF Country Report No 24/032.

2024
JUN

SELECTED ISSUES PAPER

 SIP/2024/017

IMF Selected Issues Paper
Middle East and Central Asia Department

Mitigating Fiscal Risks in Oman
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Authorized for distribution by Cesar Serra
June 2024

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ABSTRACT: Fiscal risks are multifaceted in Oman and their potential impact on the fiscal position could be significant. Identification, monitoring, transparent reporting, and effective risk management of fiscal risks are a key component of a sound medium-term fiscal framework and paramount in underpinning fiscal credibility and the sustainability of public finances. This note revisits the exposure of Oman's fiscal position to an array of potential risks, zooming in on the impact of oil price volatility and potential risks stemming from state-owned enterprises. It documents actions taken by Omani policymakers to mitigate the impact of fiscal risks and provides further recommendations on fiscal risk disclosure and management.

RECOMMENDED CITATION: AlHassan, Abdullah, and Dalia Aita. 2024. "Mitigating Fiscal Risks in Oman." IMF Selected Issues Paper (SIP/2024/017). Washington, D.C.: International Monetary Fund.

JEL Classification Numbers:	Fiscal risks are multifaceted in Oman and their potential impact on the fiscal position could be significant.
Keywords:	Oman, Fiscal Risks, Oil Price, Transparency
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* The authors would like to thank the Ministry of Finance's Macro-Fiscal Unit (Salim Ahmed Said Al-Jahwari, Salwa Abdullah Nasser Al-Jabri, Abdullah Saleh Mohamed Al-Brashdi, Hajar Hamed Hamood Al-Ghafri) and Oman Investment Authority.

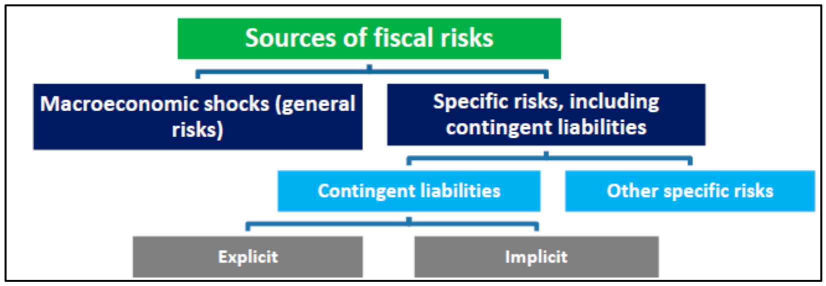
SELECTED ISSUES PAPERS

Mitigating Fiscal Risks in Oman

Oman

A. Context

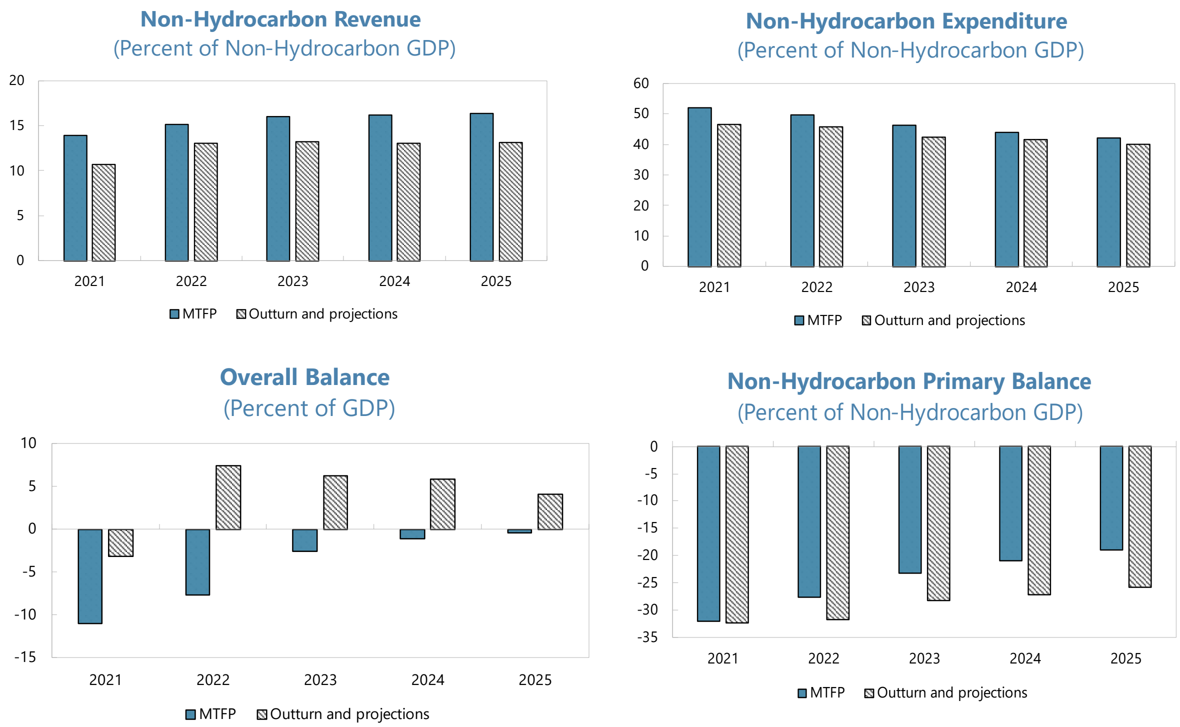
1. Fiscal risks are multifaceted in Oman. Oil and gas are the major sources of export income and fiscal revenues, and this income impacts the rest of the economy through government spending and savings. As of end of 2022, Oman's economy remains particularly dependent on hydrocarbons, which represent about 40 percent of GDP, nearly 80 percent of total fiscal revenue, and 65 percent of total export of goods. Fiscal risks comprise potential shocks to government revenues, expenditures, assets, or liabilities, which are not reflected in the government's fiscal forecasts (IMF 2014). These risks, which may arise from different sources, can be broadly classified into two main categories:[1]



