Working paper WP/21/2:

Total Debt is So Much More Than Just Sovereign Debt.

Contingent Liabilities in Armenia, Belarus, Kyrgyz Republic, and Tajikistan

EFSD Chief Economist Group

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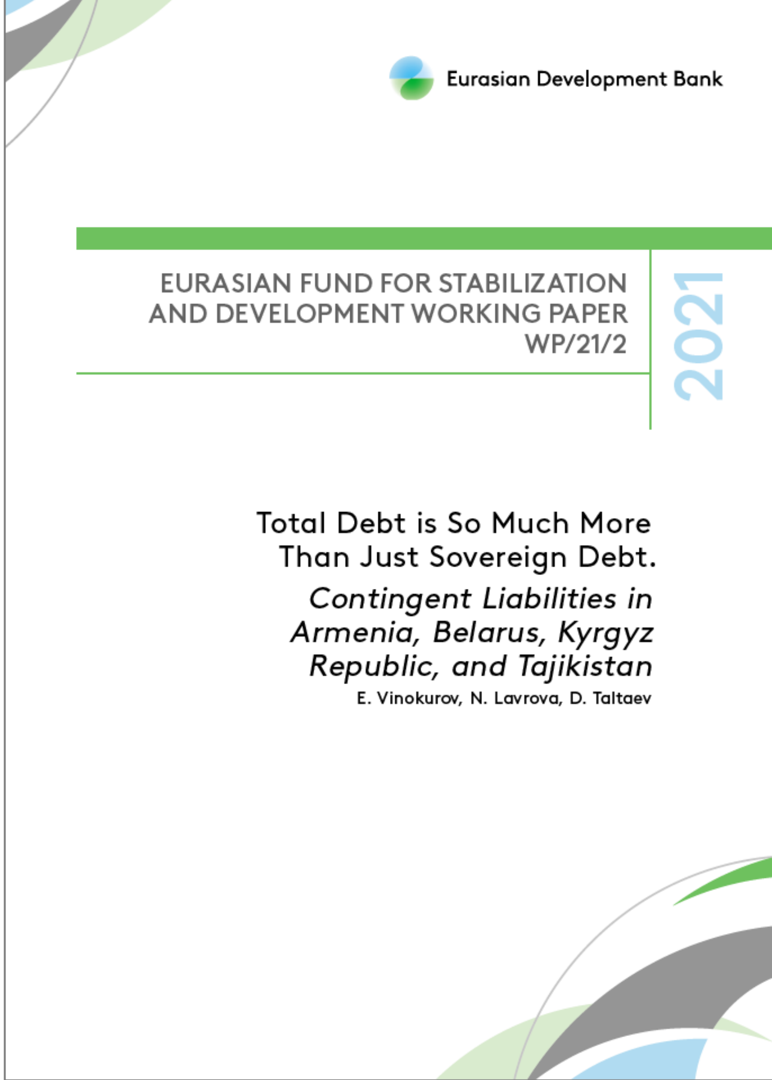
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Total Debt is So Much More Than Just Sovereign Debt.

Contingent Liabilities in Armenia, Belarus, Kyrgyz Republic, and Tajikistan

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Countries' debt sustainability depends not only on the public debt level, but also to a significant extent on their private debt obligations.

This study aims

to contribute to understanding the potential risks and impacts of both explicit and implicit contingent liability shocks on government fiscal and debt positions in the EFSD recipient countries

Explicit contingent liabilities
consist of state-guaranteed debt and on-lending operations

Implicit contingent liabilities
obligations related to the possibility of default of SOEs on nonguaranteed loans

COVID-19 pandemic has put more pressure on countries' debt positions than global financial crisis

