

# Fiscal Risks and Contingent Liabilities

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# Outline

- 1. Sources of fiscal risks**
- 2. Nature of fiscal risks**
- 3. Fiscal risk disclosure and analysis—  
State of Best Practices**
- 4. Fiscal risk management**

# 1. Sources of Fiscal Risk

# Sources of Fiscal Risks

## Sources of Unexpected Increase in General Government Debt (percent of GDP, 2007-2010)

	FRA	DEU	NLD	ESP	PRT	GBR	USA	GRC	IRL	ISL	AVE*	Issues Revealed by the Crisis
<b>Underlying fiscal position</b>	<b>1.7</b>	<b>3.2</b>	<b>-2.4</b>	<b>1.8</b>	<b>11.3</b>	<b>3.7</b>	<b>8.1</b>	<b>16.3</b>	<b>1.3</b>	<b>10.9</b>	<b>6.0</b>	
Revisions to 2007 deficit & debt	1.7	1.8	-0.9	-0.1	0.1	1.5	7.1	2.5	1.6	4.0	4.7	Unreported Deficits
Changes to government boundary	-0.7	1.4	-0.2	0.6	9.4	1.9	0.9	11.2	-0.1	2.5	1.1	SoEs & PPPs
Cash-accrual adjustments	0.7	0.0	-1.3	1.3	1.7	0.3	0.0	2.6	-0.2	4.5	0.2	Arrears
<b>Exogenous shocks</b>	<b>8.4</b>	<b>12.8</b>	<b>14.2</b>	<b>15.4</b>	<b>8.1</b>	<b>17.0</b>	<b>6.3</b>	<b>40.0</b>	<b>60.2</b>	<b>39.5</b>	<b>9.8</b>	
Macroeconomic shocks	8.3	4.7	5.2	13.0	4.4	8.9	3.8	38.4	35.7	-3.3	6.0	Macroeconomic Risks
Financial sector interventions	0.0	8.1	9.0	2.5	3.6	8.1	2.5	1.6	24.5	42.8	3.8	Contingent Liabilities
<b>Policy changes</b>	<b>2.3</b>	<b>3.8</b>	<b>1.9</b>	<b>4.9</b>	<b>4.7</b>	<b>1.1</b>	<b>6.4</b>	<b>-8.0</b>	<b>-9.9</b>	<b>-4.3</b>	<b>4.7</b>	Stimulus / Consolidation
<b>Other factors</b>	<b>2.1</b>	<b>-0.3</b>	<b>6.5</b>	<b>1.9</b>	<b>3.7</b>	<b>6.2</b>	<b>8.3</b>	<b>-6.7</b>	<b>7.5</b>	<b>21.6</b>	<b>5.9</b>	
<b>Total Unforecast Increase in Debt</b>	<b>14.4</b>	<b>19.5</b>	<b>20.2</b>	<b>24.0</b>	<b>27.8</b>	<b>28.0</b>	<b>29.1</b>	<b>41.7</b>	<b>59.1</b>	<b>67.7</b>	<b>26.4</b>	

