Independent Authority for Fiscal Responsibility

# Opinion on Fiscal Risks

AIReF

March 13th, 2025

# Opinion on Fiscal Risks


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2 Definition of fiscal risks

3 Macroeconomic risks

4 Environmental risks

5 Legal action against the State

6 Contingency Fund: a mitigation tool

# 1 Introduction

# AIReF publishes its first Opinion on Fiscal Risks today: why are we publishing this opinion?

## Shocks of an extreme and unexpected nature

- Financial and sovereign debt crisis
- COVID-19 pandemic
- Geopolitical instability due to trade wars
- Adverse natural phenomena such as the DANA

**Increased intensity and frequency**

## Extreme events are not the only sources of risk

**IMF Fiscal Transparency Handbook (2018)**

- Macroeconomic risks: growth, interest rates and commodities prices
- Specific risks: legal claims and State-owned enterprises

**IMF: international evidence of the fiscal cost and best practice**

## 1 The materialisation of these risks has had a significant impact on Spanish public finances

**RISK MANAGEMENT**

Identification
Quantification
Mitigation

**Sustainability of public finances: AIReF's mandate**

**Key to new European fiscal framework: improved medium-term planning**

**Transparency in communication: reinforcing credibility**

**Greater macroeconomic stability**

# AIReF publishes its first Opinion on Fiscal Risks today: why are we publishing this opinion?

2

**Spanish practice to date has limitations**

## 2021: AIReF's opinion on Fiscal Transparency in GG

- **Macroeconomic risks: basic level** (some coverage in SPU - sensitivity)
- **No comprehensive report on specific fiscal risks** (fragmented analysis; partial IGAE annual report)
- **Insufficient practice for a number of specific risks** (valuation of assets and liabilities or environmental risks)

## Current analysis shows that room for improvement

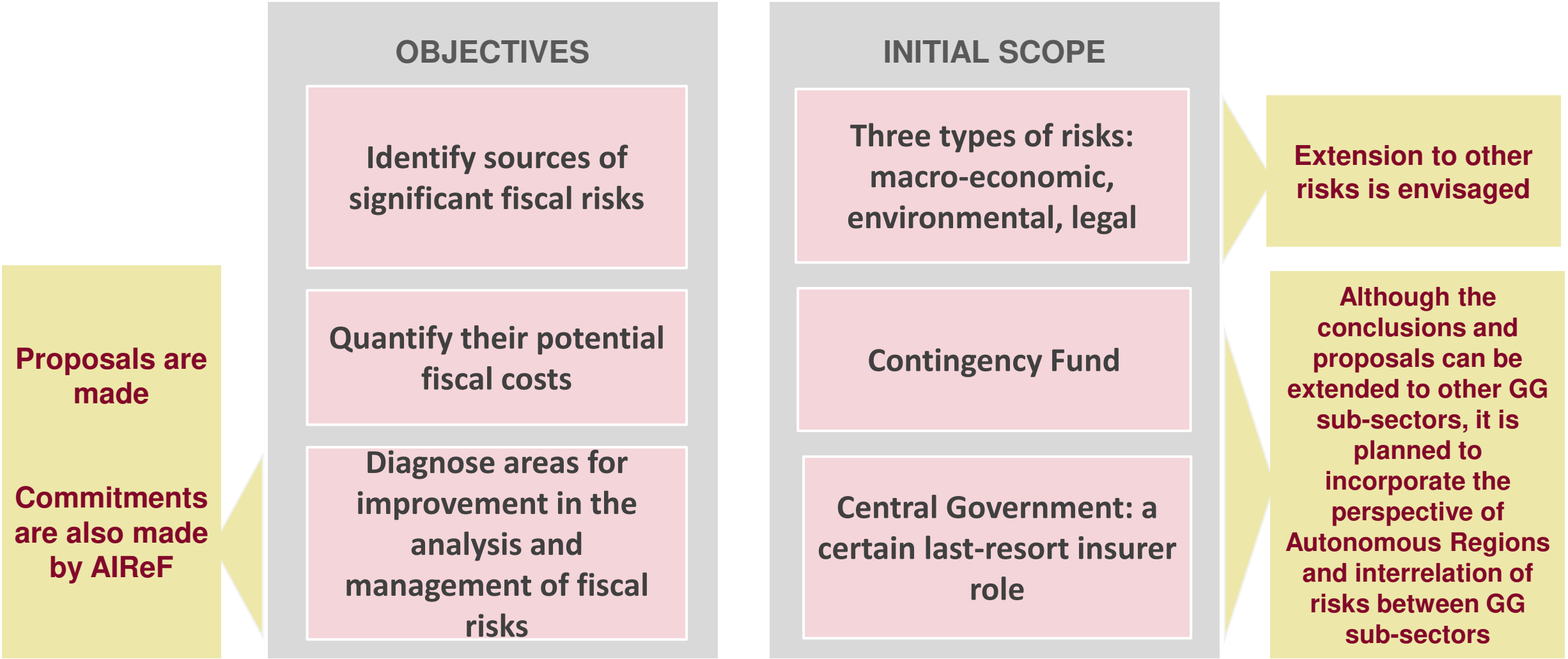
- **European governance reform has not led to improvements in macroeconomic risks** (MTP: insufficient progress in practice)
- **The lack of a full summary and strategy document persists**
- **The MTP does not present a full analysis of specific fiscal risks** (limited to guarantees)

