Fiscal risk management
Institutional arrangements

Eivind Tandberg
CEF Ljubljana, March 2019
Vista in the news

1. VG NYHETER
   Rapport om barnevernet: Gir enorme profitmuligheter, liten kontroll med pengebruken

2. Kapital
   Norway's leading business magazine
   Torsdag 15. desember

3. Handelen følger folk
   Handelen fjær skynten før tyvenes utfordringer. Men handlet er ikke årsaken.

4. Daniel Appyday (37) kom til Norge, universitetsgrad.

5. DN
   Dagens Næringsliv

6. KLASSEKAMPEN
   Vestlandet Myra på bunn
   Side 6-9
   Kommer i tilbakegang
   Velte: Årets Kommune-NM tegner elige bakte av en oljelekvisje i kr. har det gått ut over kristiansund.

7. Dagsavisen
   Anbefaler ulike bomtakster
   Miljødifferensierede bompenger kan realiseres i løpet av neste år: En slik ordning vil føre til krutige kutt i utslippene av NOx, ifølge Vegdirektoratet.
News from www.vista-analyse.no

Er det behov for en nasjonal oversikt over tilgjengelige fosterhjem?
04.12.2017
På oppdrag for KS har Vista Analyse utredet om det er behov for en nasjonal oversikt over tilgjengelige, kommunalt rekrutterte fosterhjem. Vi har sett på hvordan en slik oversikt eventuelt kan...

Norges Bank følger Vistas råd
17.11.2017
I en rapport fra mars i år argumenterte Vista Analyse med at olje fondet burde selge sine oljeaktjer for å redusere den norske statens samlede risiko. Årsaken er blant annet at staten allerede er...

Første helårsevaluering av aktivitetskollen i Drammen
15.11.2017
Vista Analyse og ideosevisende har på oppdrag fra Drammen kommune gjennomført den første helårsevalueringen av proveprosjektet ”Aktivitetskollen i Drammen Kommune”. Aktivitetskollen skal...

Kostnad-nytteteanalyse av klimatilpasningsprosjekter
08.11.2017
Vista Analyse har utarbeidet en veiledere for hvordan en kan utføre kostnad-nytteteanalyse av klimatilpasningsprosjekter. Veilederen gir også et eksempel på hvordan metoden kan anvendes på én type...

Vista i Georgia
01.11.2017
Vista Analyse skal bistå georgiske myndigheter med å utarbeide praktiske retningslinjer forvervnet av virkninger på biodiversitet og forurensning av vann og grunn fra aktiviteter knyttet...

Velkommen til Orvika!
24.11.2017
Vi er strålende fornøyd med at Orvika Rosnes har takket ja til å begynne i Vista Analyse. Orvika kommer fra forskningsavdelingen i Statistikk sentralbyrå og har tidligere jobbet i Econ Analysis....

Nytt prosjekt: Evaluering av foringstilskuddet
24.11.2017
Vista Analyse har fått i oppdrag av Nærings- og fiskeridepartementet å evaluere effektene av foringstilskuddet i fiskeriproduksjonen. Vi har også hatt kontakt med flere organisasjoner...

Fire fakta som forklarer SSB-bråket
10.11.2017
Haakon Vennemo, partner og styreleder i Vista Analyse, har skrevet et innlegg i Dagens Næringsliv om striden i SSBs artikkelen her....

Nytt prosjekt: Kunnskapsgrunnlag for miljøkrav i drøsjørenningen
06.11.2017
Foto: Petter Haugeland/ebi.no/Vista Analyse har fått i oppdrag fra Miljødirektoratet å gjennomføre en kartlegging som skal gi kunnskapsstatus og oversikt over problemstillinger knyttet til...

Barnevern - nytt oppdrag og nytt oppslag
31.10.2017
Foto: Tore Bringsdal, VG/Vista Analyse har fått et nytt oppdrag om barnevern. Vi skal kartlegge rammeverkene for kommunale fosterhjem for Fosterhjemssutvalget, slik at utvalget får et best...
Outline

- Defining fiscal risks
- The importance of fiscal risks
- A framework for managing fiscal risks
- Key messages

- Managing specific fiscal risks (If time allows)
  - State-owned enterprises
  - Subnational governments
  - Guarantees
What are fiscal risks?