- ***Macroeconomic risks.*** These could materialize when outcomes markedly deviate from baseline forecasts, as envisaged in Oman's Medium-Term Fiscal Plan (MTFP), for key variables, such as oil prices, GDP, inflation, and borrowing costs, which are themselves key determinants of fiscal performance (Figure 1). To mitigate macroeconomic risks, the authorities are developing an early warning system.
- ***Specific fiscal risks.*** These arise from the realization of contingent liabilities or other uncertain events, such as those related to state-owned enterprises (SOEs), public-private partnerships (PPPs), power purchase agreements (PPAs), and natural disasters. The materialization of one risk could trigger other risks, which can amplify its impact on public finances. Macroeconomic downturns also tend to trigger the realization of these risks.

[1] Fiscal shocks can be large, adverse, and nonlinear. Cross-country analysis shows that governments experienced on average an adverse fiscal shock of 6 percent of GDP once every 12 years (IMF 2016).

Figure 1. Fiscal Performance Compared to the Initial MTFP



Sources: Country authorities; and IMF staff estimates.

2. Oman's Ministry of Finance has identified key fiscal risks. Oman's General Budget outlined key potential fiscal and economic risks for the first time in 2023. These include oil price volatility, tighter global financial conditions, global inflationary pressures, climate change and natural disasters, and geopolitical tensions.

B. Fiscal Risk Management

This section highlights the exposure of Oman's fiscal position to key risks, zooming in on the impact of oil price volatility and fiscal risks stemming from SOEs. It documents the actions taken, ongoing, and planned by Omani policymakers to mitigate the impact of the potential realization of fiscal risks.

Key Fiscal Risks

Oil Price Volatility

3. The volatility of oil prices is the major fiscal risk for Oman. Volatility and unpredictability of oil prices have increased in recent years due to a combination of supply and demand shocks, posing significant fiscal challenges. The uncertain path of oil prices ahead is particularly elevated as the energy transition unfolds with the need to balance climate change and energy security considerations. With the high degree of oil dependency, sharp declines in oil prices over the past decade resulted in sizable fiscal deficits (20 percent and 16 percent of GDP in 2016 and 2020, respectively) and surging public sector indebtedness (central government and SOEs) by close to 80 percent of GDP during 2015-2020. A stress scenario of a one-standard-deviation decline in oil prices, relative to current assumptions in the IMF's World Economic Outlook, would turn overall fiscal balances from surpluses under the baseline to persistent deficits and revert all the gains achieved so far in rebuilding fiscal buffers (Figure 2).