3

**The analysis of fiscal risks forms part of AIReF's 2020-2026 Strategic Plan.**

- **Fiscal supervision pillar: strengthening early warning of risks**
- **Accountability pillar: commitment to external evaluation. This first and subsequent opinions implement Recommendation 2.2:** *"Strengthen risk analytical capacities"*

# This new series of opinions is a pioneering analysis for the case of Spain in terms of its objectives, scope…



# ...and approach

**Given the heterogeneity of fiscal risks and the novel nature of this analysis**

**It combines different methodologies**

- **Macroeconomic risks: econometric analysis**
- **Environmental risks: exhaustive analysis of information sources and database construction**
- **Legal risks and Contingency Fund: case studies**

**It involves several ministerial departments**

- **Ministries of Finance, Economy, Interior, Ecological Transition and, Transport and Sustainable Mobility**
- **They receive proposals and mandatory consultation.**

**Fiscal risks are separated from fiscal pressures**

**Long-term pressures, such as demographics or climate change, must take centre stage, regardless of the difficulty of quantification**

**Incorporated in Opinion on Long-Term Sustainability (upcoming publication)**

# First Opinion at a glance

## 1 Macroeconomic risks

They materialise as extreme events or continuously in response to changes in the economic situation: COVID crisis or changes in interest rates

These risks are reflected in forecast errors in macro variables and their translation into forecast errors in fiscal variables

**Opinion**: study of the Government's macro and fiscal forecast errors 2000-2023
Econometric analysis of macroeconomic shocks

## 2 Environmental risks

They result from the occurrence of increasingly frequent natural disasters such as droughts, wildfires and floods

Fiscal costs are incurred: repair costs and disaster support measures

**Opinion**: this is a pioneering analysis in Spain; to date there have been no studies to identify and quantify the fiscal cost of these risks

## 3 Legal action against the State

They pose a fiscal risk due to the high cost of compensation and indemnities, showing the negative impact on current and future fiscal stability

**Opinion**: presents an analysis of lawsuits against the State and concludes that there are recurrent errors

## 4 Contingency Fund

This is the main mitigation tool included in the General Budgetary Law to deal with unexpected spending

**Opinion**: presents an analysis of the use of the Contingency Fund and finds that 43% of spending is recurrent and discretionary in nature, limiting the its ability to mitigate and manage fiscal risks

# Type of proposals of this First Opinion

**Proposals Opinion on Fiscal Risks**

**It reiterates and builds on the 2021 proposal to develop a Report on Fiscal Risks and integrate it into the budgetary planning instruments: the report should set out potential risks that may affect fiscal projections, as well as a risk mitigation strategy**

**It formulates proposals for specific risk management: among others, creating a database of the fiscal cost of natural disasters, adopting a proactive judicial strategy and improving efficiency and guaranteeing adequate use of the Contingency Fund to fulfil its main function**

**In the context of new European governance, assign AIReF the task of evaluating the quality of the macroeconomic forecasts contained in annual and multi-year fiscal planning**

**AIReF is considering the extension of its macroeconomic risk analysis with a more quantitative approach to the potential impact on fiscal variables (new models are being developed)**