• The possibility of fiscal outcomes deviating from expectations (as in the budget or other forecasts).

• Different from “policy risks” arising from changes in government policies.
# Fiscal risk (liabilities) matrix

<table>
<thead>
<tr>
<th></th>
<th>Direct</th>
<th>Contingent</th>
</tr>
</thead>
</table>
| Explicit | Macroeconomic shocks  
Budget revenue estimates  
Expenditure estimates  
Interest rate changes  
Exchange rate changes  
Statutory transfers | Calls on guarantees  
PPP minimum revenue payments  
Legal claims  
Natural disasters  
Deposit guarantees |
| Implicit | Long term pension costs  
Long term health care costs | Local government bailouts  
State enterprise bailouts  
Financial sector intervention  
PPP contract cancellation |
### Why fiscal risks are important?

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

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

* GDP-weighted average

Issues Revealed by the Crisis

- Unreported Deficits
- SoEs & PPPs
- Arrears
- Macroeconomic Risks
- Contingent Liabilities
- Stimulus / Consolidation
Why fiscal risks are important?
Why fiscal risks are important?


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

• Fiscal outturns often differ substantially from budget or other fiscal projections
• Unexpected spending pressures or revenue losses often require disruptive ad-hoc adjustments during the fiscal year
• Failure to identify, measure, disclose, and prepare for such risks can cause additional government obligations, larger public debts, and, occasionally, refinancing difficulties and crises
Framework for managing fiscal risks

Identifying and monitoring
- Establishing the context
- Identifying areas of risk
- Central coordination unit
- Information collection

Mitigating
- Risk allocation strategy
- Institutional responsibility

Analyzing
- Economic sensitivity analysis
- Asset-liability assessment
- Valuing contingent liabilities

Reporting
- Economic sensitivity analysis
- Public sector balance sheet
- Fiscal risk statement

Incorporating in budget
- Budget margins/reserves
- Stabilization funds
- Debt level
- Caps
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Identifying and analyzing fiscal risks

Identification and monitoring requires risk assessment framework and inter-institutional process typically led by the MoF.
Identifying fiscal risks: economic and fiscal structures

**Structures**

- Nature of the macro-economy
  - Key sectors
  - Linkages between sectors
- Structure of the public finances
  - Sources of revenue (tax / grants)
  - Structure of expenditure
  - Size and composition of debt
- Structure of the public sector
  - Extra-budgetary funds
  - Sub-national government
  - State-owned enterprises
- International position
  - Trade
  - External debt obligations
  - Regional arrangements
- Other structural issues
  - Environmental risks
  - Political risks

**Risk factors**

- Concentration
  - Dependence on dominant sector
- Volatility
  - Exposure to global commodity prices
- Uncertainty
  - Likelihood of natural disaster occurring
- Feedback mechanisms
  - Transmission of shocks between sectors
- Inflexibility
  - Inability to adjust to shocks, eg non-discretionary spending
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How to analyze fiscal risks?

• Where does the source reside?
  • Endogenous: those arising from a government activity (e.g. credit guarantees)
    • Probability/impact can be influenced by the government
  • Exogenous: those arising from actions/events outside of government control (e.g. natural disasters)

• What is the nature of incidence?
  • Continuous: regular events (e.g. commodity price volatility)
  • Discreet: occurring irregularly (e.g. banking crisis); can be further classified on the basis of likelihood:
    • Probable – likely to materialize in near term
    • Possible – likely at some point in time
    • Remote – difficult to predict
Approaches to analyzing general fiscal risks

**Sensitivity Analysis – Philippines**  
(billion Pesos per annum)

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Revenues</th>
<th>Disbursements</th>
<th>Budget Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 percentage point increase in Real GDP growth</td>
<td>15.2</td>
<td>15.2</td>
<td></td>
</tr>
<tr>
<td>1 percentage point increase in Inflation rate</td>
<td>14.6</td>
<td>14.6</td>
<td></td>
</tr>
<tr>
<td>1 percentage point increase in Merchandise Imports</td>
<td>4.7</td>
<td>4.7</td>
<td></td>
</tr>
<tr>
<td>1 percentage point (100 bps) increase in T-bill rate, all maturities</td>
<td>8.2</td>
<td>3.2</td>
<td>5</td>
</tr>
<tr>
<td>1 Peso appreciation in foreign exchange rate</td>
<td>-6.6</td>
<td>-2.6</td>
<td>-6</td>
</tr>
</tbody>
</table>