$ 281.5 tln

or

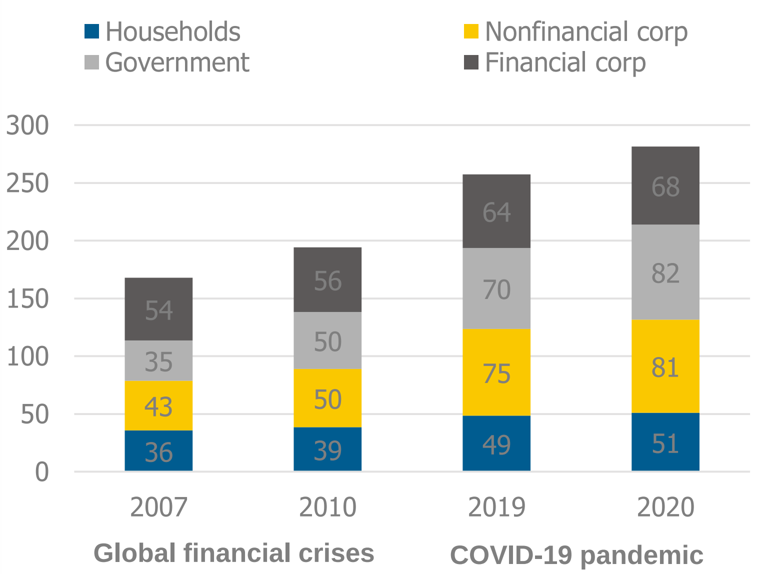
355% of GDP

total global debt in 2020

34 p.p. rise of total global debt for the period 2019-2020

87% of the increment in total global debt in 2019-2020 was due to advanced economies

Global Debt Outstanding by Sector, USD trillion



Sources: Moody’s Investor Service and IMF

Average quarterly growth, %	Q4/2007 – Q4/2010	Q4/2019 – Q4/2020
Total	1.2	2.3
Government	3.0	4.1
Nonfinancial	1.3	1.7
Households	0.6	1.3
Financial	0.3	1.5

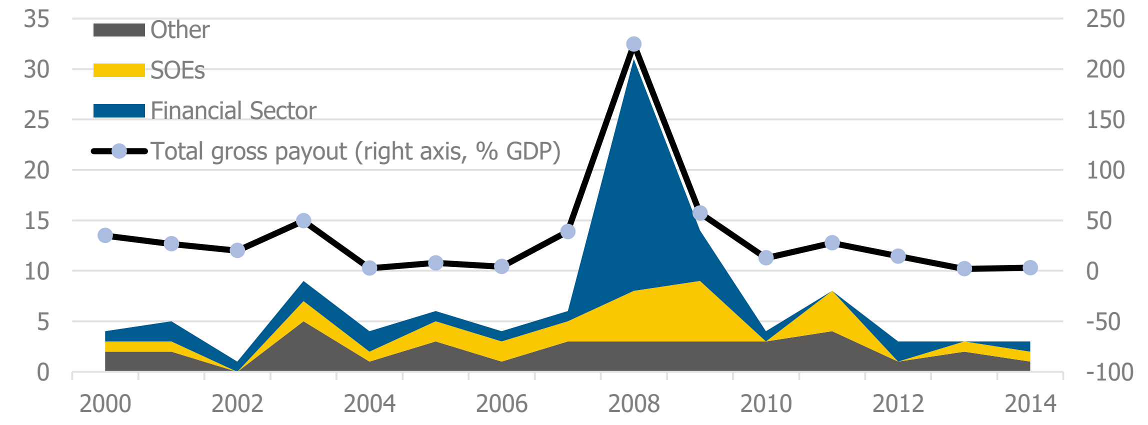
History shows, the problems of the private sector are often the cause of an unexpected increase in sovereign debt

A key structural consequence of any economic crisis is the materializing of fiscal and debt risks. Companies’ bailouts, bank recapitalizations and other effects of macroeconomic shocks lead to materializing of contingent liabilities, which may increase risks to sovereign balance sheets

1/5 of unexpected sovereign debt growth for the period 1990-2016 is associated with the materialization of contingent liabilities

20% of the total number of materialized contingent liabilities related to the activity of SOEs and public-private partnerships

