



PERÚ

Ministerio
de Economía y Finanzas

Report on Explicit Contingencies of the Non-Financial Public Sector

2015

This report is a tool for monitoring and keeping the transparency of the public finances. The main explicit contingencies of the Non-Financial Public Sector are presented, its fiscal situation at the occurrence of these explicit contingencies and the proposed actions to be implemented by the Government to mitigate them, complying with part b), numeral 18.2 of the article 18 of the Act N° 30099, titled "Strengthening of Fiscal Responsibility and Transparency Act".

Presentation

Since the end of 1999, the Non-Financial Public Sector (NFPS) was conducted within a macro fiscal framework established by the “Fiscal Responsibility and Transparency Act”¹, which contributed to correct the unpredictable behavior of the public finances, reduce the tendency to maintain fiscal deficits and diminish the high levels of public debt. In 2013, the Government approved a new macro fiscal framework with the “Strengthening of Fiscal Responsibility and Transparency Act” (SFRTA)², to continue improving the public finances. The goal of this Act is to reduce the pro-cyclicality and volatility of public expenditure, simplify fiscal rules of Regional and Local Governments, strengthen fiscal transparency as well as analyze the public finances from a fiscal risk management approach.

As part of these transparency efforts, the framework of the SFRTA incorporates the commitment of the Ministry of Economy and Finance (MEF) to elaborate and publish, in June of each year, an annual report analyzing the explicit contingencies assumed by the NFPS, as well as the loan guarantees and similar given by the Government, and assess the fiscal position and sustainability from a fiscal risk approach. The goal of this report, in the short and medium term, is to propose mechanisms of mitigation and management of fiscal risks and then set the basis for designing an optimum fiscal response if explicit contingent liabilities occur. With this report, we continue a process of gradual convergence to higher international standards of fiscal transparency and management of fiscal risks.

In this way, and complying with the SFRTA³, the Ministry of Economy and Finance elaborates the second Report on Explicit Contingencies of the NFPS, where it states: i) conceptual framework about contingent liabilities; ii) international experience regarding management of these contingencies; iii) report on explicit contingent liabilities of the SPNF, as well as loan guarantees and similar; iv) the fiscal situation of the Peruvian economy and the possible fiscal effects at the event of these explicit contingencies; and, finally, v) actions implemented by the Ministry to mitigate these explicit contingent liabilities. It is worth noting that this report presents the sources of these explicit contingent liabilities, according to the revised conceptual framework.

This report was elaborated with information up to December 2015.

¹ Act N° 27245.

² Act N° 30099.

³ Part b), numeral 18.2 of the article 18° of the Strengthening of Fiscal Responsibility and Transparency Act.

Executive Summary

- **The sustainability of public finances, in advanced economies as well as emerging ones, could be considerably affected in an unexpected way by the occurrence of fiscal risks such as contingent liabilities.** Regarding this, for example, The International Monetary Fund (IMF, 2016) estimated that for a sample of 80 countries including advanced and emerging economies between 1990-2014, the average fiscal cost of 174 events of contingent liabilities taking place (explicit and implicit) was 6.1% of GDP; while the highest fiscal cost of the occurrence of one out of these 174 events, was 56.8% of GDP. Because of this, it becomes necessary to implement policies of fiscal transparency and efficient management of fiscal risk that allow the design of mechanisms to mitigate these risks derived from contingent liabilities.
- **The new macro fiscal framework of Peru, established by the “Strengthening of Fiscal Responsibility and Transparency Act” (SFRTA)⁴, reaffirms the commitment of the Ministry of Economy and Finance to evaluate every year the exposure of the country to fiscal risks generated by the occurrence of explicit contingent liabilities.** These explicit contingencies represent possible fiscal obligations derived from binding documents which existence have to be confirmed by one or more specific events taking place in the future, being unexpected and not entirely under control of the Treasury.
- **Regarding this report, it presents the fiscal risks derived from the explicit contingent liabilities, in line with common practices at the international level and within the current legal framework.** However, it is important to note that this quantification is preliminary, mostly because of the lack of proper information, such as judicial processes not reported to the public accounts because of non-quantifiable amounts. In the same way, it is necessary to point out that there are other fiscal risks, such as implicit contingent liabilities, long-term risks such as pensions and social security liabilities, other specific contingent liabilities of the Financial Public Sector, which are presented for informational purposes in different official documents and are monitored continually by the Ministry of Economy and Finance.
- **According to available information, it is estimated that by the end of 2015, the highest possible exposure of the NFPS to explicit contingencies was about 9.70% of GDP, higher than the 8.21% registered in 2014 (See Graph 1). This increase of 1.49% of GDP of the explicit fiscal contingencies in 2015⁵ compared to 2014 is explained mainly by the increase of contingencies associated to lawsuits (1.34% of GDP).** One of the factors that explain this increase is the improvement of the reported information on lawsuits involving NFPS companies that sent information in a given format. The increase in disputes