**Alternative Scenarios – NZ**  
Operating Balance (before gains and losses)

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

**Long-term Analysis – Aust.**

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Integrating fiscal risk analysis: The Fiscal Stress Test (FST)

• Integrates macro analysis and contingent liabilities realization
  • Examines impact of a very large event, typically 2-3 standard deviations from the average historical volatility
    • Choice of stress scenario also considers comparator countries experience
  • Considers correlation between different macro variables and contingent liabilities
  • Impact analyzed using a detailed fiscal forecasting framework
    • Granularity of the fiscal forecasting framework used to capture fiscal non-linearities

• Examines impact of shocks on both fiscal flows and stock variables
  • Adopts a comprehensive balances sheet approach that allows examining impact on future assets and liabilities

• Three summary outputs provide a guide to solvency, liquidity risk and fiscal burden
FST: An Illustration
### FST: An Illustration: A Comprehensive Balance Sheet

<table>
<thead>
<tr>
<th></th>
<th>Baseline</th>
<th>Shock</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Financial assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Currency and deposits</td>
<td>9.2</td>
<td>9.0</td>
</tr>
<tr>
<td>Loans</td>
<td>8.5</td>
<td>8.4</td>
</tr>
<tr>
<td>Shares and other equities</td>
<td>17.9</td>
<td>9.0</td>
</tr>
<tr>
<td>Other accounts receivable</td>
<td>7.0</td>
<td>7.0</td>
</tr>
<tr>
<td>NPV Revenues</td>
<td>860.2</td>
<td>777.0</td>
</tr>
<tr>
<td><strong>Liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Securities other than shares</td>
<td>21.8</td>
<td>42.8</td>
</tr>
<tr>
<td>Loans</td>
<td>20.4</td>
<td>27.3</td>
</tr>
<tr>
<td>Insurance technical reserves</td>
<td>18.0</td>
<td>18.1</td>
</tr>
<tr>
<td>Other accounts payable</td>
<td>7.4</td>
<td>7.4</td>
</tr>
<tr>
<td>NPV Expenditures</td>
<td>875.3</td>
<td>823.0</td>
</tr>
<tr>
<td><strong>Net Financial Worth</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Existing Net Financial Worth</td>
<td>-24.3</td>
<td>-61.6</td>
</tr>
<tr>
<td>Future discounted deficits</td>
<td>-15.1</td>
<td>-46.0</td>
</tr>
</tbody>
</table>
How do countries analyze fiscal risks?

**Macro Analysis**

**Long-term Sustainability Projections**
Framework for managing fiscal risks

Identifying and monitoring
- Establishing the context
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- Central coordination unit
- Information collection

Mitigating
- Risk allocation strategy
- Institutional responsibility

Analyzing
- Economic sensitivity analysis
- Asset-liability assessment
- Valuing contingent liabilities

Incorporating in budget
- Budget margins/reserves
- Stabilization funds
- Debt level
- Caps

Reporting
- Economic sensitivity analysis
- Public sector balance sheet
- Fiscal risk statement
Mitigating fiscal risks

Government must first decide whether to bear the risk:
Pros: Public policy benefit (e.g. auto. stabilizers for stability; guaranteeing bank deposits to discourage runs)
Cons: Moral hazard, risk transfers are less transparent, solvency