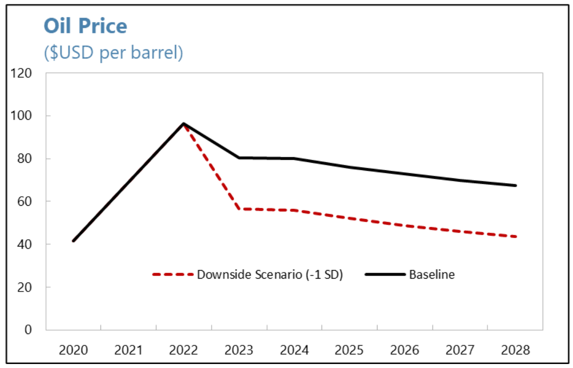
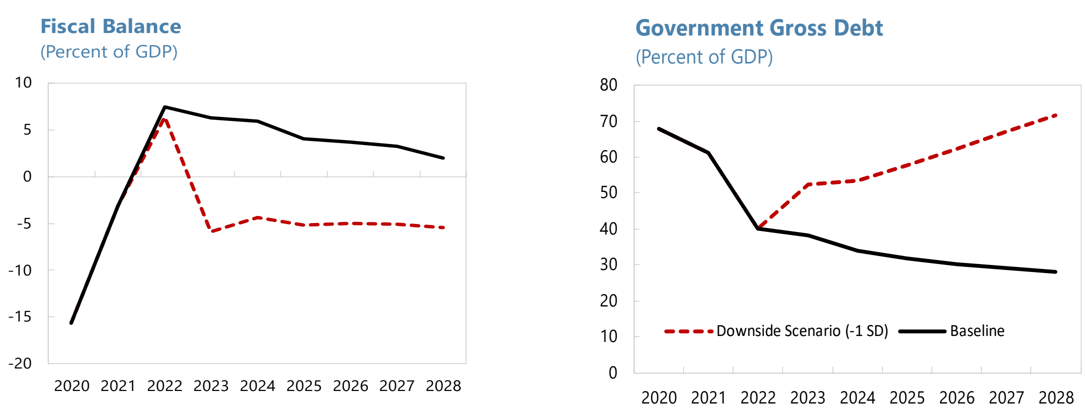


Figure 2. Downside Oil Price Scenario 1/



Sources: IMF staff calculations.
1/ The downside oil price scenario assume a one standard deviation below the WEO oil price from 2023 to 2028. The scenario assumes no change in government spending, non-hydrocarbon revenue collections, or external borrowing relative to the baseline scenario.

4. The authorities have followed different strategies to hedge against oil price shocks.

- **Fiscal adjustment.** Rationalizing expenditure and mobilizing non-hydrocarbon revenue, including the introduction of excises in 2019 and VAT in 2021, have helped mitigating the risk from volatile oil prices. Nonetheless, achieving the medium-term objectives under Oman's Medium-term Fiscal Plan would require additional revenue and expenditure measures, including a comprehensive tax administration reform, the introduction of PIT, and phasing out untargeted energy subsidies.
- **Medium-term Fiscal Framework.** Given uncertainties in oil markets, the 2023 budget continued to assume a conservative price for oil ($55 per barrel) to contain public spending and as a precaution against oil price volatility. While such a strategy has helped contain spending pressures to an important extent in the past, it has not prevented budget overruns and has delinked the budget process from expenditure ceilings under Oman's Medium-term Fiscal Plan. Instead, the authorities, based on IMF technical assistance, are working to adopt a full-fledged and legally binding Medium-term Fiscal Framework with quantifiable fiscal targets from which near- and medium-term aggregate expenditure ceilings can be

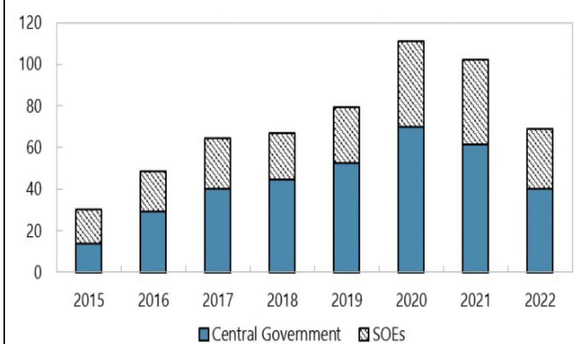
estimated. These in turn should anchor the budget preparation process to instill fiscal discipline regardless of the level of oil prices.

- **Fiscal buffers.** The authorities have continued accumulating buffers that could be mobilized at times of need. They continue transferring a portion of its fiscal revenue to the Petroleum Reserve Fund (PRF) each year.[2] As of end of 2022, the central government maintains ample buffers as deposits with domestic commercial banks (14.4 percent of GDP) and the Central Bank of Oman (3.5 percent of GDP). In addition, Oman Investment Authority (OIA) holds substantial liquid assets amounting to about 10 percent of GDP.