Contingent Liabilities Materializing by Year and Type, number of cases

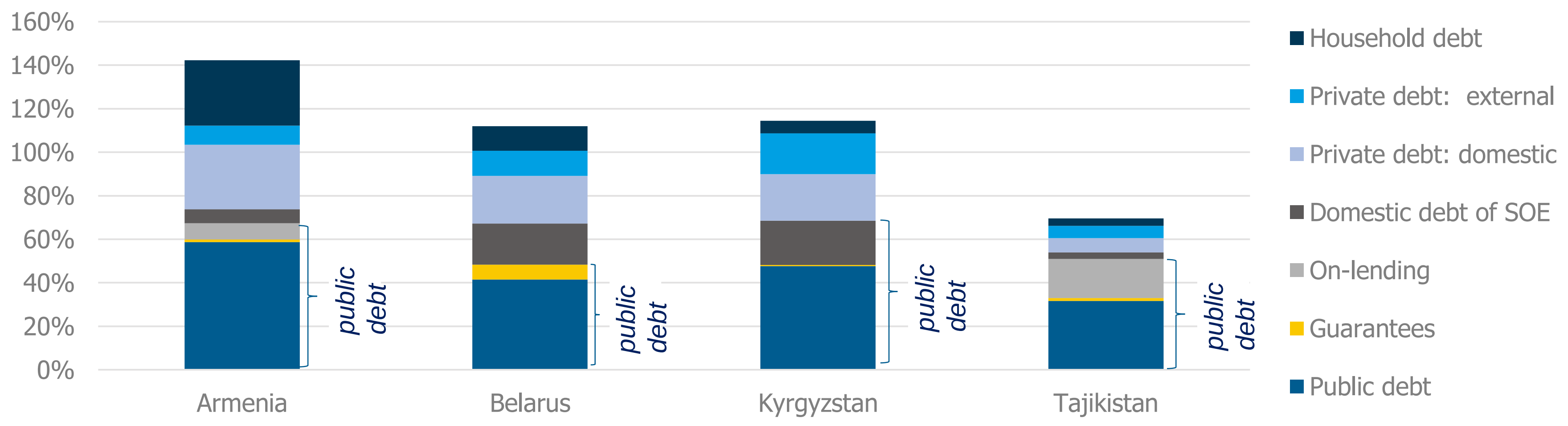


Sources: IMF Fiscal Monitor

Total debt obligations, including loans from the private non-financial sector, have been consolidated across the EFSD countries

Available global or regional debt datasets, even the most comprehensive of the IMF and the World Bank include separate debt categories of the EFSD countries, while the non-sovereign component of debt often remains in shadows. In EFSD study, a more comprehensive analysis is carried out, including an analysis of private obligations.

Sovereign debt and private debt of non-financial sector, at the end of 2020, % of GDP



Sources: Authors' calculations

Explicit and implicit contingent liabilities: Armenia

1.1% of GDP

the total stock of state guarantees in 2020

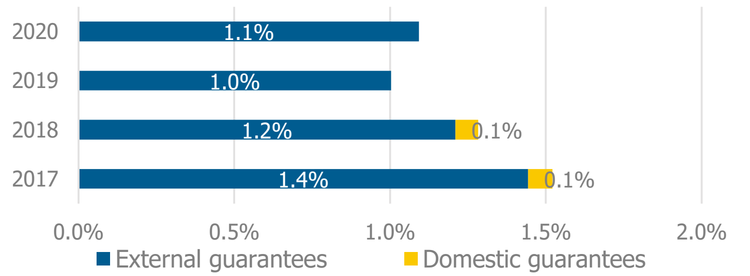
6.6% of GDP

the total amount of on-lent loans issued in 2020

6.4% of GDP

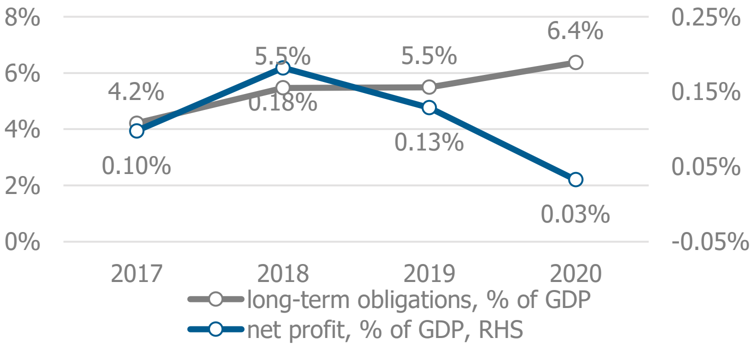
the total SOEs' long-term liabilities on loans and borrowings in 2020

Armenia's state guarantees, % of GDP



Sources: Authors' calculations

SOE financial indicators, % of GDP



Sources: State Property Management Department of RA

While the situation with guarantees does not seem fragile, on-lending is the focus of current concerns over fiscal risks. On-lent loans rose from 6.6% of GDP in 2019 to 7.5% in 2020.

Implicit contingent liabilities are concentrated in energy loss-making entities. But over the past 5 years, Armenia has focused on developing its private sector, thus, it has persistently reduced the dominance of SOEs.