<table>
<thead>
<tr>
<th>Reduce probability of risk occurring</th>
<th>Reduce exposure to risk</th>
<th>Create fiscal space to absorb retained risk</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Controls on activities of public entities</strong></td>
<td><strong>Market instruments</strong></td>
<td><strong>Budget provisioning</strong></td>
</tr>
<tr>
<td>• Ceilings for guarantees (Netherlands, Czech Republic)</td>
<td>• Disaster Insurance (Caribbean Catastrophe Risk Insurance Facility)</td>
<td>• Contingency reserves</td>
</tr>
<tr>
<td>• Limits on liabilities or borrowings of local authorities</td>
<td>• Catastrophe bonds (Mexico earthquake bonds)</td>
<td>• Expense expected cash flows for calls on CLs (Columbia, US)</td>
</tr>
<tr>
<td><strong>Incentivize behavior</strong></td>
<td>• Hedging instruments (Mexico oil price options)</td>
<td>• Prudent price assumptions (Chile)</td>
</tr>
<tr>
<td>• Partial guarantees</td>
<td><strong>Policy instruments</strong></td>
<td><strong>Buffer funds</strong></td>
</tr>
<tr>
<td>• Charge risk related guarantee fees</td>
<td>• Regulating building codes to insulate against disasters</td>
<td>• Natural Disaster Funds (NZ, Mexico, Turkey)</td>
</tr>
<tr>
<td>• Reduce debt bias in the tax system</td>
<td>• Upper limits on disaster or deposit insurance schemes</td>
<td>• Stabilization Funds (Chile)</td>
</tr>
<tr>
<td><strong>Regulate those benefiting from govt. risk-bearing</strong></td>
<td></td>
<td>• Deposit Insurance Funds (US)</td>
</tr>
<tr>
<td>• Financial sector regulation (e.g. capital requirements)</td>
<td></td>
<td>• Guarantee Funds (Chile, Columbia, US, Sweden)</td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>Fiscal headroom</strong></td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Prudent debt limits (NZ)</td>
</tr>
</tbody>
</table>
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Incorporating risks in the budget

- **Buffers**
  - Low debt / Stabilization funds
  - Contingency reserves / Margins

- **Budget flexibility**
  - Virements
  - Supplementary budgets

- **Public sector fiscal planning**
  - Include SOE flows and stocks within fiscal projections, plans and objectives

- **Caps**
  - Create budget ceilings for contingent liabilities such as guarantees, PPPs etc
Incorporating in budget: Reserves

• The dilemma:
  • sufficient buffer to absorb justified uncertainty
  • maintain discipline restriction in the budget

• Factors affecting the appropriate size:
  • time frame
  • composition of expenditure
  • risk exposure

• 1-3 % of total expenditure is common practice

• Robust access criteria and approval process
How do countries mitigate and provide for risks?

Direct Control
- Guarantees: Limits on liabilities
- Financial: Lending controls
- SOEs: Limits on explicit liabilities
- PPP: Limits on liabilities
- Subnationals: rules/limits

Indirect Measures
- Guarantees: Risk-based fees
- Financial: Regulate bank exposures
- SOEs: performance targets
- Commodities: tax base diversification
- PPP: value for money checks

Risk Transfer
- Guarantees: reinsure/securitize
- Financial: bank levy
- Commodities: hedging
- Nat. Disaster: insure public assets

Budget Provisioning
- Guarantees: provision/expense
- Financial: deposit insurance funds
- SOEs: expense QFAs
- Commodities: Stabilization funds
- Nat. Disaster: provisions/fund

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What do disclosure standards require?

### Fiscal Transparency Code

<table>
<thead>
<tr>
<th>FISCAL RISK DISCLOSURE AND ANALYSIS</th>
<th>PRACTICES</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>BASIC</td>
</tr>
<tr>
<td><strong>Macroeconomic Risks:</strong> Government reports on how fiscal outcomes might differ from forecasts.</td>
<td>Budget includes discussion of macro fiscal risks.</td>
</tr>
<tr>
<td><strong>Assets and Liabilities:</strong> Risks relating to major assets and liabilities are disclosed and managed.</td>
<td>Fiscal reports cover cash, deposits and debt and risks are analyzed and disclosed</td>
</tr>
<tr>
<td><strong>Specific Fiscal Risks:</strong> The government provides a regular summary report on the main specific risks to its fiscal forecasts.</td>
<td>Fiscal risks are disclosed and discussed.</td>
</tr>
<tr>
<td><strong>Long-Term Fiscal Sustainability Analysis:</strong> The government regularly publishes long-term fiscal projections.</td>
<td>Fiscal projections for at least 10 years are produced, incl. for health and social security funds</td>
</tr>
</tbody>
</table>
Wide diversity of reports on fiscal risks

While the more advanced approaches require high quality data and technical capacity, the coverage and depth of the statement can be expanded over time.