State-Owned Enterprises

5. The realization of contingent liabilities from SOEs can be a significant source of fiscal risk. Such risk can be either explicit (e.g., government loan guarantees) or implicit (e.g., support during slowdown in economic activity). SOE debt increased from 16 percent in 2015 to 41 percent of GDP in 2021, before declining to 30 percent in 2022. The marked decline was driven by asset divestments, improved SOE financial performance, and deleveraging initiatives, underpinned by the ongoing SOE reform led by Oman Investment Authority (OIA) (see below). Explicit government guarantees to SOEs are limited and reached 8 percent of GDP in 2022. Guarantees are extended to the development phase of an SOE's project until the start of its operations. So far, no guarantee has been called. Nevertheless, a deterioration of the financial performance of SOEs could impose fiscal costs from direct budget subsidies (e.g., due to the impact of COVID-19 on the aviation sector, the government provided temporary support to Oman Air, amounting to 0.3 percent of GDP in 2022, while also initiating restructuring and refinancing operations for the company).

Sovereign Debt
(Percent of GDP)



[2] Oil revenue equivalent to the value of 20,000 barrels per day, on average, are transferred to the PRF on an annual basis.

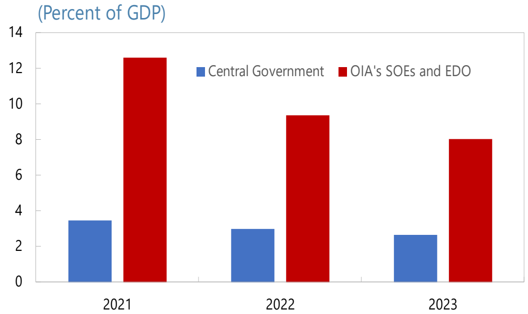
Box 1. Overview of State-Owned Enterprises

The Oman Investment Authority (OIA) was established in 2020 to manage existing sovereign financial assets and most state-owned companies (SOEs). Energy Development Oman (EDO) was also established in 2020 to manage oil and gas exploration as well as renewable energy projects in Oman. Government ownership in all non-financial SOEs, previously overseen by the Ministry of Finance, was transferred to OIA except for EDO. The OIA has embarked on a comprehensive SOE reform, guided by the Rawabet program, with the main goals of enhancing SOEs governance and efficiency, and setting the strategic priorities and the evaluation framework across OIA-affiliated entities.

SOEs operate across several sectors. Capital spending by SOEs (OIA-affiliated and EDO) amounted to 13.6 percent and 9.3 percent of GDP in 2021 and 2022, respectively. It is projected at 8.2 percent of GDP in 2023. This compares against central government's capital expenditure of 3 percent of GDP, on average, over the same period. The lower capital spending in 2023 is primarily attributed to OIA's strategy to stimulate private sector participation in the economy, where OIA's share in new projects is limited to 40 percent, as well as due to the planned divestment of a few SOEs. Capital spending is concentrated in energy and services sectors, accounting for approximately 90 percent of total capital spending during 2021-2023.

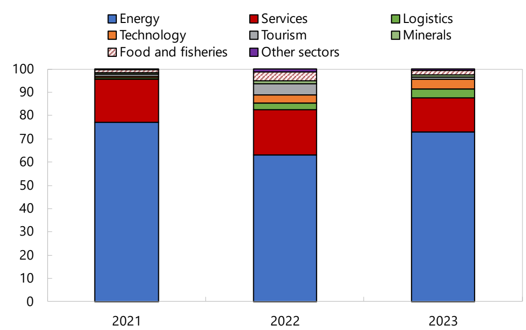
SOEs have sizable assets and liabilities. As of end of 2022, SOE assets amounted to about 31.4 percent of GDP, while liabilities accounted for 29.9 percent of GDP. SOEs debt is concentrated in few entities, largely OQ (Oman Oil Company), Energy Development Oman, NAMA (Electricity Holding Company), Oman Air, Asyad's Group (integrated logistics services provider), and Omantel (representing 90 percent of total SOEs debt in 2022). Most of the indebtedness of Oman's SOEs is project-based financing. Explicit government guarantees to SOEs amounted to 8 percent of GDP in 2022.
Sources: National authorities; and IMF staff estimates.