# 2 Definition of fiscal risks

# Definition of fiscal risks

El Confidencial

Diez años de rescate bancario y ni rastro de los 55.000 millones

EL PAÍS

AUTOPISTAS >

**El rescate de las autopistas que iba a ser gratis ya cuesta más de 1.000 millones**

CincoDías

CORREOS >

**Pacto de SEPI con los sindicatos para inyectar hasta 4.000 millones en Correos**

LA RAZÓN

**Nueva condena firme contra el Estado por las renovables**

rtve.es

## La crisis disparó la deuda del Estado en 2009

elEconomista.es

Los daños por la DANA rozan los 22.000 millones de euros

QUIEBRAS

EL MUNDO

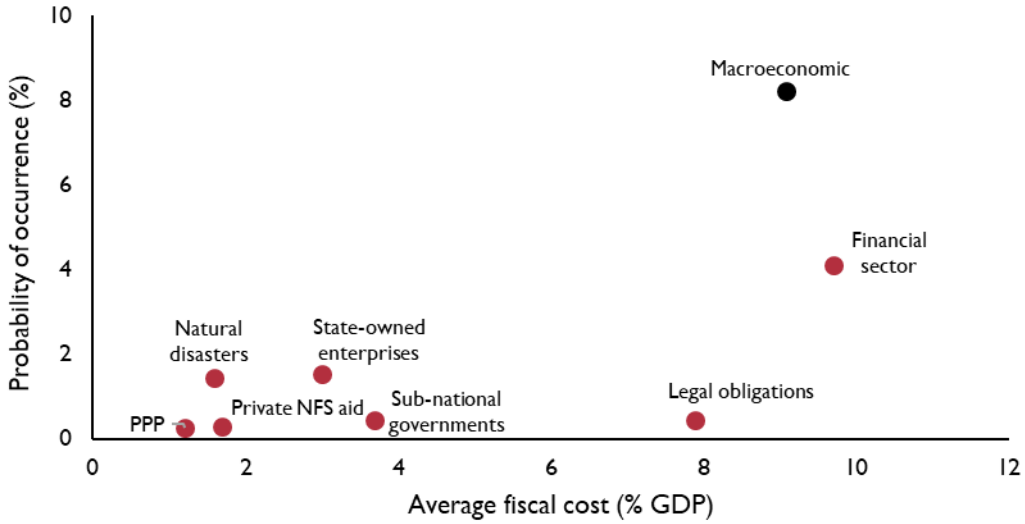
Empresas rescatadas por el ICO empiezan a declararse en concurso de acreedores

# Definition of fiscal risks

*IMF (2018): factors that may cause fiscal outcomes to deviate from expectations or forecasts. These factors comprise potential shocks which are not reflected in the Government's fiscal forecasts or reports*

- Macroeconomic risks: these arise when outturns differ (significantly) from forecasts for key macroeconomic variables for fiscal performance
- Specific risks: these stem from the realisation of contingent liabilities or other uncertain events, such as a natural disaster, the bailout of a troubled public corporation or subnational government by the Central Government which entail a fiscal cost to the Government
- Institutional risks: constraints to the effective management of fiscal policy or fiscal risks

**FREQUENCY AND COST OF MATERIALISATION OF FISCAL RISKS**




**Source:** IMF Fiscal Transparency Handbook (2018).

# 3 Macroeconomic risks

# Extreme events are a source of materialisation of macroeconomic risks

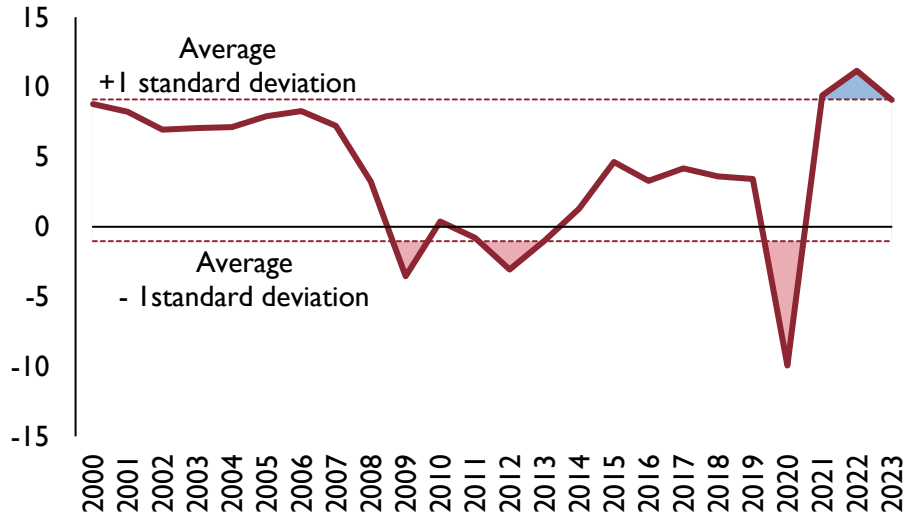
**MACROECONOMIC RISKS**

**Deviations of fiscal variables due to the impact of macroeconomic shocks:**

- Unexpected shocks impacting on exogenous variables (interest rates, commodity prices, etc.)
- Unanticipated endogenous factors affecting economic growth