- Australia: Statement of Risks in budget documentation
- Brazil: Budget annex on Riscos Fiscais
- Chile: Informe de pasivos contingentes
- Colombia: Medium Term Fiscal Plan
- France: detailed discussions on provisions and contingent liabilities within the Compte General de l’Etat
- Iceland: Risk Chapter in Debt Report
- Indonesia: Section in budget report
- New Zealand: Chapters in Budget and Half-Year Economic and Fiscal Updates
- Philippines: Fiscal Risks Statement
- United Kingdom: Fiscal Risk Report
- United States: Chapter on credit and insurance in Analytical Perspectives
What are the Benefits of a fiscal risk statement?

<table>
<thead>
<tr>
<th>Improved risks management</th>
<th>Improved economic efficiency promotes earlier and smoother policy responses</th>
<th>Reduced borrowing costs and increased attractiveness</th>
</tr>
</thead>
</table>
| • Submit the analysis to additional scrutiny, helping to ensure that risks are properly assessed and recognized.  
  • Strengthens accountability for risk management | • Improves the quality of decisions on whether the government should take on risks in the first place  
  • Leads to more careful assessment of cost-effectiveness of contingent liabilities and inspection for implicit subsidies. | • Fiscal transparency is associated with better sovereign bond ratings and greater access to international capital markets  
  • Fiscal transparency has been found to foster foreign direct investment |
# Moldova Fiscal Risk Statement 2017

<table>
<thead>
<tr>
<th>Risk</th>
<th>Nature of the risk</th>
<th>Pot. impact</th>
<th>Probability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Macroeconomic shocks</td>
<td>Unpredicted macroeconomic developments change economic prospects and financial position</td>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td>Estimated revenue</td>
<td>Poor revenue collection leads to deterioration of the budget balance</td>
<td>Medium</td>
<td>High</td>
</tr>
<tr>
<td>Unexpected spending</td>
<td>Legal obligations or political pressures lead to expenditure adjustment</td>
<td>Medium</td>
<td>High</td>
</tr>
<tr>
<td>Exposure to public debt</td>
<td>Unexpected market developments increase the debt and the debt service costs</td>
<td>Medium</td>
<td>High</td>
</tr>
<tr>
<td>State-owned enterprises</td>
<td>Government is required to bail out insolvent SOEs and JSCs with state capital</td>
<td>High</td>
<td></td>
</tr>
<tr>
<td>Financial sector insolvency</td>
<td>Government is required to bail out insolvent, systemically important banks</td>
<td>High</td>
<td></td>
</tr>
<tr>
<td>Local governments</td>
<td>Local governments transfers must be increased to ensure service delivery</td>
<td>Low</td>
<td></td>
</tr>
<tr>
<td>Public-private partnership</td>
<td>Payments related to PPPs are higher than expected and provisioned for</td>
<td>Low</td>
<td></td>
</tr>
<tr>
<td>State guarantees</td>
<td>Government is obliged to make payments under state guarantees</td>
<td>Low</td>
<td></td>
</tr>
</tbody>
</table>

\[1\] High indicates possible impact more than 3 percent of GDP, medium 1 – 3 percent, low below 1 percent.

\[2\] High indicates probability more than 30 percent, medium 10 – 30 percent, low below 10 percent.
How do countries disclose fiscal risks?

Fiscal Risk Statement

Government Balance Sheet
Key Messages

• Informed policy making requires awareness of fiscal risks in both quantitative and qualitative terms
  • Governments need to develop a more complete understanding of risks and better integrate risk analysis into fiscal policymaking

• Fiscal risks are varied, large, correlated and with non-linear impact

• General macroeconomic risks and risks from financial sector are typically the largest and more challenging to analyze
Key Messages

• A systematic risk management approach can be built around five steps – (i) identification (ii) analysis and quantification; (iii) mitigation; (iv) provisioning; and (v) disclosure

• Identification, disclosure, and management of fiscal risks are mutually supporting activities
  • Some empirical evidence to suggest a link between disclosure and sovereign credit rating

• Risk management needs a clear legal and administrative framework
State-owned enterprises
Managing specific fiscal risks
Why state-owned enterprises?