⁴Act N° 30099.

⁵It is worth noting that this increment considers that the highest exposure to contingencies related to lawsuits and judicial arbitrages for 2014 was revised upwards in 0.31% of GDP, compared to the data published in the Report on Explicit Contingencies of the NFPS of 2014. This is explained by updating the highest possible exposure with information at the end of the fiscal year 2014.

over international investments, loan guarantees, and the contingencies assumed by the State in Public-Private Partnerships rose 0.04%, 0.03% and 0.08% of GDP for 2015, respectively (See Table 1), due to a exchange rate effect, since the domestic currency depreciated against the US dollars during 2015 (variation of 12.2%yoy). Note that the nominal amount in dollars in the first two types of explicit contingencies have not changed, while last year it registered a reduction in the nominal amount in dollars.

Graph 1. Highest exposure of the Non-Financial Public Sector: 2014 vs 2015
(Percentage of GDP)

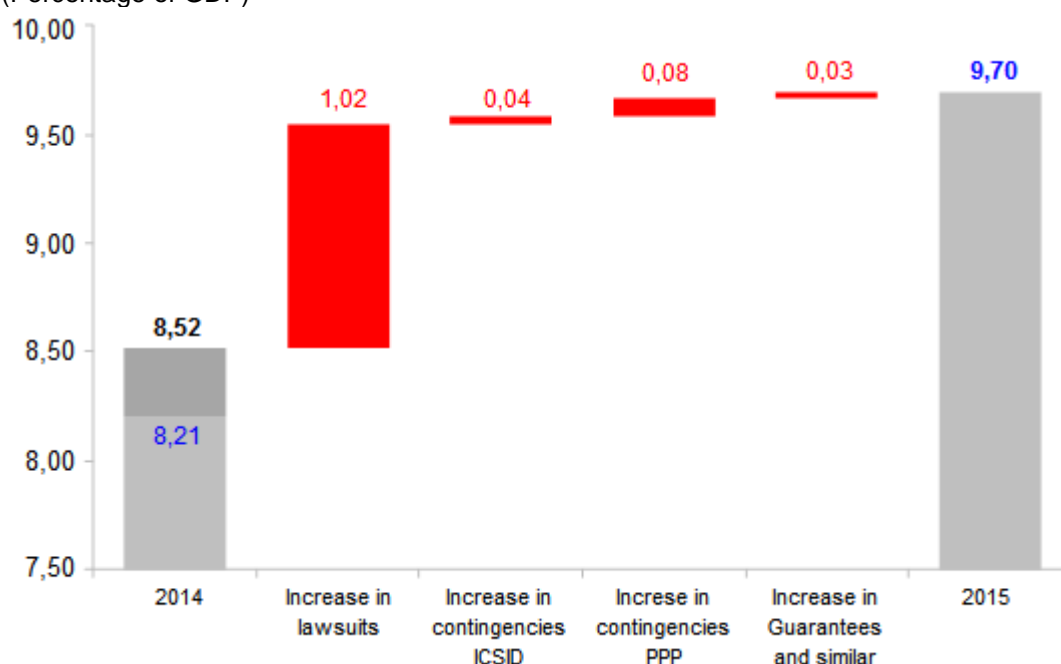


Table 1. Summary of Explicit Contingent Liabilities of the Non-Financial Public Sector 2015

(Percentage of GDP)

Type of explicit fiscal contingencies	Highest exposure		Difference
	2014	2015	2015 - 2014
1. Lawsuits and Arbitrages ^{a/ b/}	4.51%	5.53%	1.02%
2. Disputes over international investments - ICSID	0.80%	0.84%	0.04%
3. Explicit contingencies assumed in PPP contracts	2.69%	2.78%	0.08%
4. Loan Guarantees and similar	0.52%	0.54%	0.03%
TOTAL	8.52%	9.70%	1.18%

a/ Highest exposure for 2014 considers information through the end of the fiscal year 2014.

b/ Highest exposure for 2015 considers preliminary information collected in May 2016.