\* GDP-weighted average

# Sources of Fiscal Risks—Contingent Liabilities



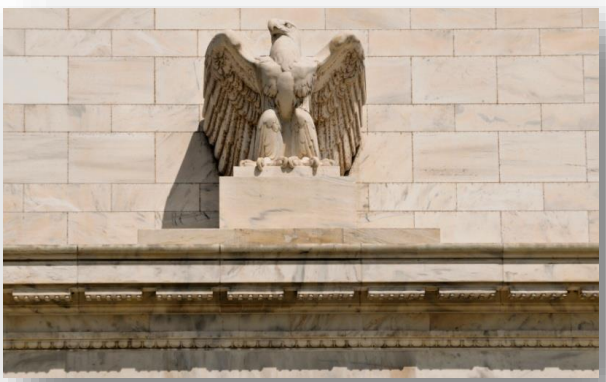
**Financial sector**



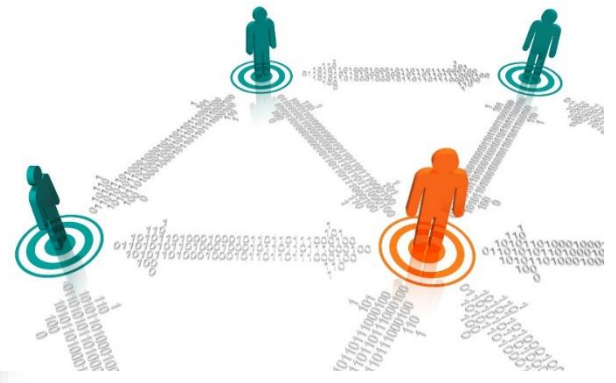
**Legal sector**



**State-owned enterprises**



**Subnational governments**



**Public private partnerships**



**Natural disasters**

# Sources of Fiscal Risks—Costs of CL realizations

## Distribution of Gross Fiscal Costs of CL realizations (% of GDP)

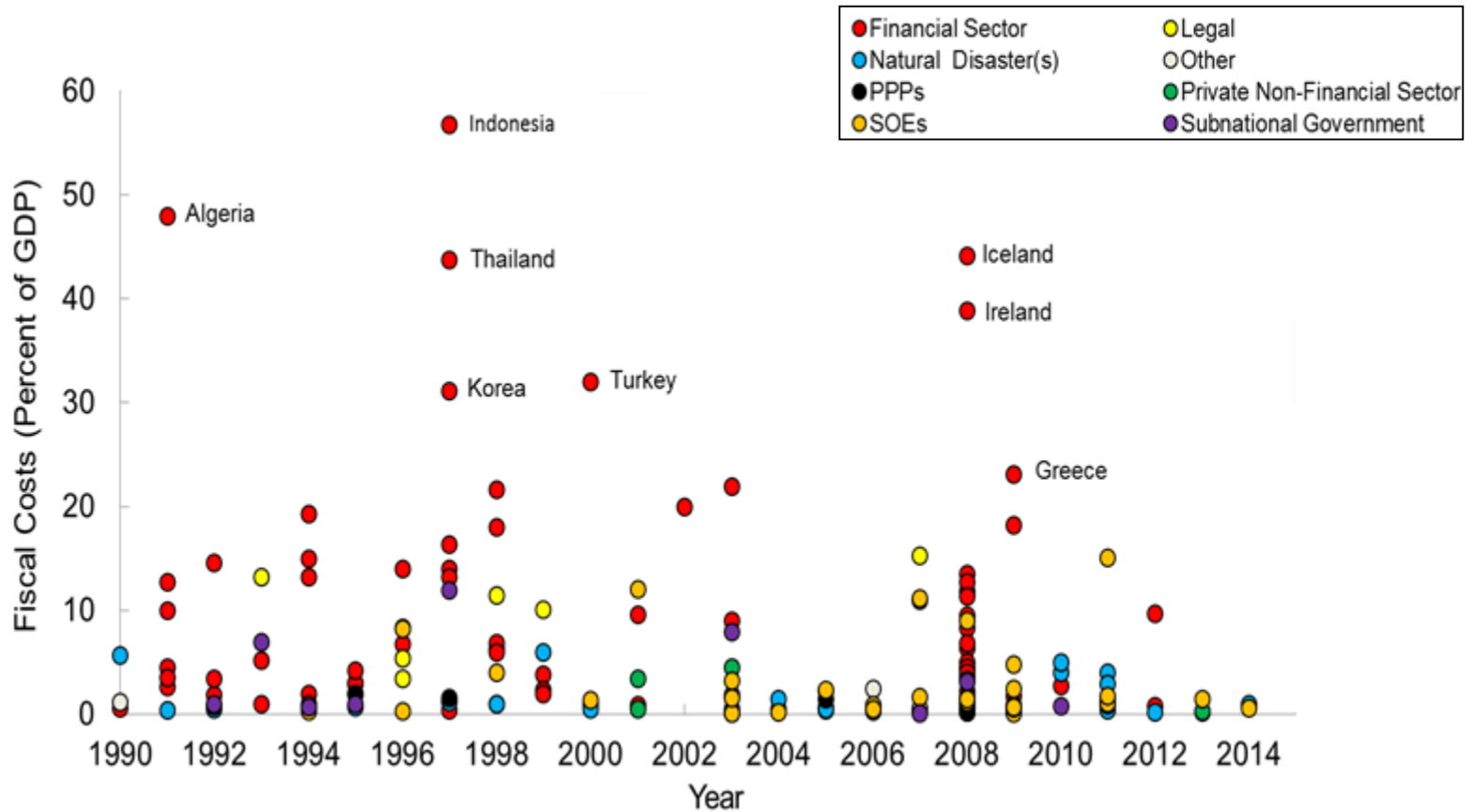
Type of Contingent Liabilities	Number of Episodes	Number of Episodes with Identified Fiscal Costs	Avg. Fiscal Costs (% GDP)	Maximum Fiscal Costs (% of GDP)
Financial Sector	91	82	9.7	56.8
Legal	9	9	7.9	15.3
Subnational Government	13	9	3.7	12.0
SOEs	32	31	3.0	15.1
Natural Disaster(s)	65	29	1.6	6.0
Private Non-Financial Sector	7	6	1.7	4.5
PPPs	8	5	1.2	2.0
Other	5	3	1.4	2.5
<b>Total</b>	<b>230</b>	<b>174</b>	<b>6.1</b>	<b>56.8</b>



230 episodes, 174 episodes of which with identified fiscal cost  
Average fiscal cost 6.1% of GDP

# Sources of Fiscal Risks—CL realizations since 1990

## Fiscal Costs of Contingent Liabilities: by Sub-categories and Year (Percent of country's GDP)



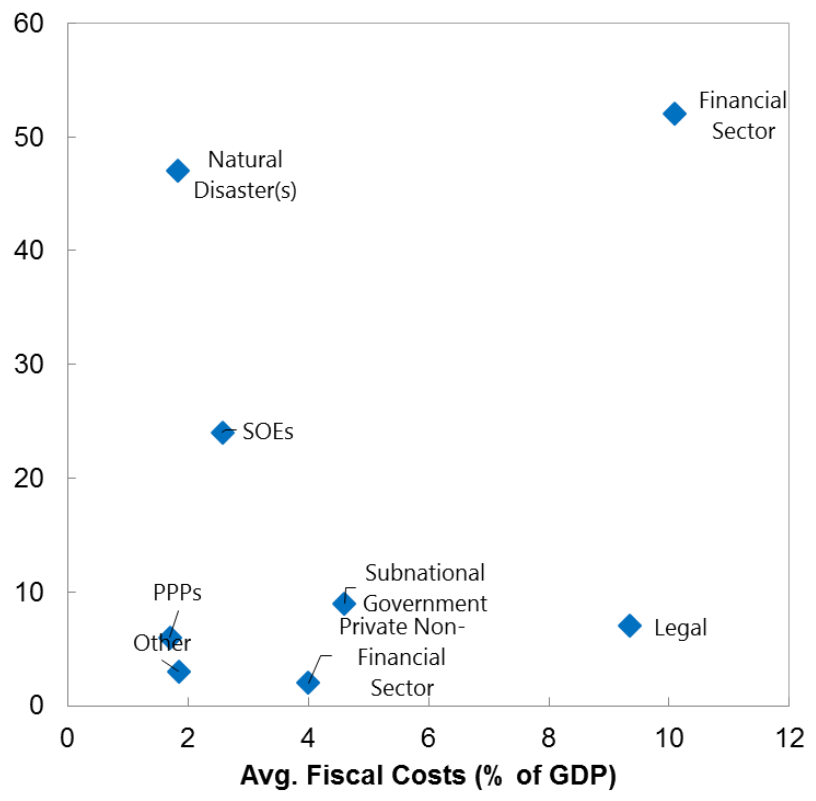
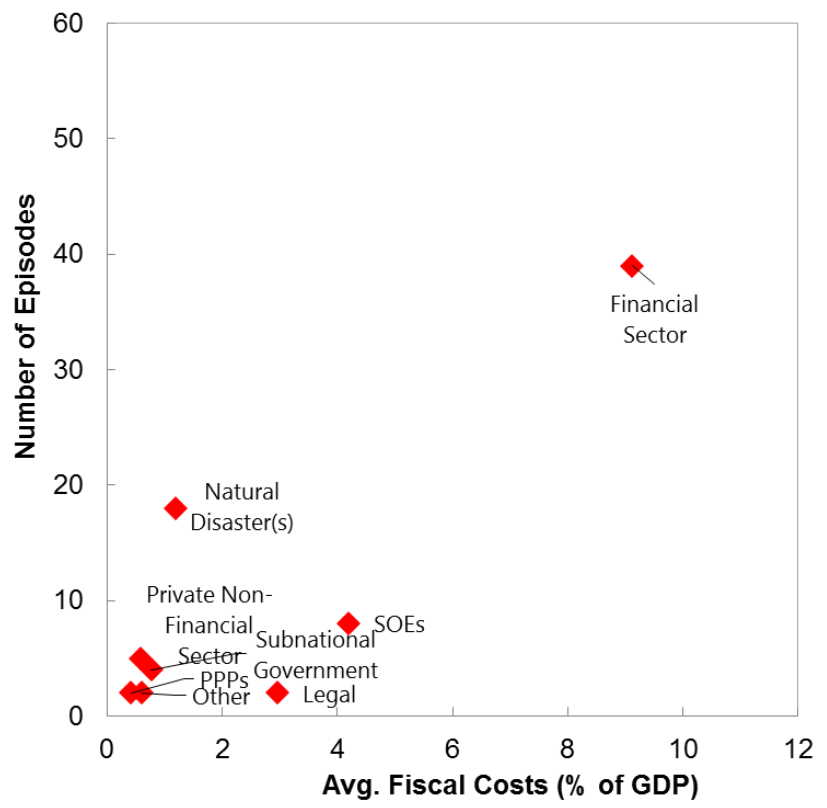
Sources: IMF staff calculations.

1/ Only includes those episodes for which a fiscal cost number is available.



# Sources of Fiscal Risks—CL realizations since 1990

## Contingent Liabilities Episodes: Advanced Economies vs. Emerging Economies



Sources: IMF staff calculations.