**Historical materialisation:** large swings in nominal GDP, a key variable for the fiscal position

**NOMINAL GDP IN SPAIN. ANNUAL GROWTH RATE (%)**




**Source**: Prepared by AIReF based on Haver

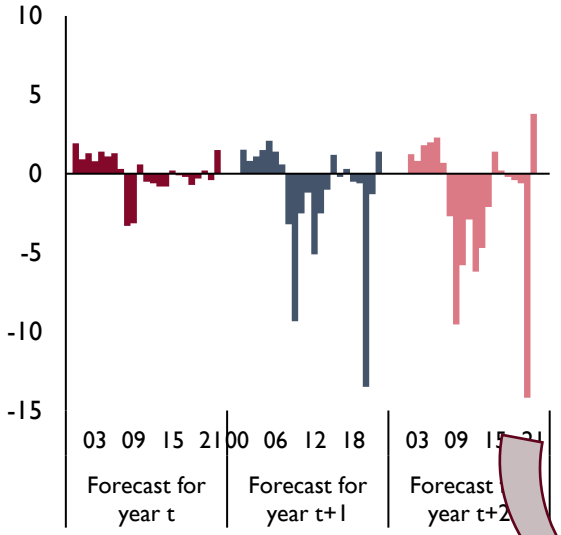
**Extreme events associated with large deviations in nominal GDP growth (financial and sovereign debt crisis, COVID-19)**

# The forecast errors show the relevance of macroeconomic risks

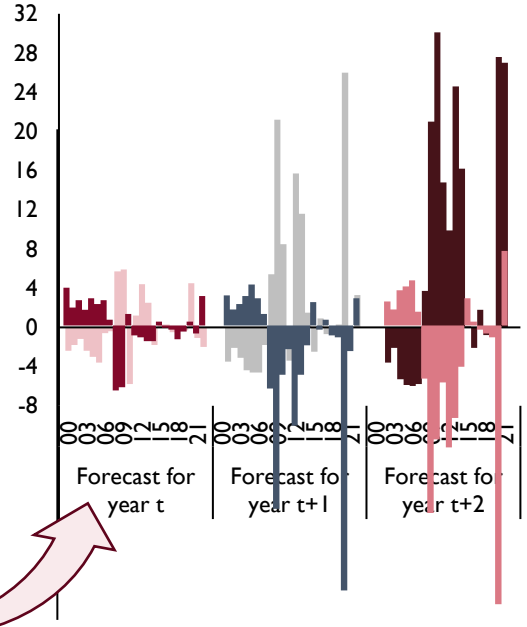
## Studying forecast errors enables analysis of the materialisation of macroeconomic risks

- Forecast errors in macroeconomic variables may result from unexpected shocks
- Forecast errors in fiscal variables may result from deviations in macro variables

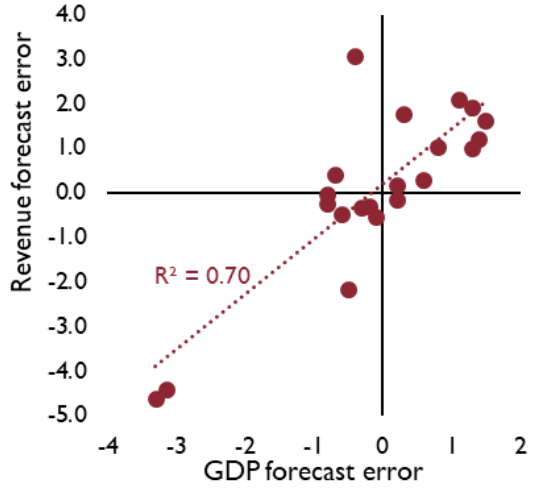
**FORECAST ERRORS IN NOMINAL GDP GROWTH. PP**




**FORECAST ERRORS IN THE PUBLIC DEBT-TO-NOMINAL GDP RATIO. PP**




**FORECAST ERRORS IN THE PUBLIC DEBT-TO-GDP RATIO. PP**




**Source:** Stability Programmes and AIReF

**The high correlation between macroeconomic and fiscal forecast errors points to the relevance of macro risks from both extreme events and smaller shocks**