Sources: DGCP, DGETP, DGAEICYP, FONAFE, PETROPERÚ.

- It is important to note that the short term sustainability of the public finances is not compromised in the scenario of a possible expected occurrence of the explicit contingencies estimated for the NFPS. Thus, in case the explicit contingent liabilities are activated (an expected occurrence in 2016 of 1.16% of GDP, see Table 2), public debt may increase, indirectly, compared to the 23.3% of

GDP registered at the end of 2015 and will stabilize around 25.6% of GDP from 2018 onwards. Moreover, using a stochastic forecast, we got a probability of 65% that the ratio of public debt sits below 30% by 2024 (see Graphs 2, 3 and 4). It must be noted that this scenario considers that only public debt pays for the explicit contingencies taking place, leaving the assets of the NFPS unaffected.

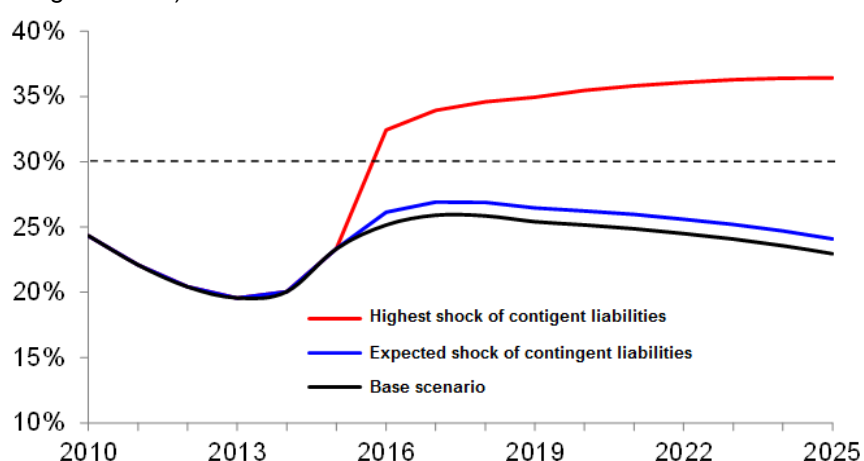
Table 2. Summary of Explicit Contingencies of the NFPS, 2015
(Percentage of GDP)

Type of explicit fiscal contingencies	Highest exposure	Expected contingency
	2015	2016
1. Lawsuits and Arbitrages ^{a/}	5.53%	0.94%
2. Disputes over international investments - ICSID	0.84%	0.03%
3. Explicit contingencies assumed in PPP contracts	2.78%	0.19%
4. Loan Guarantees and similar	0.54%	0.00%
TOTAL	9.70%	1.16%

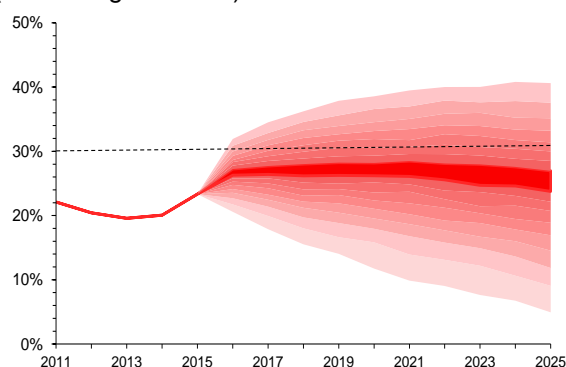
a/ The highest exposure for 2015 considers preliminary information collected on May 2016.

Source: DGCP, DGETP, DGAEICYP, FONAFE, PETROPERÚ.