1/ Number of episodes includes all episodes, average fiscal cost is calculated using only those episodes for which a fiscal cost number is available. 8



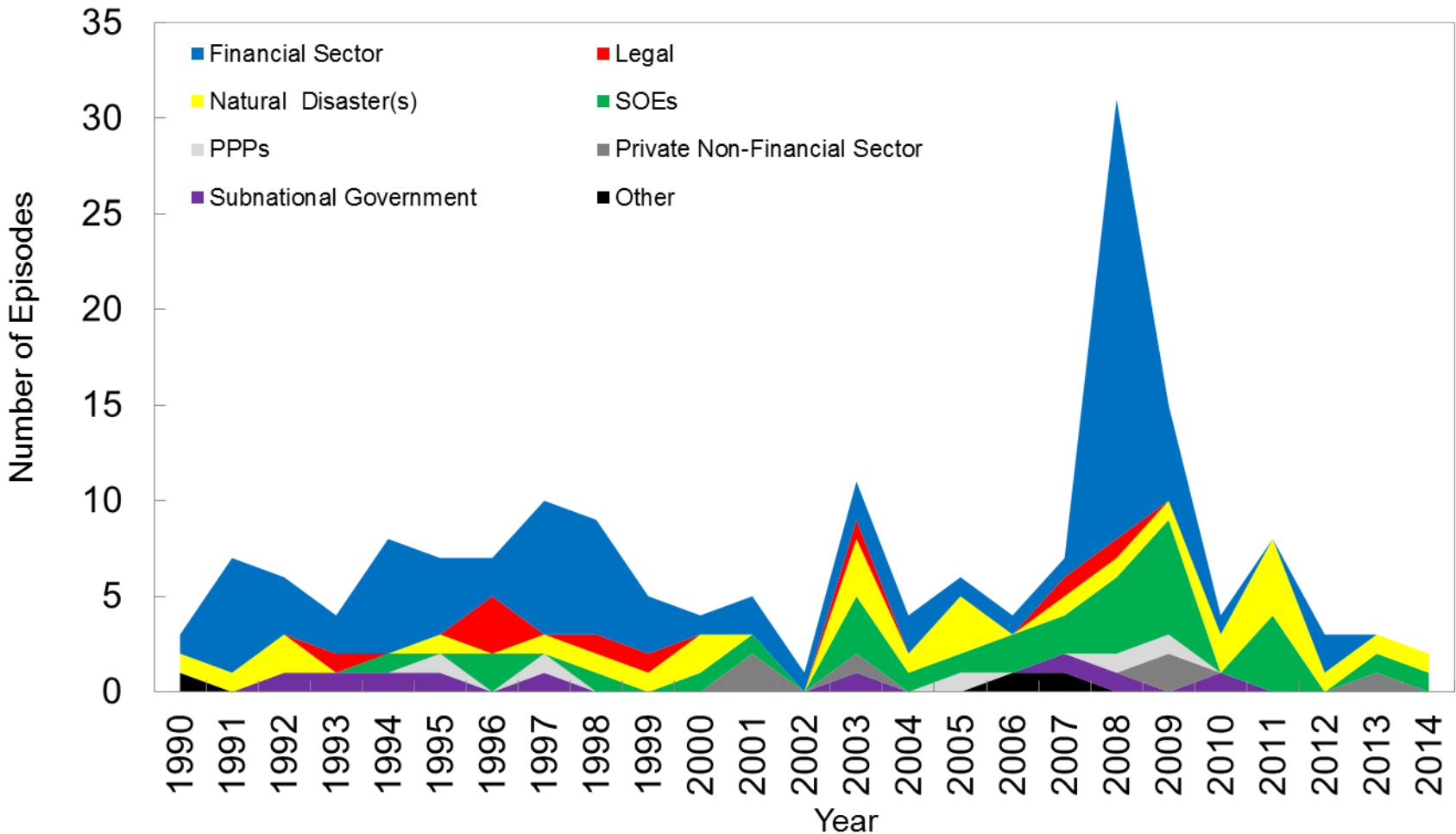
## 2. Nature of Fiscal Risks

## Nature of fiscal risks

- **Can be very large, and threaten both immediate fiscal solvency and long-run sustainability.**
- **Asymmetric, and tilted toward the downside.**
- **Not independent, but highly correlated with each other.**
- **Associated costs can be highly non-linear and disruptive.**

# Nature of fiscal risks—CL realizations since 1990

## Number of Contingent Liabilities Episodes from 1990 to 2014



Sources: IMF staff calculations.

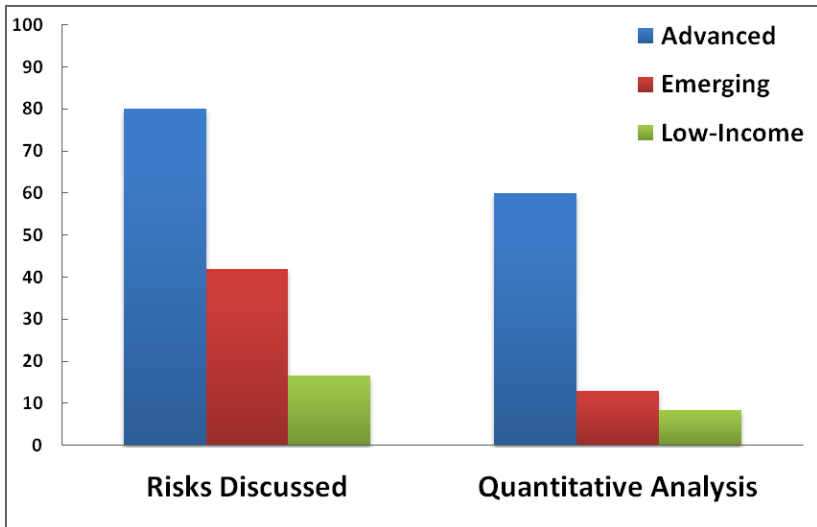
# Nature of fiscal risks—Current environment

- ***Interdependence:*** Risks often related to the state of the economy
  
- ***Global economy:***
  - Debt levels high
  - Weak global growth
  - Falling commodity prices
  - Depreciating currencies
  
- ***Strains:*** Deteriorating corporate balance sheets (public and private, financial and nonfinancial)

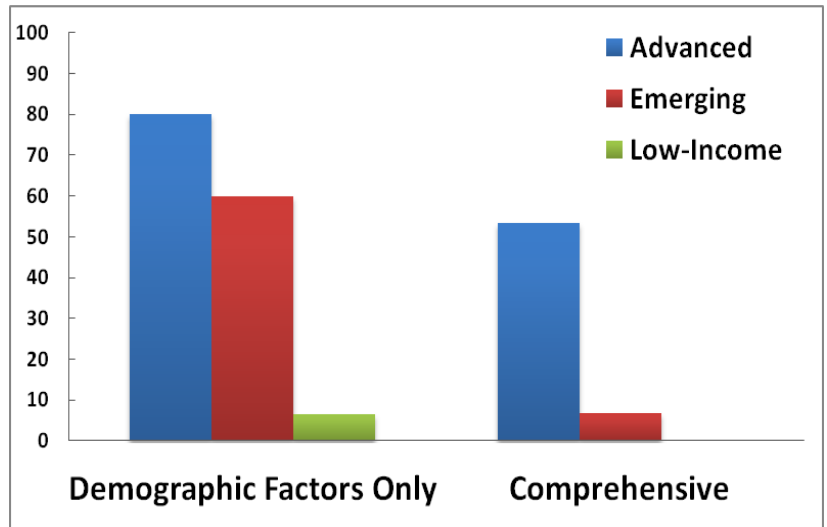
### 3. Best Practices of Risk Assessment