# Demand shocks seem to be the predominant source of macroeconomic risks

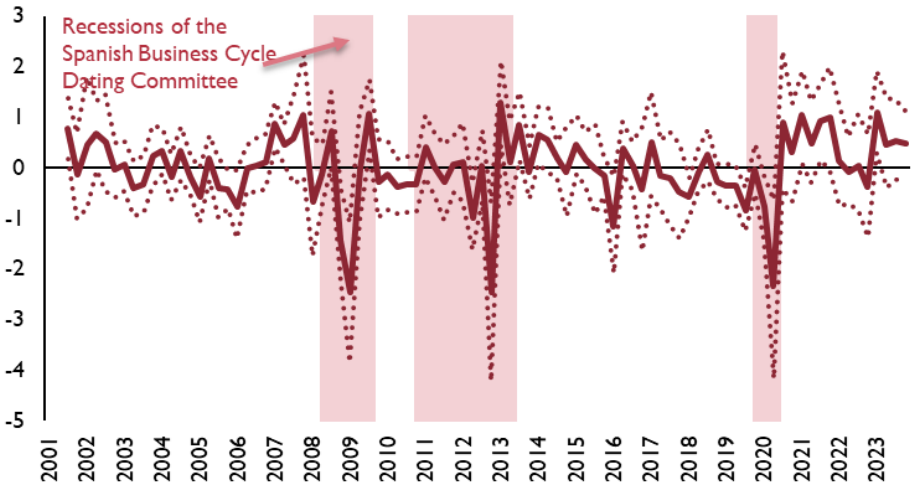
**QUANTIFICATION OF MACROECONOMIC RISKS**

**Macroeconometric techniques:** Sensitivity analysis + scenarios + fan charts for fiscal variables

**BVAR model with sign restrictions**: impact of macroeconomic shocks on fiscal variables

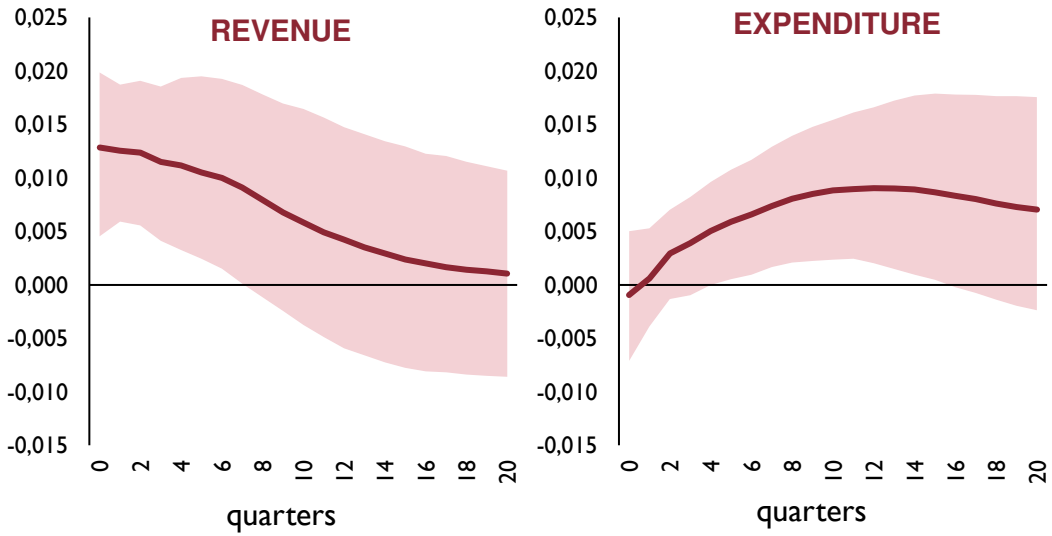
- **Demand shock**: significant positive impact on revenue and expenditure

DEMAND SHOCK




**Source**: Prepared by AIReF

RESPONSE OF FISCAL VARIABLES TO THE DEMAND SHOCK




- **Supply shock (costs)**: no significant impact on revenue and expenditure
- **Financial conditions shock**: positive and significant impact on expenditure

# Macroeconomic risks: AIReF's conclusions and proposals

- ❑ Macroeconomic shocks in the Spanish economy have a significant impact on fiscal variables
- ❑ Demand shocks appear to be predominant, with significant effects on public revenue and expenditure
- ❑ Macroeconomic risks need to be analysed with different approaches in order to quantify their impact
- ❑ AIReF is developing new tools to quantify macroeconomic risks by means of sensitivity and scenario analysis

**Proposal 1: Improving the analysis of forecast errors as a source of macroeconomic risk**

- Include an analysis of forecast errors in macroeconomic and fiscal forecasts in fiscal planning reports
- Reform the national fiscal framework to adapt it to the new EU economic governance, assigning AIReF the *ex-post* evaluation of macroeconomic and budgetary forecasts

**Proposal 2: Quantifying the macroeconomic risks underlying macroeconomic and fiscal forecasts**

- Present scenario or sensitivity analysis of macroeconomic and fiscal forecasts in fiscal planning reports
- Incorporate a full debt sustainability analysis in fiscal planning reports

