Contingent Liabilities

Introduction

Contingent liabilities are conditional obligations that arise from past events that may require an outflow of resources embodying economic benefits based on the occurrence or non occurrence of one or more uncertain future events not wholly within the control of the government. Contingent liabilities can be distinguished from the liabilities as these are conditional in nature and do not represent the present obligations of the government. Accordingly, a contingent liabilities are not recognized as liabilities regardless of the likelihood of the occurrence (or non-occurrence) of the uncertain future event.

The public debt may be understated without reporting contingent liabilities. Contingent liabilities are not added to the overall debt of the country, however, such off-balance sheet transactions cannot be overlooked in order to gain a holistic view of a country's fiscal position and unveil the hidden risks associated with the obligations made by the government outside the budget. Therefore, it is imperative to examine the contingent liabilities in the same manner as a proposal for a loan, taking into account, inter alia, the credit-worthiness of the borrower, the amount and risks sought to be covered by a sovereign guarantee, the terms of the borrowing, justification and public purpose to be served, probabilities that various commitments will become due and possible costs of such liabilities etc.

Contingent liabilities of Pakistan include, explicit and implicit guarantees issued to Public Sector Enterprises (PSEs). The government guarantee is only extended to the public sector entities for the purpose of achieving the following objectives:

- To improve financial viability of projects/activities undertaken by government entities, with significant social and economic benefits, that would not otherwise be financially viable;
- To enable PSE's to raise resources when it is unable to finance activities due to weak balance sheet strength;
- To fulfill the requirement in cases where government guarantee is a precondition for concessional loans obtained by the government entities from bilateral/multilateral agencies to sub-sovereign borrowers.

Public disclosure of information about guarantees is an essential component of fiscal transparency, but it is more important to reflect the impact of financial risk associated with guarantees in the fiscal account. During first nine months of current fiscal year, the government issued fresh/rollover guarantees aggregating to Rs. 67 billion, whereas, outstanding stock of government guarantees as at end March, 2015 amounted to Rs. 600 billion. The rupee guarantees accounted for 80 percent of the total guarantees stock.

Table-1.1: Guarantees Outstanding as on March 31, 2015	(Rs. in billion)
Outstanding Guarantees extended to Public Sector Enterprises (PSEs)	**600**
-Domestic Currency	481
-Foreign Currency	119
Memo:	
Foreign Currency (US$ in million)	**1,167**

Source: Debt Policy Coordination Office Staff Calculations, Finance Division

The volume of government guarantees undertaken during a financial year is limited under Fiscal Responsibility and Debt Limitation Act 2005 which stipulates that the government shall not give guarantees aggregating to an amount exceeding 2 percent of the GDP in any financial year including those for rupee lending, rate of return, output purchase agreements and other claims and commitments provided the renewal of existing guarantees shall be considered as issuing a new guarantee. The limit of 2 percent of the GDP is applicable on guarantees issued both in local and foreign currencies. During July-March, 2014-15, Government of Pakistan issued fresh/rollover guarantees aggregating to Rs. 67 billion or 0.2 percent of GDP [as shown in Table 1.2].

Table-1.2: New Guarantees Issued

(Rs. in billion)	**2010**	**2011**	**2012**	**2013**	**2014**	**2015***
New guarantees issued	224	62	203	136	106	67
(as percent of GDP)	1.5	0.3	1.0	0.6	0.4	0.2

*July – March
Source: Debt Policy Coordination Office Staff Calculations, Finance Division

The year wise outstanding stock of government guarantees from 2009-10 till March 31, 2015 is presented through Table 1.3:

Table-13: Guarantees Stock (Rs. in billion)

	2010	**2011**	**2012**	**2013**	**2014**	**2015***
Outstanding guarantees extended to PSEs	**603**	**559**	**516**	**626**	**555**	**600**
-Domestic Currency	329	301	262	355	426	481
-Foreign Currency	274	258	254	271	129	119
Memo:						
Foreign Currency (US$ in million)	3,246	2,999	2,689	2,716	1,310	1,167

*July – March
Source: Debt Policy Coordination Office Staff Calculations, Finance Division

Guarantees issued against commodity operations are not included in the stipulated limit of 2 percent of GDP as the loans are secured against the underlying commodity and are essentially self-liquidating and thus should not create a long term liability for the government. The quantum of these guarantees depends on the supply-demand gap of various commodities, their price stabilization objectives, volume procured, and domestic and international prices. The guarantees were issued against the commodity financing operations undertaken by TCP, PASSCO, and provincial governments. As on March 31, 2015, the outstanding stock issued against commodity operations was Rs.485 billion against the end-June 2014 position of Rs. 604 billion.