# Fiscal Risk Disclosure and Analysis Global Practices

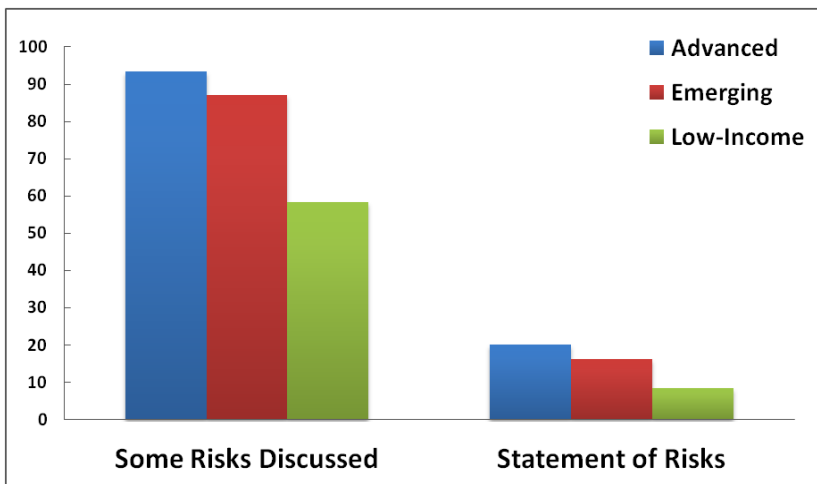
### Macroeconomic Risk Analysis



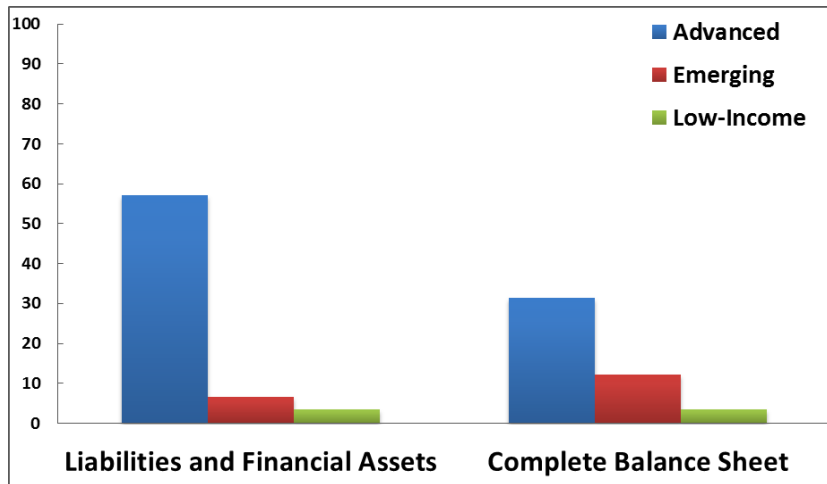
### Long-term Sustainability Analysis



### Disclosure of Contingent Liabilities



### Assets and Liabilities



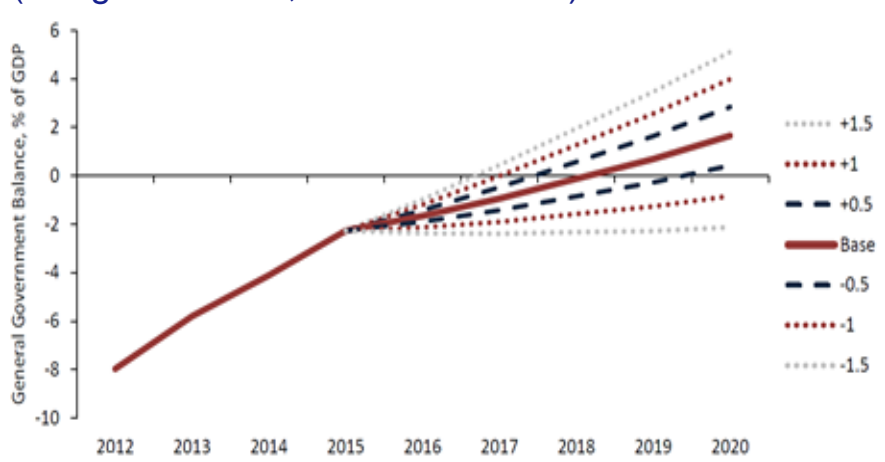
# Fiscal Risk Disclosure and Analysis

## Macroeconomic Risk Analysis

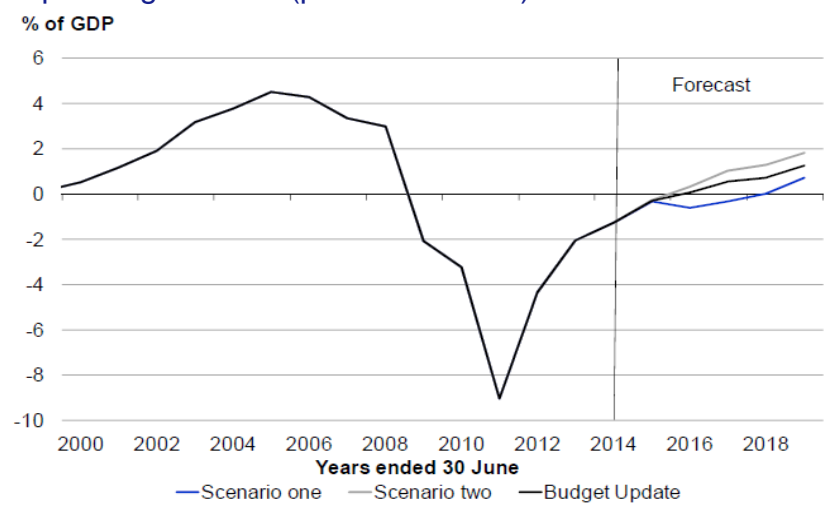
### Sensitivity Analysis – Philippines (in billion Pesos per annum)

Particulars	Revenues		Disbursements		Budget Balance	
	2015	2016	2015	2016	2015	2016
1 percentage point increase in Real GDP growth	24.3	21.6			24.3	21.6
1 percentage point increase in inflation rate	23.5	20.8			23.5	20.8
1 percentage point increase in merchandise Imports	6.3	4.3			6.3	4.3
1 percentage point increase in interest rates	0.6	0.6	3.3	3.2	(2.70)	(2.60)
1 percentage point increase in LIBOR (180-Day)			3.1	4.2	(3.10)	(4.20)
1 Peso depreciation in foreign exchange rate	8.7	10.5	2.2	2.1	6.5	8.4