# 4 Environmental risks

# The materialisation of environmental risks in Spain is frequent due to droughts, wildfires, floods and meteorological phenomena

**ENVIRONMENTAL RISKS**

**Natural disasters generate fiscal costs of a direct and unforeseen nature:**

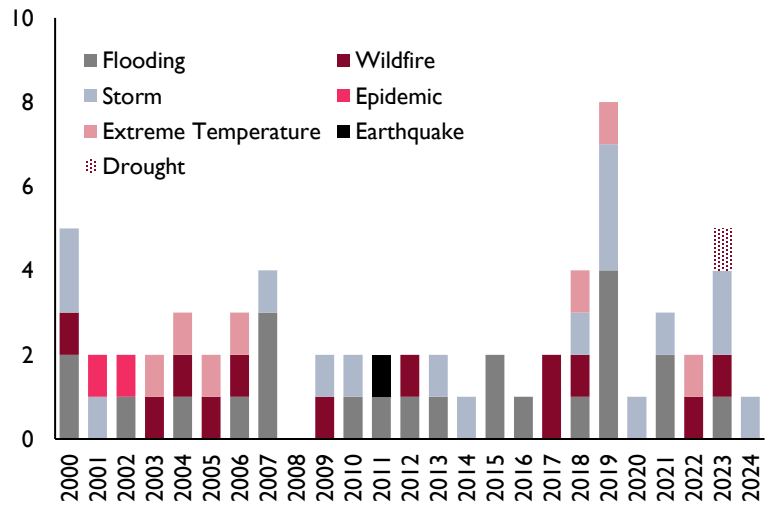
- Disaster relief
- Damage repair

**The historical materialisation of environmental risks will depend on the type of natural disasters and the institutional framework for disaster response**

## Categorisation of disasters

- Geophysical
- Meteorological
- Hydrological
- Climatological
- Biological
- Extraterrestrial

## Materialisation of disasters in Spain




**Source**: EMDAT

- **Climatological**: droughts and wildfires
- **Hydrological:** floods
- **Meteorological**: rainfall, thunderstorms and extreme temperatures

## Institutional framework

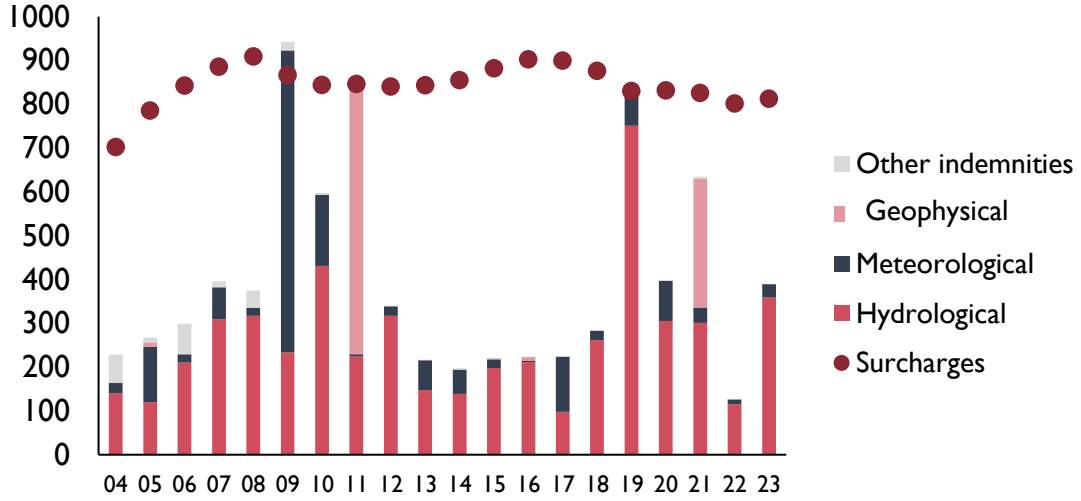
- Insurance Compensation Consortium
- Support and subsidies for disaster victims (RD 307/2005)
- Repair of infrastructures

# The CCS is a good risk mitigation instrument, but there is room for improvement in support and subsidies for disaster victims

## Insurance Compensation Consortium (CCS)

Compensation for natural disaster risks (hydrological, meteorological, geophysical and extraterrestrial) financed by a surcharge on insurance premiums