Explicit and implicit contingent liabilities: Belarus

6.9% of GDP

the total stock of state guarantees in 2020

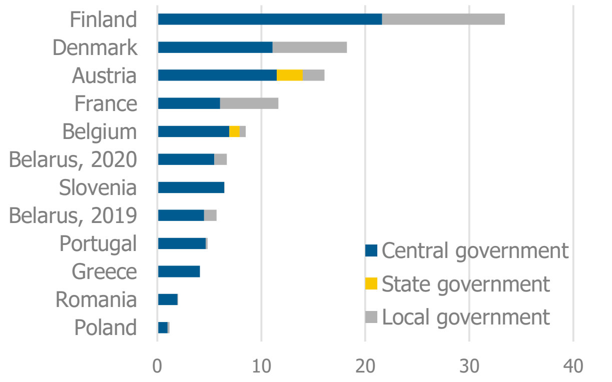
46% of GVA

produced by the Belarus state sector (but contributed only 4% to the economy's total profit)

78%

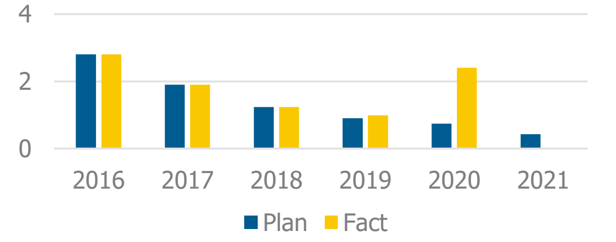
of total arrears on loans and borrowings are concentrated by SOEs

Government guarantees, 2020, % of GDP



Sources: Eurostat

Lending under government programs: actual and projected, BYN bln



Sources: Authors' calculations

The volume of guarantees is consistent with the average 7% of GDP in European countries. But while in most emerging economies state guarantees have a heavy presence in natural monopoly sectors such as energy and transportation, Belarus has notable exposure to manufacturing and agricultural sectors. This implies that a public corporation's presence in Belarus goes beyond those industries where government ownership is explained by economic rationale.

The Belarus state sector produces around 45.5% of total gross value added. However, their efficiency remains low and the level of arrears remains high.

Explicit and implicit contingent liabilities: Kyrgyz Republic

1.1% of GDP

the annual amount of on-lending operations

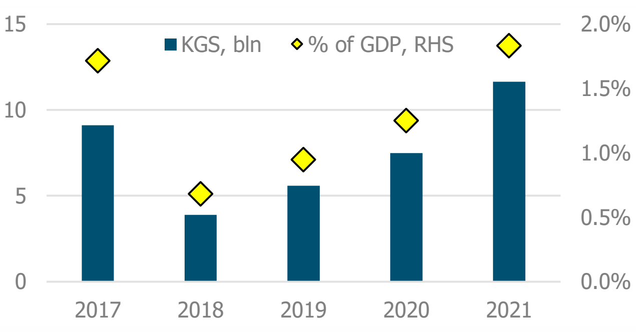
20% of GDP

the outstanding debt of SOEs in 2020

95%

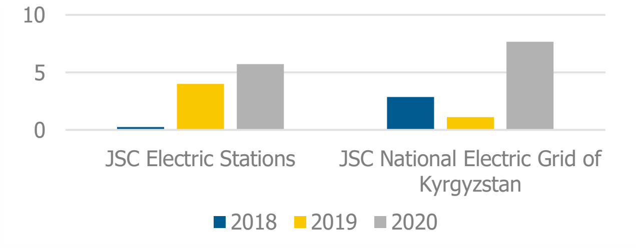
of SOEs liabilities fall on unprofitable energy companies

Kyrgyz Republic: annual on-lending operations



Sources: Authors' calculations

Accumulated losses of the largest debtors on government on-lent loans, bln som



Sources: Financial statements of companies

In the Kyrgyz Republic, the government does not provide direct guarantees. Nevertheless, the Kyrgyz government's balance sheet may be exposed to fiscal risks through on-lending operations. On-lending is one of the key channels of government support to SOEs, 95% of on-lending operations are concentrated in loss-making energy companies.

The role of private sector activity is higher than in other EFSD countries. In 2019, the share of private companies exceeded 83% of GDP. But almost half of SOE assets are concentrated in the energy sector, which is subsidized below-cost tariffs for customers.