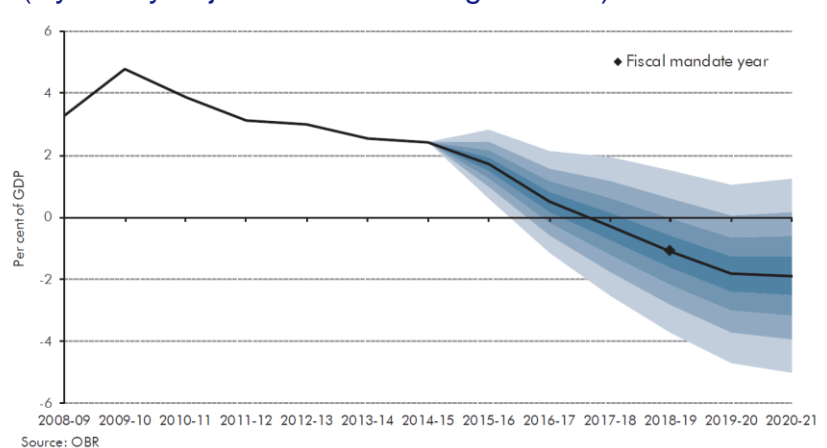
### Sensitivity Analysis – Ireland (Budget Balance, Percent of GDP)