### CSS COMPENSATION AND SURCHARGES FOR EXTRAORDINARY RISKS 2004-2023. MILLION EUROS AT 2023 PRICES



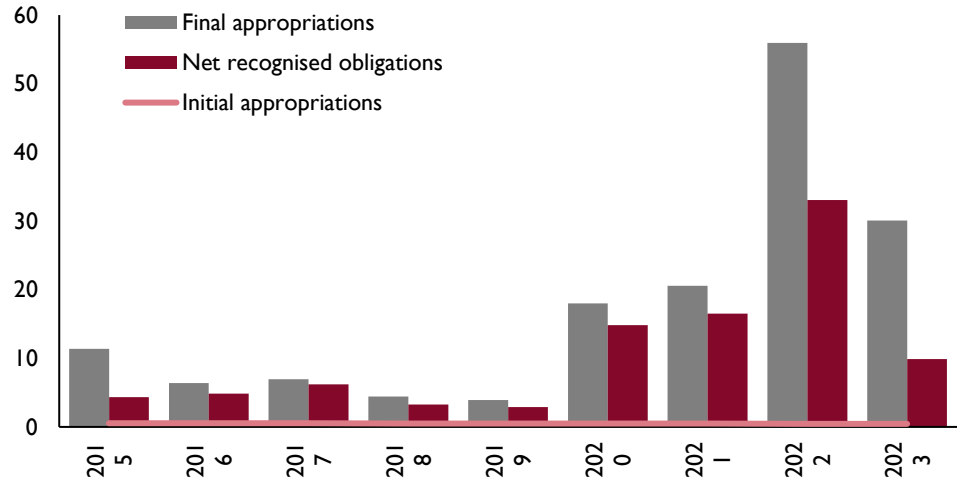

**Source**: CCS. Extraordinary Risk Statistics 1971-2023

The CCS compensation amounted to €7.789bn between 2005 and 2023 (at 2023 prices), which were more than covered by the surcharges

## Support and subsidies for victims (RD 307/2005)

Civil Protection support to cover personal and material damage and spending by Local Governments in the event of emergencies or catastrophic situations

### CIVIL PROTECTION EXPENDITURE ON DISASTER RELIEF. MILLION EUROS AT 2023 PRICES




**Source**: IGAE

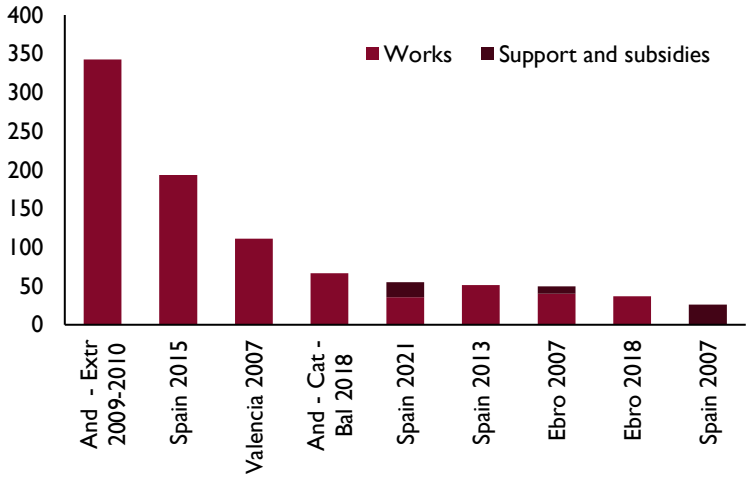
Civil Protection support and subsidies amounted to €96.8m between 2005 and 2023 (at 2023 prices), with a tendency for underbudgeting

# Environmental risks have a significant fiscal cost, especially when the cost of COVID-19 is considered

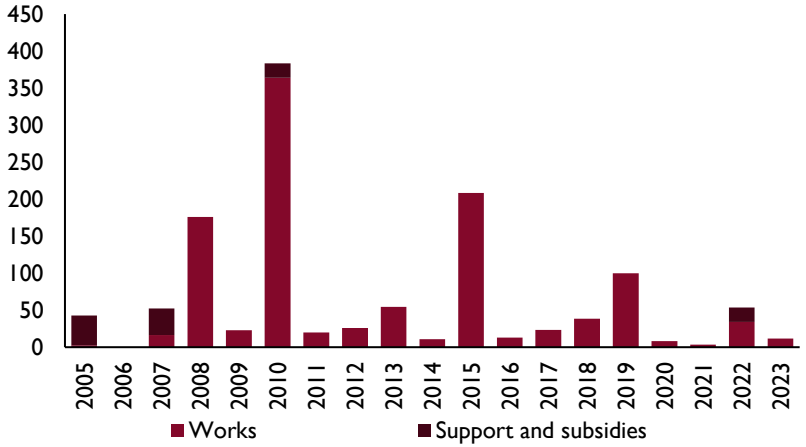
**COST OF REPAIR OF DAMAGE AND RECONSTRUCTION OF INFRASTRUCTURE**

- Emergency contracts to be approved by the Council of Ministers
- Construction and interpretation of natural disaster cost database from Council of Ministers records
- Identification of hydrological and climatological risks with AI and analyst's judgement

