Fiscal Risks
Sources, Disclosure, and Management

Paolo Mauro
Fiscal Affairs Department
International Monetary Fund
Introduction

• Fiscal Risks: Deviations of fiscal outturns (deficits, debt/GDP) from expectations at the time of the budget or other fiscal forecasts.
• How large are fiscal risks for different groups of countries?
• What are the most important sources of risk?
• What can policy makers do about fiscal risks?
Motivation

• Pressure to reduce deficits can result in governments assuming off-budget risks, including through guarantees.
• Identification, disclosure and management of fiscal risks are mutually supporting activities.
Context

- Increasing interest in fiscal risk disclosure and management: more and more countries are doing fiscal risk statements; request from APEC countries
- Presentation draws on paper recently discussed at the IMF’s Executive Board.
- Preliminary Guidelines: not prescriptive; a tool for policymakers that will evolve with experience.
- More requests for advisory services in this area.
Outline of Presentation

• How large are fiscal risks?
• What are the main sources?
• Identification, Disclosure and Management—Benefits and Broad Principles.
• Guidelines
How Large Are Fiscal Risks?
Surprise Deviations in Debt/GDP

Deviations of Debt/GDP -- All Countries

Total obs. 398; mean = 0.77; sd = 6.78; skewness = 0.21; kurtosis = 6.96
How Large Are Fiscal Risks?
Surprise Deviations in Balance/GDP

Deviations of Balance/GDP--All Countries

-6sd -5sd -4sd -3sd -2sd -1sd mean +1sd +2sd +3sd +4sd +5sd +6sd

Total obs. 1397; mean = -0.36; sd = 3.21; skewness = -0.47; kurtosis = 8.96

In percent of GDP; positive deviation if actual > forecast

10th Percentile
Surprise Deviations in Balance/GDP

Advanced Countries

Emerging Countries

Developing Countries

Total obs. 378; mean=0.02; sd=2.20; skewness=-0.42; kurtosis=6.80

Total obs. 388; mean=-0.57; sd=3.52; skewness=-0.66; kurtosis=10.34

Total obs. 631; mean=-0.45; sd=3.49; skewness=-0.21; kurtosis=6.86

In percent of GDP; positive deviation if actual > forecast
Sources of Fiscal Risk

- Macroeconomic shocks: growth, commodity prices, interest rates, and exchange rates.
- Contingent liabilities: obligations triggered by uncertain events.
  - Explicit: those defined by law or contract, e.g., debt guarantees, PPPs, legal claims against the government.
  - Implicit: expected obligations for the government, e.g., natural disasters; bailouts of banks or public sector entities assumptions of debts.....
- Desirable policy response depends on whether shocks are temporary or permanent; and their degree of correlation.
Currency Crises
(depreciation by at least 25 p.p. and at least 10 p.p. greater than the previous year)

Deviations of Balance/GDP--All Countries

-3sd -2sd -1sd mean +1sd +2sd +3sd

In percent of GDP; positive deviation if actual > forecast

Total obs. 46; mean=-2.22; sd=3.33; skewness=-0.91; kurtosis=3.12
Oil Exporters: Years of Oil Price increase

Deviations of Debt/GDP--Fuel Exporters

Total obs. 27; mean=-6.07; sd=10.23; skewness=-0.70; kurtosis=2.94

Deviations of Balance/GDP--Fuel Exporters

Total obs. 26; mean=3.16; sd=5.18; skewness=-0.41; kurtosis=5.69
Results: Sources of Fiscal Risks

• Really big, immediate, unexpected increases in debt/GDP: banking crises; exchange rate crises (especially when large share of debt is denominated in foreign currency); assumptions of debts.

• More common/fiscal risks to the deficit: economic growth slowdowns, adverse terms of trade changes.
Fiscal Costs of Banking Crises

Gross costs vs. Net costs

Recovery rates: fiscal risks on the asset side
Banking Crises: Net Fiscal Costs
(in percent of GDP)
Banking Crises: Recovery rate
(recovery as a share of gross fiscal costs)
Benefits of Disclosure

• Identification, disclosure and management of fiscal risks are mutually supporting activities.
• Disclosure imposes discipline to identify and manage fiscal risks.
• Disclosure may reduce long-run borrowing costs.
• The public often knows the risks are there.
Management of Fiscal Risks: Key Principles

- Sound macroeconomic and public financial management policies
- Risk sharing with other parties
- A clear legal and administrative framework that guides the allocation of roles and responsibilities in risk management
  - Centralized vs. Decentralized depends on country circumstances
Guidelines for Fiscal Risk Disclosure and Management

• Fiscal risks to which the government is exposed should be identified and disclosed so as to facilitate an effective fiscal policy.
• Fiscal risks should be mitigated in a cost-effective manner.
• There should be a clear legal and administrative framework to regulate overall fiscal management and the government’s exposure to fiscal risks.
• Fiscal risks should be systematically incorporated in fiscal analysis and the budget process.
Guidelines: Identification and Disclosure

• Availability of information: compilation and monitoring of all risks—importance, probability, and where possible, quantification.

• Legislative/accounting framework for disclosure of risks, with presumption of publication; exceptions based on clear criteria (materiality, moral hazard, prejudice national interest).

• Full presentation of risks in budget documentation, possibly in statement of fiscal risks.
Guidelines: Legal and Administrative Framework

• Clear allocation of responsibilities between central government and rest of the public sector on use of public funds.
• Fiscal risk management may be facilitated by a central government unit that can monitor and control overall risk and consider interactions.
• Integration with overall fiscal management is facilitated by location within MoF.
• Line ministries and agencies to have clearly specified responsibilities for managing their risk exposure.
• Responsibility for taking on risks should be separate from that of estimating their potential fiscal costs.
Guidelines: Incorporating Fiscal Risks in Fiscal Policy and Budget Process

• Risk analysis should be incorporated in the macroeconomic policy framework with fiscal targets allowing for the possibility that some risks may materialize
  – The government’s exposure to fiscal risks should be incorporated in fiscal sustainability analysis.
  – A limited annual centralized contingency appropriation should be considered.
Guidelines: The case of Guarantees

• Decisions over guarantees and other contingent liabilities should be integrated with the annual budget cycle so that proposals are considered alongside competing instruments.

• A framework should be in place to require parliamentary approval of guarantees.

• An annual budget appropriation could be included to cover expected calls on guarantees (general, category, or specific).
Guidelines: detail on the Case of Guarantees

• **Why important?**
  – Guarantees prevalent during current financial turmoil
  – Guarantees often hide true fiscal costs
  – Guarantees are seen as less expensive that actual cash payout

• **Options to mitigate fiscal risks from guarantees**
  – Budget appropriations for expected cash cost of payouts to meet calls on guarantees
  – Alternatively, appropriate the full expected NPV cost
  – A fee-based guarantees fund to meet the cost of calls on guarantees
  – Annual quantitative limit on guarantees
Lessons for Policy Makers

• Identify your risks, coordinate information, and analyze risks in a comprehensive framework.
• Sources can be macro shocks (exchange rates, interest rates,...), contingent liabilities (implicit—e.g. natural disasters, banking system) or explicit (guarantees, PPPs).
• Disclose and manage risks (more and more countries are doing fiscal risk statements).
• Consider how guidelines apply to country-specific circumstances, and provide feedback on guidelines.