### Alternative Macro Scenarios – NZ Operating Balance (percent of GDP)



### Probabilistic fan chart – UK (Cyclically adjusted current budget deficit)

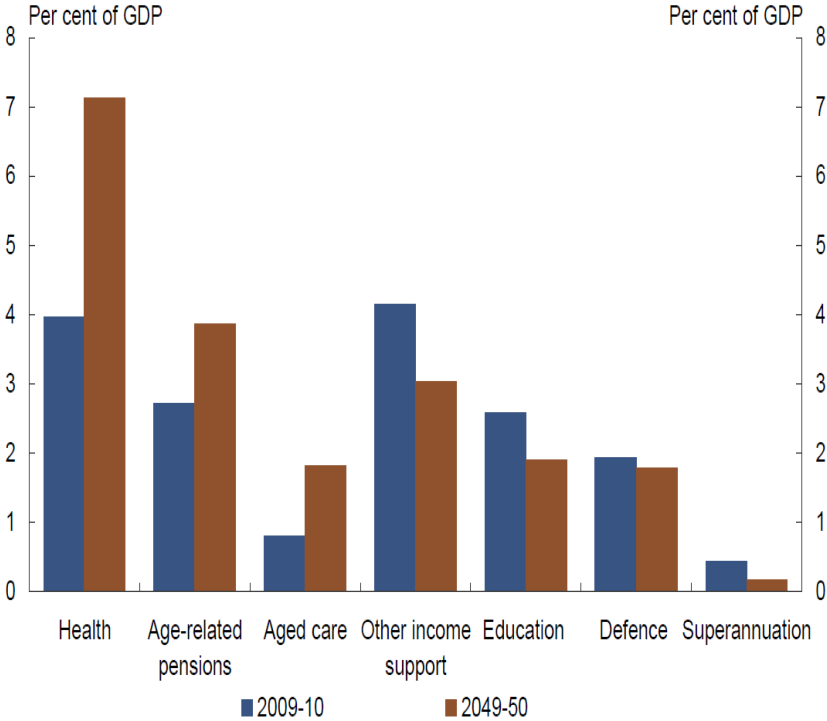




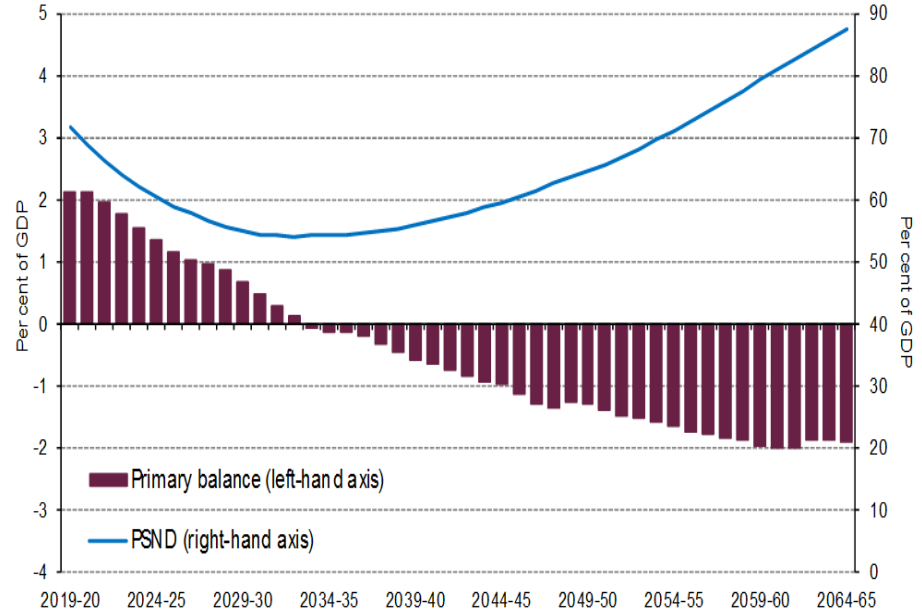
# Fiscal Risk Disclosure and Analysis

## Long-Term Sustainability Analysis

### Long-term Spending Projections: Australia



### Long-term Spending Projections: UK



Source: O BR

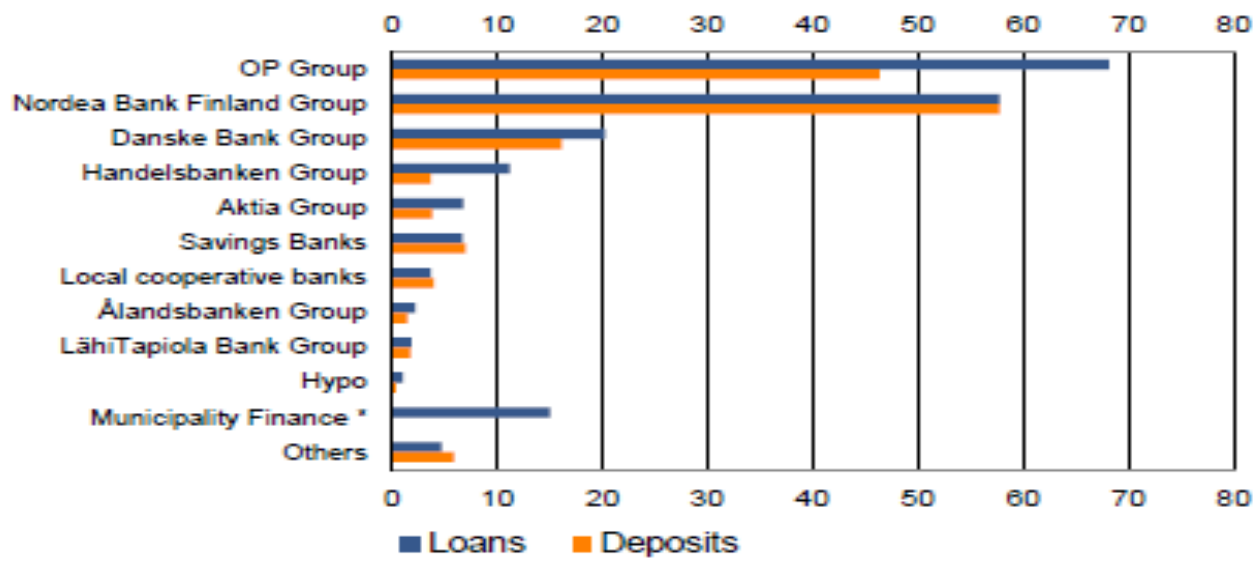
# Fiscal Risk Disclosure and Analysis

## Contingent Liabilities

### UK: Quantifiable Explicit Contingent Liabilities

	£ billion		
	2011-12 restated	2012-13	Difference
Financial Stability interventions	9.9	9.9	0.0
Export guarantees and insurance policies	9.9	12.7	2.8
Clinical negligence	8.4	10.5	2.1
Taxes subject to challenge	14.5	14.5	0.0
Supporting international organisations	32.6	32.1	-0.5
Oil and gas field decommissioning revenues	20.0	0.0	-20.0
Other	5.5	8.2	2.7
<b>Total quantifiable contingent liabilities</b>	<b>100.8</b>	<b>87.9</b>	<b>-12.9</b>

### Finland: Implicit Contingent Liabilities (EUR Billion)



# Fiscal Risk Disclosure and Analysis

## Assets and Liabilities

### Public Sector Wide Balance Sheet - UK

	2010-11	2011-12	2012-13	2013-14
	£bn	£bn	£bn	£bn
Property, plant and equipment	714	744.5	746.8	762.6
Gold, cash and other financial assets	254.6	282.1	311.2	324
Trade receivables	145.1	141.9	138.9	149.1
Equity in public sector banks	59.5	40.8	40	43
Intangible assets	34.8	35.2	34.5	31.9
Other physical assets	26.3	26.1	26.1	26.7
<b>Total Assets</b>	<b>1,234.30</b>	<b>1,270.60</b>	<b>1,297.50</b>	<b>1,337.30</b>
Public sector pensions	961	1,005.80	1,171.90	1,301.90
Government borrowing	908.2	965.5	996.2	1,096.10
Financial liabilities	295.4	374.3	472.8	490.6
Trade payables	148.4	158.9	153.5	158.7
Provisions	107	113	131	141.8
<b>Total Liabilities</b>	<b>2,420.00</b>	<b>2,617.50</b>	<b>2,925.40</b>	<b>3,189.10</b>
Net Liabilities	1,185.70	1,346.90	1,627.90	1,851.80
% of GDP	75%	83%	100%	111%

### Comprehensive Balance Sheet - NZ

NZ\$ billion		Assets	Liabilities	Net Worth
Based on accounting principles	Social	130	86	44
	Financial	122	96	25
	Commercial	23	11	13
<b>Accounting Net Worth</b>		<b>275</b>	<b>193</b>	<b>82</b>
Add	Contingent Liabilities	0	18	(18)
Add	NPV future expenses & revenue	785	886	(101)
<b>Comprehensive Net Worth</b>		<b>1078</b>	<b>1098</b>	<b>(20)</b>

Illustrative figures only

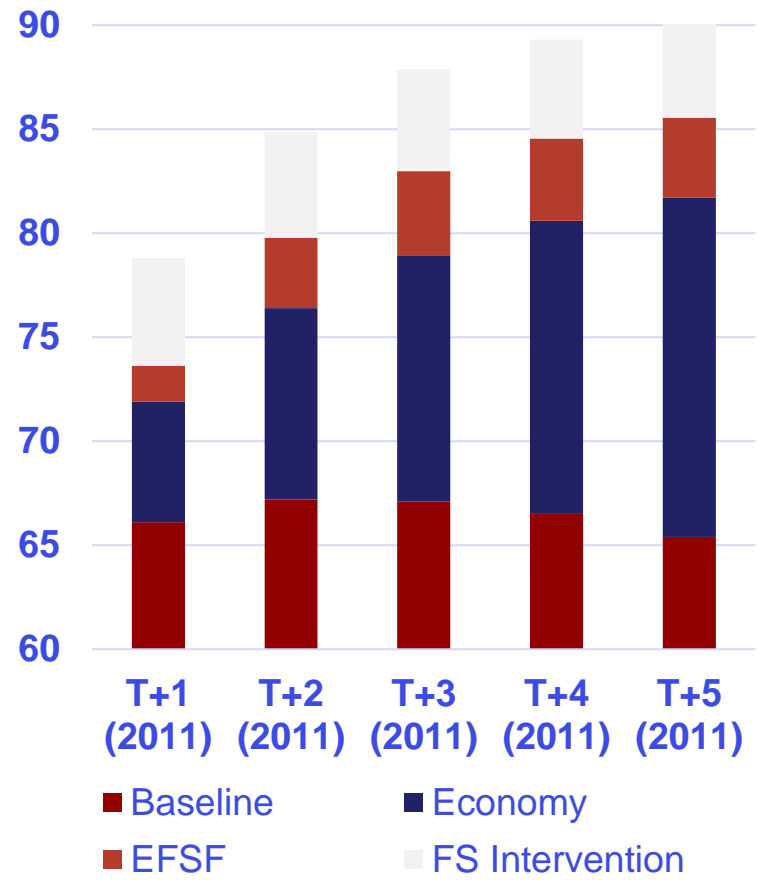
# Fiscal Risk Disclosure and Analysis

## Fiscal Stress Test

The Netherlands--Stress scenario  
(Percentage points)

Exogenous variable (GDP is endogenous)	Financial crisis
Relevant world trade	-15%
Share prices	-40%
House prices	-10%
Energy price in euro	-20%
Import price in euro	-5%
Nominal interest rate (10y)	-0,8%*
Euro/Dollar	0%

