



**PERÚ**

Ministerio  
de Economía y Finanzas

## **Report on Explicit Contingencies of the Non-Financial Public Sector**

**2014**

This report is a tool of transparency and monitoring of public finances, complying with the part b) numeral 18.2 of the article 18° of the Act N° 30099, “Strengthening of Fiscal Responsibility and Transparency Act”. This report introduces the main explicit contingencies of the Non-Financial Public Sector, the fiscal situation facing the occurrence of these explicit contingencies and the actions to be implemented to mitigate them.

## Presentation

Since the end of 1999, Peru has a macro fiscal framework established by the “Fiscal Responsibility and Transparency Act” (FRTA)<sup>1</sup>, which contributed to correct the unpredictable behavior of the public finances, reduce the tendency to maintain fiscal deficits and decrease the high levels of debt. Subsequently, aiming to strengthen the public finances the Government approved in 2013 a new macro fiscal framework promulgating the “Strengthening of Fiscal Responsibility and Transparency Act” (SFRTA)<sup>2</sup>. The objective of it was to reduce the pro-cyclicality and volatility of public expenditure, simplify the fiscal rules of Regional and Local Governments, strengthen fiscal transparency, as well as analyze the public finances from a fiscal risk management approach.

The new macro fiscal framework of the SFRTA incorporates the commitment of the Ministry of Economy and Finance to elaborate and publish an annual report that analyzes the explicit contingencies assumed by the Non-Financial Public Sector (NFPS), as well as the loan guarantees and similar, given by the National Government, and assess the fiscal position and sustainability from a fiscal risk approach.

Complying with the SFRTA<sup>3</sup>, a Report on Explicit Contingencies of the Non-Financial Public Sector is elaborated, where the main explicit contingent liabilities for the NFPS are presented, the current fiscal situation of the Peruvian economy and the possible effects of the occurrence of said explicit contingencies, as well as the actions to be taken to mitigate these contingent liabilities. The goal of this report, in the short and medium term, is to propose mechanisms for mitigation and management of fiscal risks and, in this way, setting the basis for the design of an optimum fiscal response in the face of an activation of these explicit contingent liabilities.

This report was elaborated with information up to December 2014.

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<sup>1</sup> Act N° 27245.

<sup>2</sup> Act N° 30099.

<sup>3</sup> Part b), numeral 18.2 of the article 18° of the Act N° 30099.

## Executive Summary

- **The sustainability of the public finances of advanced and emerging economies may be affected considerably in an unexpected way due to the occurrence of fiscal risks such as contingent liabilities.** To face this, it is necessary to implement policies regarding fiscal transparency and efficient management of fiscal risk that allow to design mechanisms to mitigate these risks associated to contingent liabilities.
- **The new macro fiscal framework for Peru established by the “Strengthening of Fiscal Responsibility and Transparency Act”<sup>4</sup>, states the commitment to annually assess the country’s exposure against fiscal risks generated by the occurrence of explicit contingent liabilities.** These explicit contingencies represent possible fiscal obligations derived from binding documents which existence must be confirmed by one or more specific events taking place in the future, being unexpected and not entirely under the grasp of the Treasury.
- **This document reports the fiscal risks generated by explicit contingent liabilities, in line with common practices at the international level and within the current legal framework.** However, there are other fiscal risks that are not reported in this document, such as implicit contingent liabilities and other liabilities not taken into account as public debt nor as explicit contingencies, such is the case of the bonds of the agrarian debt, among others. It should be stated that these are monitored by the Ministry of Economy and Finance.
- **At the end of 2014, it is estimated with the available information that the highest exposure of the Non-Financial Public Sector to explicit contingent liabilities, at face value, is approximately 8.2% of GDP (see Table 1).** The sources of fiscal risk are derived from lawsuits in domestic courts and arbitrages (4.2% of GDP); international controversies regarding investment (0.8% of GDP); guarantees granted to the private sector signing contracts in Public-Private Partnerships (2.7% of GDP); and loan guarantees and similar given to institutions within the public sector (0.5% of GDP). In the same way, it is estimated that the expected occurrence of explicit contingencies for the year 2015 would imply payments by the State at approximately 0.5% of GDP. It is worth noting that there are explicit contingencies not presented in this document due to lack of proper information, such is the case of lawsuits not reported to the public accounts for not being quantified.

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<sup>4</sup> Act N° 30099.