• SOEs can be a major source of fiscal risk because:
  • their financial performance impacts both revenue and expenditure sides of the budget
  • the government may have guaranteed SOE debt
  • expectations of a bailout (implicit guarantee)
  • their recapitalization needs, often due to inadequate compensation for quasi-fiscal activities
Managing fiscal risks from SOEs

• Understand magnitude of fiscal exposure to the SOE sector
  • Central oversight units to assess fiscal risks

• Reduce size of fiscal exposure
  • Limit size of SOE sector (e.g. through privatizing commercial entities)
  • Progressively reduce QFAs
  • Limit guarantees or levy guarantee fees

• Strengthen SOE governance
  • Operational autonomy, independent boards, internal audit procedures
  • Regular fiscal reporting (in line with int. accounting standards) and subject to external audit
  • QFAs should be clear and accounted for in budget
  • Disclose all guarantees

• Clarify government stance on non-guaranteed liabilities of SOEs
Subnational governments
Managing specific fiscal risks
Why consider sub-national governments?

• Sub-nationals can be a source of fiscal risk because:
  • External revenue sources can lead to an overspending and deficit bias
  • They (and their lenders) may assume central government will provide a bailout

• In addition there may be institutional risks:
  • They typically operate with more autonomy than ministries
  • They may have lower PFM capacity
  • Information on their fiscal position may be poor
Managing fiscal risks from subnational governments

• Identification and monitoring:
  • Sub-national government oversight unit in MoF
  • Obligation on sub-nationals to provide information on financial position
  • Requirements to publically report financial position at least annually

• Mitigation:
  • Controls on borrowing activities backed by enforcement mechanisms
    • Rules based controls: ceilings on debt and/or debt service
    • Administrative controls: prior approval
  • Market discipline (e.g. credible no-bailout policy)

• Trade off: controls and monitoring can increase expectations of bail-outs
IV. Subnational Governments
C. Managing risks

**Different approaches to controlling sub-national borrowing**

<table>
<thead>
<tr>
<th></th>
<th>Direct Controls</th>
<th>Rules Based regulations</th>
<th>Cooperation</th>
<th>Market Discipline</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Approach</strong></td>
<td>Prior approval for borrowing and/or limits</td>
<td>Fiscal rules and/or limits set through national legislation</td>
<td>Limits set through negotiated agreement</td>
<td>No direct control on borrowing</td>
</tr>
<tr>
<td><strong>Advantages</strong></td>
<td>High degree of central control</td>
<td>Transparent Avoids bargaining</td>
<td>Enhances responsibility</td>
<td>Emphasis on self-control</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>External monitoring</td>
</tr>
<tr>
<td><strong>Pre-conditions</strong></td>
<td>Constitutional / legal underpinning</td>
<td>Credible rules Transparency Monitoring and enforcement mechanisms</td>
<td>Culture of fiscal discipline Constitutional underpinnings</td>
<td>Developed capital markets</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Transparency Track record of no bailouts</td>
</tr>
</tbody>
</table>
Types of controls on subnational borrowing

(Share of countries in sample undertaking approach)

Note: Sample consists of 60 industrialized, developed and transitioning countries.
Government guarantees
Managing specific fiscal risks
Why guarantees are important?

• **Major source of fiscal risk**
  - No upfront cash flow, but expose the government to the risk of future cash outflows of uncertain quantum and timing.
  - Size can be significant, e.g., among the European countries 11 with >10% of GDP and 3 with >25% of GDP (excluding deposit insurance and certain other types).

• **Remain opaque**
  - Typically off-budget operations; remain invisible in budget, accounts and other fiscal reports.

• **A source of economic inefficiency**
  - May not always have sufficient economic justification.
  - Often used to bypass budgetary constraints, as a substitute for direct expenditure.

• **Typically weak control and management**
  - Escape routine scrutiny that applies to conventional expenditure, including legislative scrutiny and approval, and often used to assist low priority projects.
  - Incomplete records and disclosure.
  - Weak monitoring.
  - Insufficient budget provisions to meet obligations when they arise.
  - Inadequate risk management.
  - Ambiguity in roles and responsibilities.
How to strengthen guarantees management?

• Knowing the size of the problem

• Ensuring that existing guarantees are properly recorded and disclosed

• Regulating the issuance of new guarantees through a policy framework within a specified ceiling

• Ensuring adequate budgetary provisions to meet the claims

• Developing capacity to evaluate guarantee proposals and assess associated risks

• Developing measures to manage associated risks
Thank you!