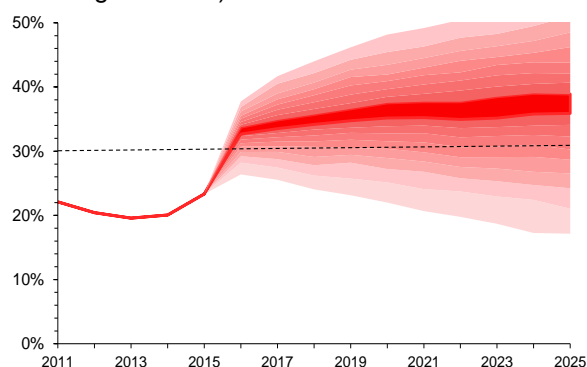
Graph 2. Public debt against explicit contingencies
(Percentage of GDP)



Graph 3. Public debt at the expected occurrence of explicit contingencies
(Percentage of GDP)



Graph 4. 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 improve the monitoring of the explicit contingencies related to lawsuits in national courts and arbitrages (57% of the total)**, in May 2016, the “Budget of the Public Sector for the fiscal year 2016 Act”⁶, ordered the **reactivation of the Assessment Commission on the State's Debt due to concluded lawsuits**. This Commission has the function of approving a complimentary list of the State's debt generated by lawsuits deemed as sentenced or in process of being judged in order to continue with the planning of such payouts. Additionally, this Regulation allowed the creation of a software platform **"Lawsuits and Arbitrages against the State"** to register, update and quantify the real contingent obligations created by lawsuits and arbitrages in every stage of the process (from the lawsuit itself until the payout), including the non-quantified lawsuits and the ones seen on supranational courts. This way, the State's Judicial Defense system is strengthened with the creation of this information platform that is reliable and systematic, and will allow us to monitor continuously the global position of this judicial defense and also will serve as a tool to propose and implement guidelines, procedures, among others.
- **Furthermore, regarding the implemented actions to improve the monitoring of the explicit contingencies derived from Public-Private Partnership (PPP)**, it is worth noting that in September 2015, the Government of Peru published the “Framework to Promote Private Investment through Public-Private Partnerships and Projects”⁷ and its Regulation, as one of its goals is the enhancement of the monitoring and transparency in the budgetary process of obligations derived from PPP. As a result, the regulation establishes the obligation of every sector to elaborate, annually, the Multiannual Report of Investments on PPP. This document will allow to: i) plan every project and the investment commitments for every PPP in every institution of the national, regional and local government that have made or is planning to make a PPP in the next 3 years, and ii) plan the use of public funds destined to investment projects through PPP for the next 10 years. In that sense, it is vital that the budgetary process of investment projects through PPP is handled with transparency. As a result of the implementation of the measures included in the framework, since March 31, 2016, Peru is the first not member of the Organisation for Economic Co-operation and Development (OECD) recognized as officially adherent to the Recommendation of the Council on Principles for Public Governance of Public-Private Partnerships. On the other hand, The Ministry of Economy and Finance trained, in 2015, the Regional Governments of La Libertad, Arequipa and Lambayeque, PROINVERSION, The Ministry of Transportation and Communications, and the Ministry of Housing, Construction and Sanitation on the implementation of the "Guidelines of valuation of quantifiable contingent commitments and income flows derived from the exploitation of investment projects related to PPP"⁸, with the goal of improving the valuation of the contingent commitments assumed by public institutions. On that same line, the Ministry of

⁶Application of the 73rd Final Complimentary Disposition of the Act N° 30372, approved by Supreme Decree N° 114-2016-EF.

⁷Legislative Decree N° 1224.

⁸Approved by Ministerial Resolution N° 048-2015-EF/52.

Economy and Finance plans to continue training ministries and local and regional governments.

- **Finally, regarding the implemented actions for the monitoring and control of loan guarantees given by the National Government**, is important to point out that in compliance with the National System of Indebtedness Act⁹, the payments for the guaranteed credits of the Metropolitan Municipality of Lima are done through a trust, so the Ministry of Economy and Finance makes a constant monitoring with the fiduciary regarding the use of funds to meet the commitment of payments of these credits. In the case of insufficiency of funds in the trust to meet the required payments, the Ministry of Economy and Finance will initiate the procedure to execute the guarantee to meet the obligation of payment with budget from debt service (available funds due to reprofiling of debt and in the extreme case, request funding from the Public Treasury) and with the conclusion of said procedure, it will proceed to register the guarantee as a statistic for public debt.

⁹16th Complimentary Disposition of the Single Unified Code of the Act N° 28563.