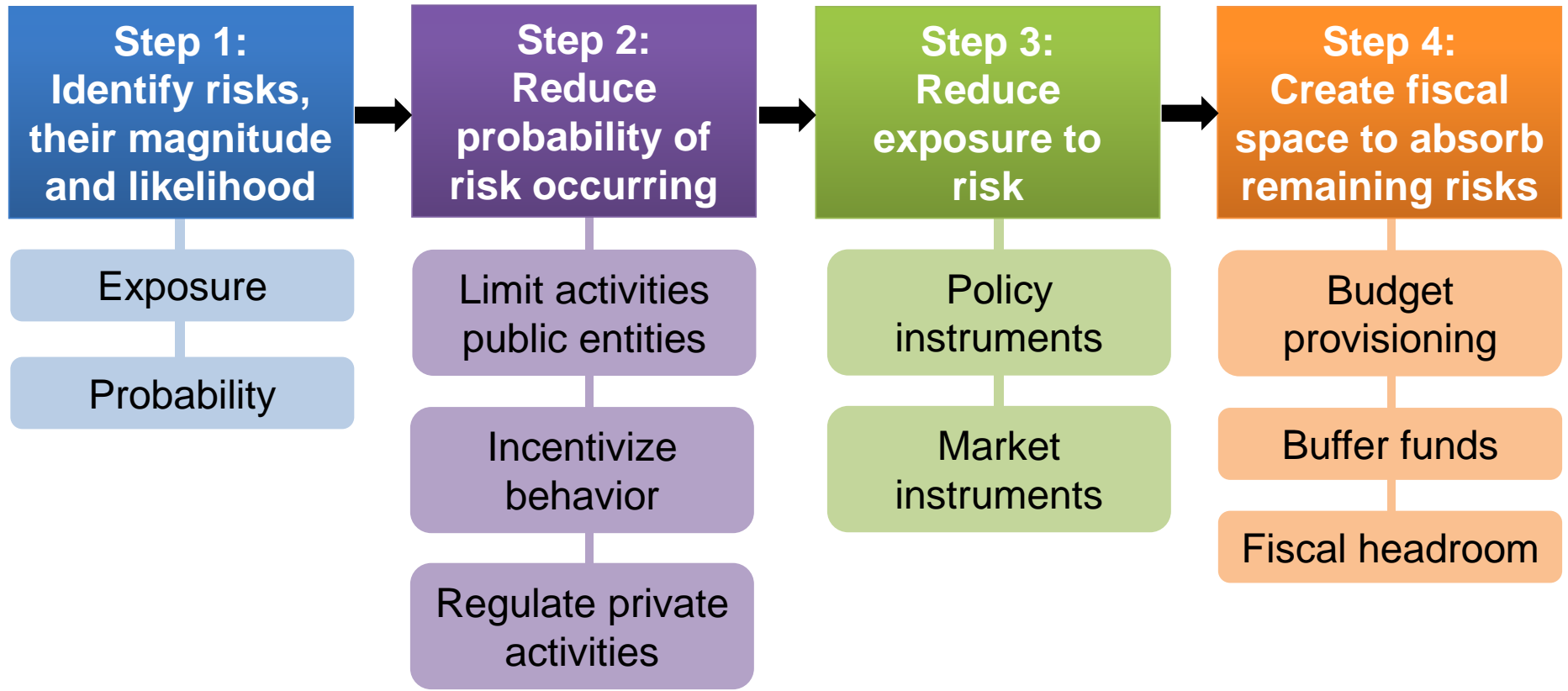
Public debt under stress scenario  
(Percent of GDP)



## 4. Management of Fiscal Risks

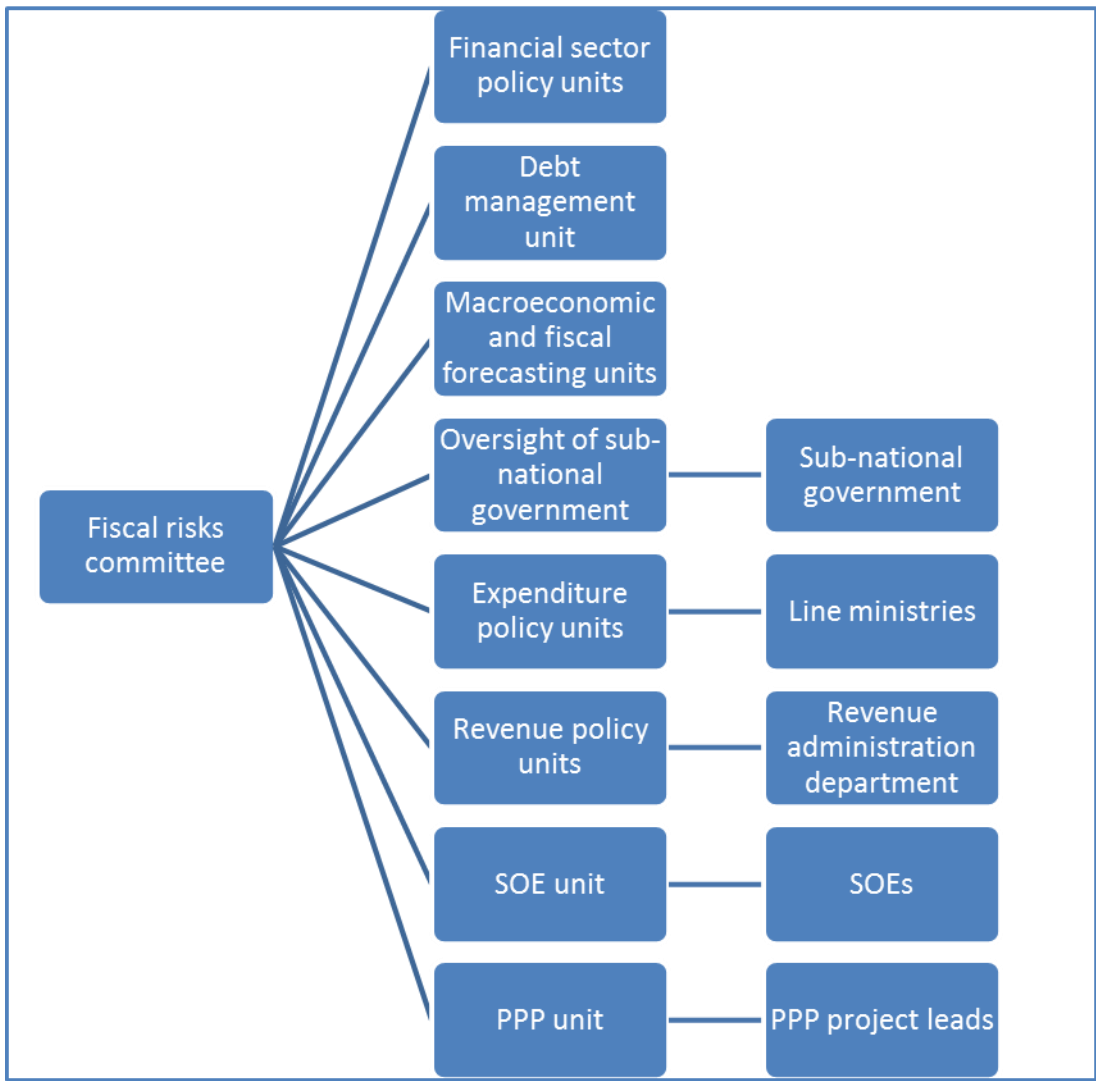
# Fiscal risk management framework

Once countries better understand the scale and sources of their fiscal risks, the remaining challenge is to manage them more actively:



The greater the capacity to reduce risk probabilities and exposures, or provision or pre-fund risks, the less need for fiscal headroom

# Fiscal risk management framework



Identification and monitoring requires risk assessment framework and inter-institutional process typically led by the MoF

- Tasks for fiscal risk committee:**
- Identifying sources of risk
  - Requesting information to monitor risks
  - Analyzing aggregate risks
  - Assessing and prioritizing
  - Providing advice to Ministers
  - Preparing published material