Public Sector Capital Spending
(Percent of GDP)



Box 1.

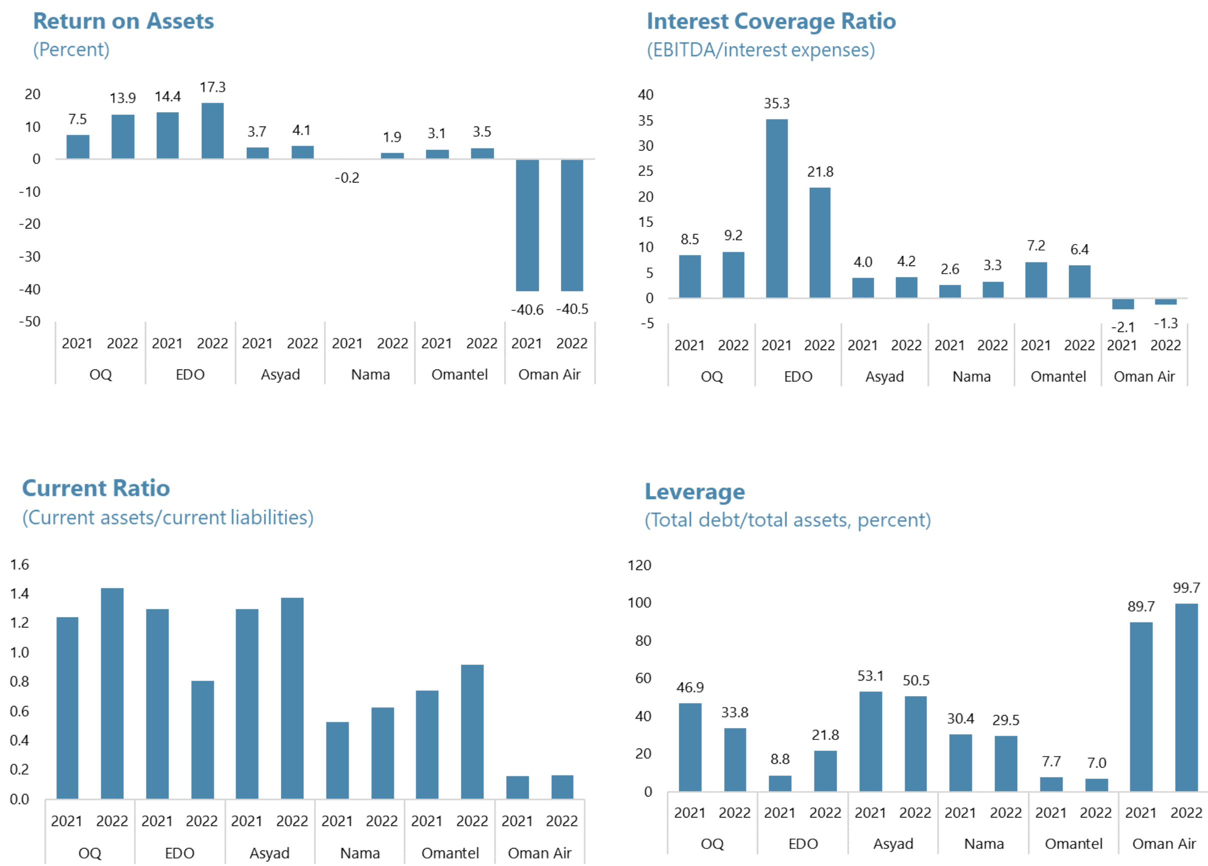
Structure of SOEs Capital Spending
(Percent of total)



Overview of State-Owned Enterprises (concluded)

Financial performance across the top SOEs is generally strong. For five out of the six SOEs representing 90 percent of total SOE debt in 2022, financial performance improved from 2021 to 2022, except for Oman Air. These SOEs have relatively high leverage, which declined in 2022. Profitability and interest coverage ratios, however, are strong and their liquidity ratios (represented by the ratio of current assets to current liabilities) are relatively healthy. Oman Air faced the brunt of the COVID-19 shock and is ongoing a restructuring process led by OIA, including a recently completed refinancing operation.

State-Owned Enterprises' Financial Indicators



Sources: National authorities; and IMF staff estimates.