**Table 1. Summary of Explicit Contingent Liabilities of the NFPS, 2014 <sup>1/</sup>**  
(Percentage of GDP)

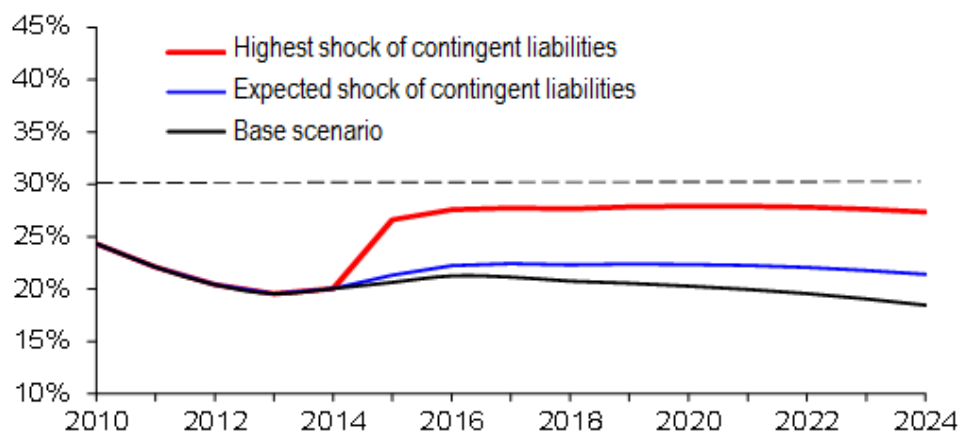
Type of explicit contingency	Highest exposure	Expected occurrence
1. Lawsuits and Arbitrages	4.2%	0.3%
2. Disputes over international investments - ICSID	0.8%	0.1%
3. Guarantees assumed in PPP contracts	2.7%	0.0%
4. Loan guarantees and similar	0.5%	0.1%
<b>TOTAL</b>	<b>8.2%</b>	<b>0.5%</b>

<sup>1/</sup> Cutoff date for gathering of information: December 2014, with the exception of disputes over international investments (March 2015), GDP 2014.

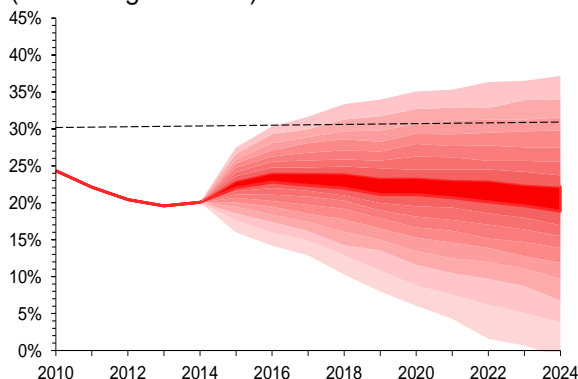
Sources: DGCP, DGETP, DGAEICYP, FONAFE, Petroperú

- **It is important to take into account that in the scenario of a possible occurrence of the estimated explicit contingencies considered in this report, the sustainability of the public finances would not be compromised in the short term.** Therefore if explicit contingent liabilities are activated (an expected occurrence of 0.5% of GDP for 2015), public debt would increase after the shock, and stabilize around 22% of GDP from 2017 onwards (see Graph 1). On a stress scenario (occurrence of the highest exposure of explicit contingencies), after the shock, public debt would increase and stabilize around 27% of GDP (see Graphs 2 and 3). These scenarios consider that only public debt is used to finance payments due to the occurrence of the explicit contingencies, without affecting the NFPS assets (like the Fiscal Stabilization Fund).

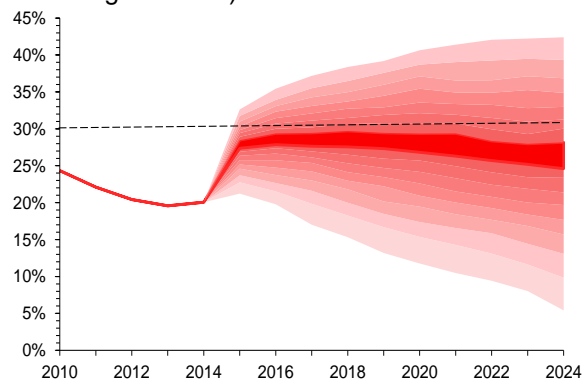
**Graph 1. Public debt against explicit contingencies**  
(Percentage of GDP)



**Graph 2. Public debt at the expected occurrence of explicit contingencies (Percentage of GDP)**



**Graph 3. Public debt at the occurrence of the highest exposure of explicit contingencies (Percentage of GDP)**



Sources: Central Reserve Bank, Ministry of Economy and Finance.

- **Regarding the implemented actions to mitigate the explicit contingencies associated to lawsuits in domestic courts and arbitrages (51% of the cases),** the Ministry of Economy and Finance has designed a software to register and quantify the current and contingent obligations due to lawsuits and arbitrages in all their stages (from the lawsuit itself through the payout), including lawsuits not currently quantified and lawsuits on international courts. This aspect strengthens the State's Judiciary Defense System because it creates a system with reliable and systematic information that allows to assess the global position of said defense, as it helps as input to propose and implement guidelines, proceedings, among others.
- **In the case of contingent liabilities related to Public-Private Partnerships (PPP), the Ministry of Economy and Finance is currently implementing the electronic module titled "Public-Private Partnership Contracts Module",** which will help to register the commitments and guarantees given by the State in contracts of this nature. In the same way, approval was given to the following guidelines<sup>5</sup>: i) valuation of contingent commitments; ii) self-sustainability of a Public-Private Partnership; and, iii) registration of commitments and net incomes in the PPP Contracts Module. Likewise, we are adopting the best international practices regarding contractual clauses referred to Permitted Creditors and contracting of insurances and reinsurances.

<sup>5</sup> Through Ministerial Resolution N° 048-2015-EF/52.