# Fiscal Risk management framework

## Fiscal Transparency Code

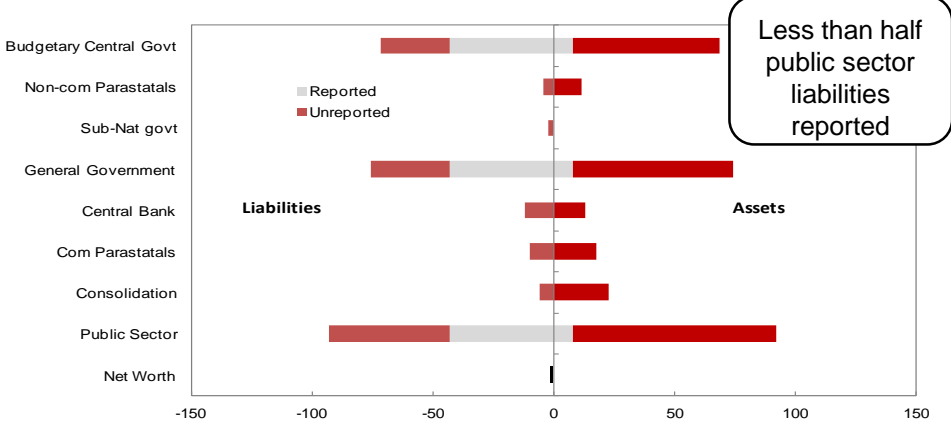
FISCAL RISK DISCLOSURE AND ANALYSIS	PRACTICES		
	BASIC	GOOD	ADVANCED
<b>Macroeconomic Risks:</b> Government reports on how fiscal outcomes might differ from forecasts.	Budget includes discussion of macro fiscal risks.	Budget includes sensitivity analysis and alternative scenarios.	Budget includes sensitivity analysis, alternative scenarios, and probabilistic forecasts.
<b>Assets and Liabilities:</b> Risks relating to major assets and liabilities are disclosed and managed.	Fiscal reports cover cash, deposits and debt and risks are analyzed and disclosed	Fiscal reports cover all financial assets and liabilities and risks are analyzed and disclosed	Fiscal reports include a full balance sheet and risks are disclosed and managed.
<b>Specific Fiscal Risks:</b> The government provides a regular summary report on the main specific risks to its fiscal forecasts.	Fiscal risks are disclosed and discussed.	Fiscal risks are disclosed and quantified.	Fiscal risks are disclosed and quantified, and their likelihood is assessed
<b>Long-Term Fiscal Sustainability Analysis:</b> The government regularly publishes long-term fiscal projections.	Fiscal projections for at least 10 years are produced, incl. for health and social security funds	Fiscal Projections for at least 30 years are produced incl. macro sensitivity analysis	Fiscal Projections for at least 30 years are produced incl. macro, demographic and other sensitivity analysis

# Fiscal Risk management framework

## Fiscal Transparency Evaluation (FTE)

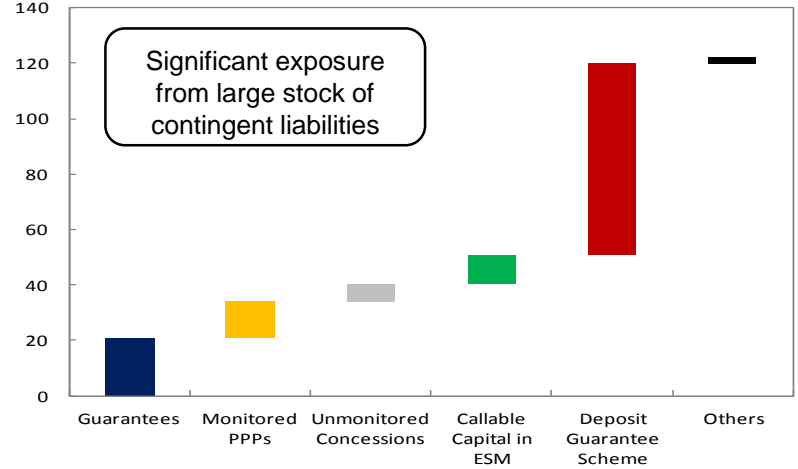
### East African Country

**Assets and liabilities: Public sector balance sheet**  
(percent of GDP)



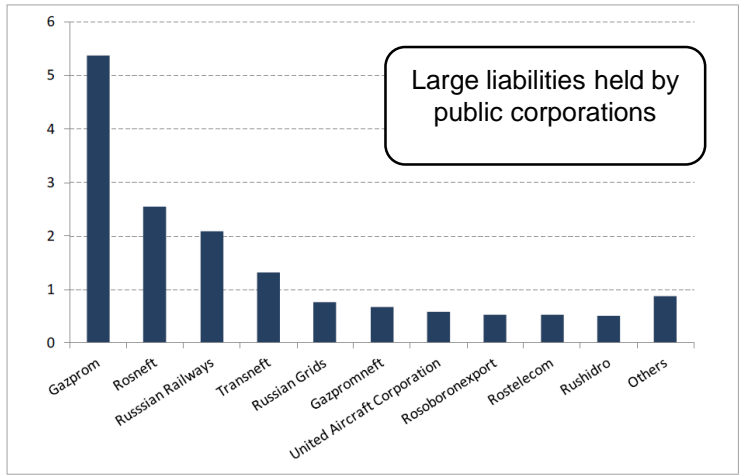
### Portugal: Contingent liabilities

(percent of GDP)

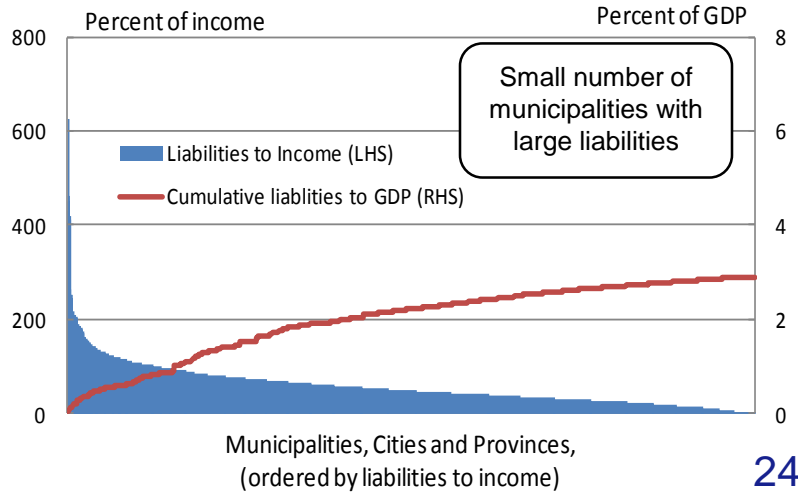


### Russia: Public non-financial corporations liabilities

(percent of GDP)



### Philippines: Sub-national gross liabilities



Source: Staff estimates based on annual reports of the 18 largest public nonfinancial joint-stock companies.

## Fiscal Risk Management-- Conclusions

- Crisis legacies show that risks to government balance sheets are varied, large, and correlated.
- Policymakers need to:
  - Build more accurate and complete balance sheet information
  - Develop a more complete understanding of risks
  - Enhance capacity to mitigate and manage risks
  - Better integrate fiscal risk analysis into fiscal policymaking



Thank You