6. OIA's Rawabet program has been instrumental in mitigating risks from SOEs. Upon its establishment, OIA inherited more than 160 companies from the state, with varying financial and non-financial performance. Different maturity levels, the lack of synergy among the companies, and unclear boundaries and relationships between the SOEs and the private sector complicated the task of resource allocation and strategic planning. In September 2020, OIA launched the Rawabet program aimed at addressing these challenges and thereby strengthening SOEs performance, governance, risk management, and their strategic direction to further their contribution to the national economy and align their activities to Vision 2040 goals. Key actions that have mitigated SOE risks include:

- **Establishing robust governance**, including through the restructuring of SOEs' boards of directors and setting a cap of two terms for board membership; and issuing a Code of Governance to improve SOEs performance, raise efficiency, and organize the work and functions of SOEs to ensure alignment between the goals of sustainable development in Oman and the purpose for which these SOEs were established.

- **Instilling accountability** through boards' KPIs covering financial sustainability, governance, in-country value, divestments, and other strategic initiatives and assessed by a certified external auditor appointed by OIA and approved by the Capital Market Authority.

- **Risk management**, including quarterly risk-based monitoring of SOEs; annual risk assessments of SOEs business plans and submission of risk registries containing detailed assessments and mitigation plans of corporate risks; and annual borrowing plans submitted to the Ministry of Finance's Debt Management Office, prior to any funding activity during the year.

- **A deleveraging and divestment strategy** to improve SOEs' creditworthiness, while fostering operational efficiency and bolstering confidence in financial management and strategic planning of the SOE sector. Deleveraging initiatives reduced SOE debt by about $10 billion during 2022-2023. OIA's divestment plans are considered as one of the levers towards empowering the private sector, securing strategic and/or financial partners, deepening the capital market, and contributing to the state budget. Since 2020, 16 SOEs have privatized and 5 partially divested. The 2023 divestment plan as approved by OIA Board consisted of divesting 8 companies through 3 IPOs and 5 trade sales.

7. **Oman's healthy public sector balance sheet helps mitigates risks.** Oman has sizable sovereign assets and liabilities. It has multiple pools of sovereign assets (OIA, PRF, and deposits in banks) and liabilities (central government and SOE debt). The consolidated public sector balance sheet—estimated based on publicly available information—has an estimated net assets (net financial assets) of 674 (-33) percent of GDP at end of 2022. The net present value of hydrocarbon assets represented about 500 percent of GDP and OIA's assets (SOEs under management and liquid assets) accounted for about 40 percent of GDP. Liabilities of about 88 percent of GDP are composed largely of central government and SOEs debt.

Oman: Public Sector Balance Sheet 1/
(2022 or latest available, percent of GDP)

	General Government		Public Non-Financial Corporations		Public Financial Corporations		
	Budgetary Central Government	Social Security Funds	SOEs	Oil company	SWFs	CB	Public Sector
Assets	**221.0**	**n.a.**	**31.4**	**499.9**	**9.2**		**761.5**
Non-Financial Assets	198.3		31.4	499.9			729.5
Fixed assets 2/	198.3						
Hydrocarbon 3/				499.9			
other assets			31.4				
Financial Assets	22.7				9.2	23.0	55.0
liquid assets	22.7				9.2	23.0	55.0
other assets						0.0	0.0
Liabilities	**40.0**	**n.a.**	**23.6**	**5.1**		19.1	**87.8**
Domestic	9.8		11.1	3.6			24.5
External	30.2		12.5	1.5			44.2
Net Assets	**181.0**		**7.7**	**494.8**	**9.2**	**-19.1**	**673.7**
Net Financial Assets	**-17.3**		**-23.6**	**-5.1**	**9.2**	**4.0**	**-32.8**
Net Liquid Financial Assets	**-17.3**		**-23.6**	**-5.1**	**9.2**	**4.0**	**-32.8**

Sources: Country authorities; and IMF staff calculations and estimates.
1/ A simplified balance sheet.
2/ IMF staff estimate using the perpetual inventory method.
3/ Net present value of government hydrocarbon revenue.

8. **The authorities have embarked on reforms to improve institutions entrusted with managing sovereign assets and liabilities.** To improve public asset management, the OIA has been created to manage efficiently public enterprises and support the government in investing the fiscal surplus achieved from the hydrocarbon windfall. An integrated central system is being developed to take full account of government assets to maximize returns and enhance transparency of sovereign assets (including tangible assets, financial assets, oil and gas reserves, PPPs, real estate investments, and SOEs). On the liability side, the authorities established a Debt Management Committee to coordinate sovereign debt issuance, whose scope has been expanded with oversight of sovereign assets and liabilities. The forthcoming Medium-Term Debt Strategy will help manage risk exposures arising from the government's debt portfolio. Moreover, the recent unification of pension funds from 11 fragmented institutions into a unified entity will ensure medium- to long-term sustainability of the pension system as it will help arrest the potential fiscal burden that could have emerged in the long term had the existing fragmented pension schemes continued.

