Sovereign Balance Sheet and Accounting for the Fiscal Response to the Global Financial Crisis

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Outline

- Setting the scene: the fiscal challenge
- Range of interventions: a quick overview
- Sovereign balance sheet: an old idea whose time has come?
  - Definition
  - Issues
  - Challenges
- Issues for discussion
Fiscal Challenge: Stylized Facts

- The scale of the problem is unprecedented
- Demographic trends remain unfavorable
- Although financial sector support only a small part of the increase in gross debt.....
- ....scale and range of interventions also unprecedented.....
- ....thus, challenging the way we account for and report on the state of public finance
Fiscal Outlook in Advanced Countries (all variables in percent of GDP)
Fiscal Challenge: Stylized Facts

G-7 PPP-Weighted Public Debt, percent of GDP

- G-7 Average Gross Government Debt
- Japan Adjusted G-7 Average Gross Government Debt

(Total debt increase: 35.5 percent of GDP)

- Automatic stabilizers: 10
- Fiscal stimulus: 3 ½
- Financial support: 3
- Revenue loss from lower asset prices and financial profits: 9
- Higher interest payments: 4
- Other: 6

(Total debt increase: 35.5 percent of GDP)
Financial System Support Measures

- Between January 2008-June 2009, about 5 percent of GDP pledged—3 percent actually used
- More than 50 countries among advanced, emerging, and developing countries
- Instruments: deposit insurance, guarantees, recapitalization, asset swaps/purchases, direct lending, and liquidity facilities
- Agencies: central banks, treasuries, public corporations, state-owned banks
Sovereign Balance Sheet: New Idea?

- Not particularly new—see earlier IMF work on BSA, GFSM 2001 framework, SWF, more recently BPM 6
- But its appeal has been revamped in light of global crisis and nature of interventions
- The concept is easy to grasp—less so to implement:

  Comprehensive information of all public assets and liabilities as analytical tool to assist governments managing their resources while taking into account their combined implications
Sovereign Balance Sheet: Institutional Coverage

<table>
<thead>
<tr>
<th>Non-Financial</th>
<th>Financial</th>
<th>Total</th>
<th>Net Worth</th>
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<td>A L A L A L (A-L)</td>
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Sovereign/Whole-of-Government
General government
Central government
   *Including:*
     - Budgetary central government
     - Other central government agencies
       e.g., Social security institutions
Subnational governments

Public enterprises 1/
Financial
   e.g., Central bank
   Deposit insurance fund
SWF
AMC
Non-financial

1/ If market producers.
Sovereign Balance Sheet: Issues

- Coverage: comprehensiveness relies at the moment on “control,” but is this the relevant concept?
- Institutional independence needs to be preserved, but who manages the sovereign balance sheet?
- How are tensions going to be resolved between general government levels, particularly in a federal system? And with “independent” central banks?
- Tensions also emerge across government (i.e., non-profit) institutions and commercially-run public enterprises
Sovereign Balance Sheet: Prerequisites

- Ongoing work with IPSASB is looking at how interventions have been accounted for and reported on in a few advanced economies
- Not surprisingly, the answer is... very differently
- This is a key problem as the magnitude of the fiscal adjustment will require concerted efforts
- Agreeing on the “correct” figures is not a trivial exercise
What are the Challenges/Prerequisites?

- Fiscal risk, contingent liabilities (and assets)
- Accounting framework and standards
- Reporting entities
- Valuation of assets, in particular, treatment of gains and losses
Fiscal Risk

- Disclosure of explicit and implicit contingent obligations (off-balance sheet)
- Publish a statement of fiscal risks with annual budget documents, including the different types of risks related to announced public interventions in support of the financial sector
- Empirical evidence suggests a link between greater fiscal risk disclosure and better sovereign credit ratings (next slide)
The sample consists of 56 countries, surveyed at different points during 1999–2007. The scatter plot reports the orthogonal components of sovereign bond ratings and fiscal risk disclosure to per capita income, GDP growth, inflation, fiscal balance, current account balance, external debt, default history, and political stability.
International public sector accounting standards (IPSAS) as well as statistics (*GFSM 2001*) require that government financial statements provide a consolidated view of the finances of all entities controlled by the government for accounting purposes.

The existence of control in the context of consolidated financial report does not in any way indicate that there is necessarily control over the manner in which statutory/professional functions are performed by an entity.

Control may have become less relevant in light of global crisis, even in light of SNA 2008 clarification.

A different standard may be required, that capture the responsibility a government has vis-à-vis taxpayers, i.e., how a government is accountable.
Accounting Frameworks and Standards

- The accounting basis defines the timing of recognition of economic events in the financial statements and, therefore, determines whether particular assets, liabilities, revenues or expenses are reported.

- Integrated framework, based on the accrual accounting concept, in accordance with explicit national or international standards.

- Frameworks that focus mainly on reporting cash flows may provide less comprehensive information, if any, on assets and actual or contingent liabilities.
Valuation

- The choice of accounting policies on valuation and related gains and losses have a direct impact on the measurement of key indicators such as fiscal surplus or deficit.

- Adherence to accepted accounting standards will enhance countries’ accountability.

- Generally GAAPs require “fair value” asset valuation.

- Recent developments have led to pressures for a retreat from marking-to-market.

- Recent proposed IFRS amendments to accounting for financial instruments retain a preference for “fair value” and limit alternatives to simple debt instruments held for their underlying cash flows.
Issues for Discussion

- Fiscal risk statement: increasingly good practice, but far from being comprehensive or reliable
- Is control the relevant concept? Wouldn’t accountability be a better concept?
- Accounting framework and standards, including valuation criteria: mandatory vs. voluntary?
- Timeliness for decision makers
- Last, who is the ultimate decision maker in managing the sovereign balance sheet? Or, who is accountable for it?
Selected IMF References