Explicit and implicit contingent liabilities: Tajikistan

1.3% of GDP

the total stock of state guarantees in 2020

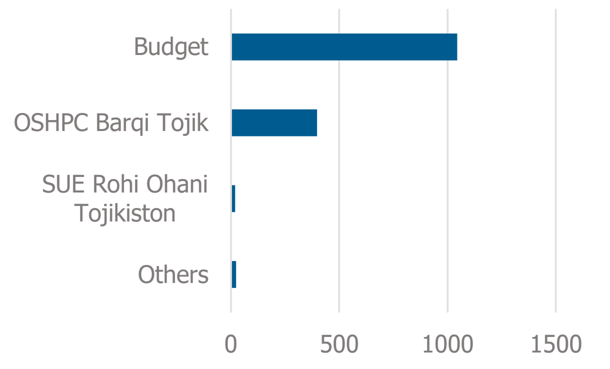
18% of GDP

the total amount of on-lent loans in 2019

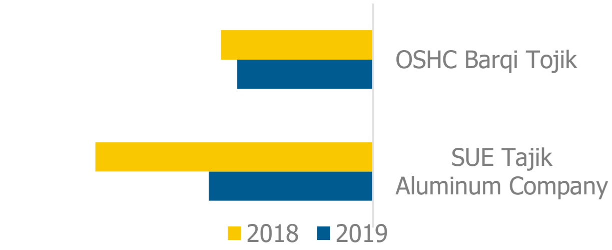
3.9 bln

somoni of contingent liabilities materialized in 2021 due to liquidation of the state banks "Agroinvestbank" and "Tojiksodirotbank"

Sources of principal repayments on external debt in 2021, mln somoni



Operating losses of two of the three largest SOEs, $ mln



Sources: Financial statements of companies

The volume of state guarantees in 2020 amounted to only 1.3% of GDP. The main mechanism to raise financing for Tajik SOEs is to receive on-lent loans from the government. Over 90% of on-lent loans are concentrated by the unprofitable energy holding OSHPC “Barqi Tojik”. Around 30% of public principal payments depend on SOEs in 2021, i.e. on whether they honor their obligations.

Tajikistan is a country with a significant share of the public sector in the country’s output – about 40% of GDP. In 2020, 12 of 27 the largest SOEs posted combined losses in 2020 that exceeded 8% of GDP. The main part of the losses was accumulated by the energy sector.

The stress-testing of the materialization of contingent liabilities was conducted using DSA tool

In the scenario of a contingent liability shock, we assume that some SOEs will be incapable of servicing their debt obligations. Thus, governments may need to bail out these companies. The shock is applied to 2022

DSA (Debt sustainability analysis) - debt sustainability analysis tool, developed by the IMF (2018), which enables to simulate debt positions and conduct stress-testing. This tool serves several functions: the assessment and forecasting of countries' debt levels under the baseline scenario, and of debt positions under a contingent liability shock.

Belarus

Shock: 14% of GDP

The size of the shock corresponds to the volume of problem loans of public corporations

Tajikistan

Shock: 12.1% of GDP

- Barqi Tojik's arrears to domestic banks and energy suppliers – 8.1% of GDP
- Tajiktransgaz loan agreement with China on the construction of a gas pipeline – 4% of GDP

The materializing of contingent liabilities may worse Belarus debt positons

12.1% of GDP

the size of shock associated with their contingent liabilities

Public debt might increase to

61% of GDP

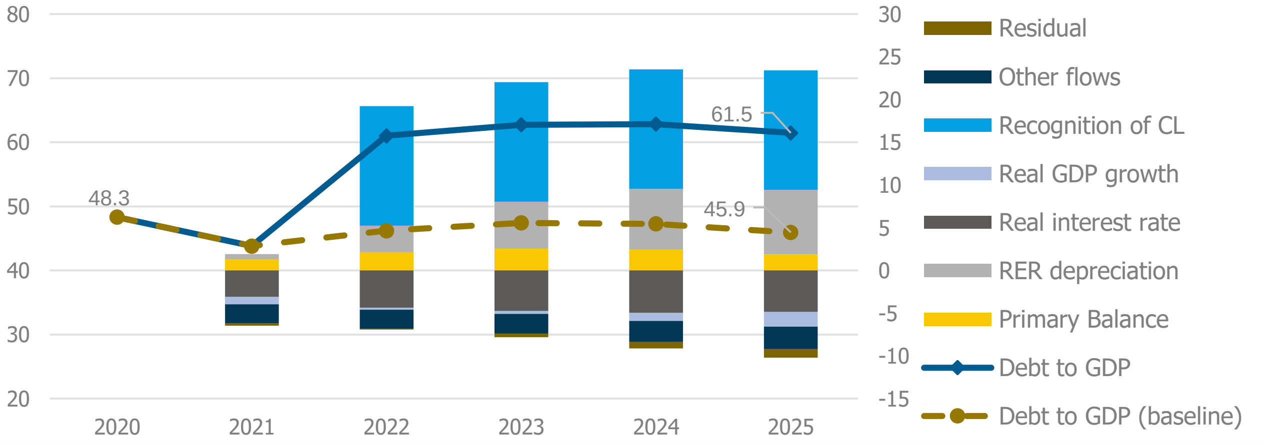
in the adverse scenario, compared to a projected 46% in the baseline scenario

In the medium run, public debt would remain above

61% of GDP

In the scenario of a contingent liability shock Belarus public debt may increase to 61% of GDP and would remain at this level in the medium run. In the short run, a contingent liability shock would result in a surge in public financing needs.