Other Fiscal Risks

Global Financial Conditions

9. While rising interest rates have had limited impact on short-term fiscal positions, tighter-for-longer financial conditions risk increasing borrowing costs over the medium-term. Nevertheless, near-term refinancing risk (about 12.5 percent of total debt matures in the next 12 months as of end-2023) and interest rate risk exposure (with 84 percent of the total debt portfolio have a fixed rate) are low. Moreover, central government gross financing needs are projected below 1.0 percent of GDP on average over the period 2024-2028.

10. The authorities have implemented policy measures to mitigate refinancing risks. In 2022-2023, they conducted liability management operations, using some of the hydrocarbon windfall to repay, prepay, and buyback part of its external debt—amounting to 7.2 percent of GDP in 2022 and 4.6 percent of GDP in 2023—to reduce future debt service costs and gross financing needs. In addition, the authorities have created debt provisions since the 2021 budget, amounting to 0.5-0.8 percent of GDP annually to the Debt Reserve Account to meet future borrowing requirements.

Public-Private Partnerships

11. Public private partnerships (PPPs) are at an incipient stage in Oman, with the Public Private Partnership Law adopted in 2019. The authorities aim to encourage private sector to invest in infrastructure projects and public services. The Ministry of Finance undertook certain projects carried out under PPPs that are expected to solve the challenges related to investment projects such delivery on-time and on-budget, optimize life cycle costs for projects, bring in private sector knowledge, and enhance efficiency, innovation, and value of money by improving production efficiency and governance framework. These projects are in education, health, transport, and port sectors.

12. The PPP Unit, under the Ministry of Finance, is preparing detailed policy measures to mitigate potential fiscal risks, including its rights, obligation, and other exposures under PPP contracts. The role of the Unit is to steer the PPP process and procedures from the project planning stage to the tendering stage. Every new PPP initiative will have to be approved by the Ministry of Finance before tendering. As a part of the project preparation stage (i.e., detailed project feasibility studies), the fiscal exposures, obligations and guarantees will be explicitly analyzed. The Unit works closely with relevant government entities to ensure any risks has been thoroughly understood, mitigated, and approved. While the government provides a comfort letter—detailing the budgeting approval process and budget allocations to various ministries and government related entities—it does not provide any guarantees.

Climate-Related Events

13. Similar to other countries, Oman is exposed to fiscal risks from natural disasters. Climate-related events have increased in recent years, as evident by changes in the number and intensity of tropical cyclones, with 14 events since 2002.[3] Natural disasters have inflicted moderate fiscal costs so far. For example, the fiscal cost of cyclone Shaheen in 2021 was about 0.5 percent of GDP.

14. The authorities have put in place funding mechanisms to address climate challenges from natural disasters. The National Fund for Emergency (NFE), with an initial contribution of 0.3 percent of GDP, was established in 2022 to tackle the aftermath of tropical cyclone Shaheen and similar natural disasters that may occur in the future. The NFE is supported annually by allocating an amount from the State's General Budget, as well as donations from companies, associations, and philanthropists. The authorities have also access to a funding support from the Green Climate Fund (GCF) to tackle potential climate change impacts, covering six areas: water resources, agriculture, marine and fisheries, urban areas, health, and energy efficiency.[4]

C. Policy Implications

15. Steadfast implementation of fiscal reforms would mitigate fiscal risks. This would require pressing ahead with additional measures to mobilize non-hydrocarbon revenue and rationalize expenditure, as well as utilizing hydrocarbon windfalls to increase buffers and reduce debt burden. Developing a full-fledge medium-term fiscal framework would help entrench fiscal discipline and provide predictability of government expenditures.

16. Comprehensive analysis, management, and reporting of fiscal risks would ensure sound public finances and macroeconomic stability as well as fiscal transparency. Building on the summary of fiscal risks that was published in the 2023 budget, developing a comprehensive fiscal risk statement would help to identify possible gaps and ensure full coverage of risks. The statement should include sensitivity analysis and alternative macroeconomic and fiscal forecast scenario to assess the impact on public finances. In this context, fiscal policy settings can respond to a range of potential fiscal shocks, where specific risks are actively monitored and managed so that abrupt and disruptive changes in policies are prevented when risks materialize. Expanding the reporting of fiscal risks would promote a better understating of the state of public finances, build support for prudent fiscal policies, and strengthen accountability for risk management.

17. Comprehensive and timely fiscal data, including extending coverage beyond the central government and specific fiscal risks, are necessary in identifying, managing, and mitigating fiscal risks. The authorities' ability to respond to fiscal risks partly depends on the quality of information about the sources and size of risks, its capacity to assess the likelihood of risks materializing, and the strength of its underlying public financial management institutions. Ongoing efforts by OIA to privatize some assets are welcome to stimulate private sector participation in the economy. Disclosing key financial performance metrics of SOEs and moving ahead with OIA's divestment process should be a priority. For specific fiscal risks, coverage would need to be expanded to PPP and pension funds to raise awareness among policymakers and the public regarding the existence and nature of these risks. Given the authorities' expected recourse to PPPs

[3] The International Disasters Database.

[4] https://www.greenclimate.fund/document/oman-country-programme.

in the coming years, setting ceilings on either the stock or the annual flow of PPP projects would prevent excessive exposure to fiscal risk.

18. It is important to develop appropriate strategies for the management and mitigation of key fiscal risks. Such strategies would include, among others, allocations in the budget, limits on the exposure to specific types of risk, etc. At the same time, it is essential to strike a balance between benefits from reducing exposure to risks against the probability of these risks occurring and costs of risk mitigation (e.g., using buffers and budget contingencies), as some risks are too large to provision for and too costly to mitigate. Such strategies should specify the conditions under which the government is prepared to accept specific fiscal risks, define the level of risk it is willing to bear, specify the decision-making processes to be carried out by the government, and define the instruments that can be used to manage risks. In this context, phased withdrawal of untargeted energy subsidies should be a priority, including lifting the fuel cap and resuming the reforms through the authorities' targeted National Subsidy System. Developing a multilayer strategy on the use of additional revenue as a result of high global oil prices—reducing public debt, accumulating fiscal buffers, or accelerating economic diversification—will be essential.

19. Long-term sustainability analysis should be part of fiscal risk management given a reliance on finite natural resources. Uncertainty concerning the volume and value of resource endowments can be one of the most significant fiscal risks. Estimating value of the natural resource assets can be used to identify whether public debt is on a sustainable path and provide guidance on how public debt will evolve under different price scenario. Such analysis helps to inform public deliberation over the sustainability and intergenerational equity issues involved.

20. Developing a sovereign asset and liability framework is paramount to managing fiscal risks. It would enhance policymakers and the public's understanding and awareness of the public sectors financial strengths and vulnerabilities. The framework should set out the government's overall financial objectives and procedures for managing the cost/risk trade-offs. By consolidating the entirety of what the public sector owns and owes, the framework provides the basis for improved fiscal risk management.

21. Better understanding of fiscal risks, combined with their transparent reporting and effective risk management underpin fiscal credibility and the sustainability of public finances. The annual budget can disclose guarantees, related beneficiaries, the expected duration, and the intended purpose. The budget should also disclose the government's rights, obligations, and other exposure under PPP contracts. There is a scope to enhance transparency of allocations for contingencies. This would include publishing a set of criteria that must be met before expenditure may be charged to the contingency reserve and reporting on the use of contingency appropriations for the previous fiscal year.

22. It is essential to identify and disclose the main fiscal risks from climate-related events and Oman's climate agenda, both in qualitative and quantitative terms. Direct impacts may occur via increased public spending on, for example, repairing damaged infrastructure and social transfers to households and indirect impacts may occur via disruption of economic activity (including reduction of tax revenue) after a major disaster or the materialization of contingent liabilities affecting SOEs and private institutions. Oman is also exposed to potential fiscal costs from the implementation of adaptation and mitigation actions, committed under its National Determined Contribution (NDCs).

23. **Effective fiscal policymaking and fiscal risk management require appropriate coordination of decision making between central government and other parts of the public sector.** In this context, the National Committee, which advice on economic policies, has nominated representatives from MoF, MoE, NCSI, CBO, and OIA to coordinate identification, analysis, monitoring, and mitigation of fiscal risks.

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