Government Debt: baseline and adverse scenarios (left axis – debt-to-GDP in %, right axis – cumulative level of debt-creating flows)



Sources: authors' estimates

The access of Tajikistan to concessional loans may partially eliminate risks of the materializing contingent liabilities

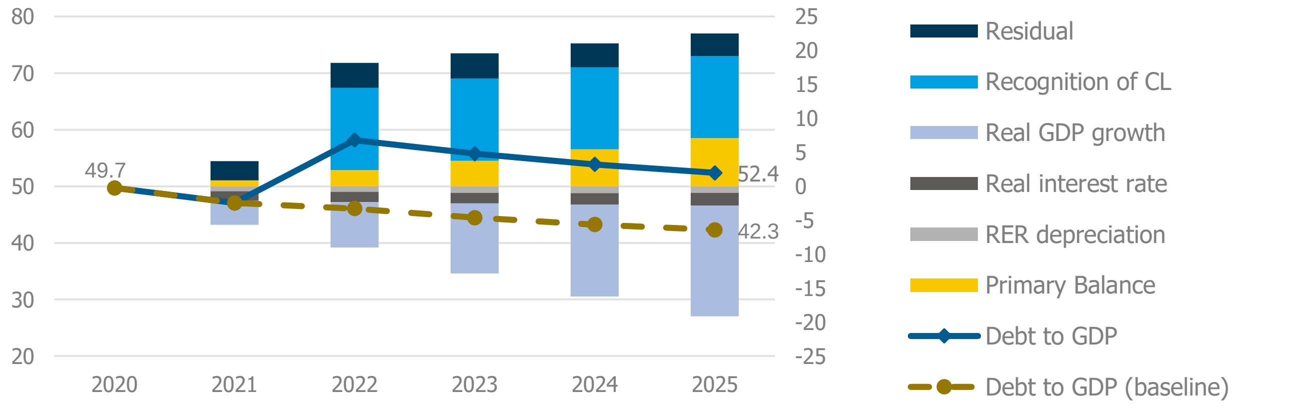
In 2022, the debt-to-GDP ratio may increase to **58%** under the adverse scenario

By 2025 public debt may decline to **52.4% of GDP** (in the baseline – 42.3% of GDP)

12.1% of GDP
the size of shock associated with contingent liabilities

In the scenario of a contingent liability shock, after the debt-to-GDP ratio increase to 58% in 2022, in the medium run, public debt should moderately decline and, by 2025, it will total 52% of GDP: due to relatively high economic growth and low interest rate. However, this implies that, over 2023-2025, the country will not be able to reduce its debt obligations to levels similar to those prevailing in 2021.

Government Debt: baseline and adverse scenarios (left axis – debt-to-GDP in %, right axis – cumulative level of debt-creating flows)



Sources: authors' estimates

Policy implications

01

Focus not only on sovereign debt, but on a broader scope of countries' finance sectors, including both direct and indirect factors. The first step in this procedure should include monitoring of balance sheets of state-owned companies and banks through their regular reporting. This implies a need for analysis of quasi-fiscal operations and their effects on both entities' financial results and companies' interactions with the budget should also be disclosed.

02

Systematically conduct a comprehensive risk analysis, including risks from on-lending, guarantees and state-owned companies, with particular focus on loss-making companies and banks. This analysis should indicate the probability of contingent liability risks materializing and their potential fiscal impact. We emphasize the importance of public corporations' performance for debt sustainability, and this type of assessment can be considered as a foundation for effective risk management.

03

Focus on data transparency. Complete and clear information on different sources of contingent liabilities may strengthen credibility and benefit the credit rating. This would be reflected in a reduced risk premium and borrowing costs. On the domestic side, this may increase the effectiveness of fiscal policy, and specifically in debt management. Apart from that, high-quality forecasts with stress-testing will contribute to widening room for maneuver in the management of budget funds.

Thank you for your attention!