**FISCAL COST OF RESPONDING TO MAJOR HYDROLOGICAL RISKS. MILLION EUROS AT 2023 PRICES**




**FISCAL COST OF RESPONDING TO HYDROLOGICAL RISKS PER YEAR. MILLION EUROS AT 2023 PRICES**




**APPROXIMATION OF THE TOTAL COST OF THE MATERIALISATION OF ENVIRONMENTAL RISKS. MILLION EUROS AT 2023 PRICES**

| | Damage repair works (CM) | Support and subsidies to disaster victims (CM) | Compensation to victims (CCS) | Other response costs | Total |
|---|---|---|---|---|---|
| Climatological | 1,020 | 1,349 | | 4 | 2,372 |
| Hydrological | 1,136 | 115 | 5,188 | | 6,438 |
| Meteorological | | | 1,677 | | 1,677 |
| Geophysical | | | 925 | | 925 |
| Biological (COVID-19) | | | | 35,745 | 35,745 |
| Total | 2,155 | 1,464 | 7,789 | 35,749 | 47,157 |

**Source**: Prepared by AIReF based on Extraordinary Risks Statistics, Council of Ministers Records and AIReF

# Environmental risks: conclusions

- In Spain, there is no public strategy to identify, quantify and manage risks to public finances from environmental sources
- The materialisation of environmental risks in Spain is frequent due to droughts, wildfires, floods and weather events, although there are limitations in the information available
- Environmental risks have a significant cost for public finances, especially when considering the cost of COVID-19
- Further quantification of the fiscal cost of natural disasters is needed
- Innovative analysis of the fiscal cost of natural disasters based on new data sources
- There is room for improvement in environmental risk mitigation as there is no explicit monitoring of the cost of natural disasters in the GSB
- The funding of CCS extraordinary risk compensation through surcharges, which mutualises risks between agents and over time, acts as a key risk mitigation instrument

# Environmental risks: AIReF's proposals

**Proposal 1: Improving sources of information on historical disaster materialisation**

- Develop aggregated time series of selected disasters (wildfires, weather events, droughts)
- Maintain updated disaster data sets (floods, earthquakes)

**Proposal 2: Improving quantification of the fiscal cost of the materialisation of natural disaster risks**

- Explicitly include in Ministry budgets the cost of repairing public infrastructure damaged by natural disasters
- Create a database of the fiscal cost of natural disasters, identifying the main events and their costs, based on budgetary execution data

**Proposal 3: Mitigating environmental risks, reducing deviations in fiscal variables**

- Revise budgeting techniques to introduce specific budgetary allocations for disaster response, avoiding under-budgeting
- Develop regular fiscal risk management strategies for environmental risks that may have a budgetary impact
- Improve the use of the Contingency Fund in the event of natural disasters

# 5 Legal action against the State

# In the last decade, numerous court rulings unfavourable to the interests of the State have been handed down

**Subject of court rulings**

- **Mainly on tax matters:** Hydrocarbon Tax (HT), Personal Income Tax (PIT), Non-Resident Income Tax (NRIT), Corporate Income Tax (CIT), Tax on Hydroelectric Production (THP), Tax on the Increase in Value of Urban Land (IVUL), penalties related to the declaration of assets abroad
- **Also on other issues:** financing of the electricity social voucher, compensation for the closure of the Castor gas storage facility

**Cost of court rulings**

- **High cost of compensation and indemnities shows the negative impact of these lawsuits on fiscal stability:** amounts reimbursed > 1 billion in the regional supplement to the Special Tax on Hydrocarbons, maternity benefits, closure of the Castor storage facility, Tax on Hydroelectric Production and offsetting of tax loss carryforwards in CIT
- **Significant additional spending on interest resulting from generally lengthy proceedings**: appeals all the way to the Supreme Court and, on occasion, intervention by the CJEU through preliminary rulings
- **High amount of compensation for recent unfavourable court rulings:** this could have a significant negative impact on the public deficit in the coming years
- **In addition, risks remain due to numerous ongoing court cases:** they could worsen the deficit in the coming years, including international energy arbitrations, transport litigation and tax issues still to be resolved in national and international courts

**Lawsuits pose significant risk to General Government finances**

# Information on court rulings and their impact on the government deficit has important limitations

**Budgetary information**

- Dispersed, incomplete and up to two years late

**National accounting information**

- Without sufficient breakdown and sometimes aggregated
- **Other Capital Transfers:** with its limitations, an essential source of information to analyse in an aggregated manner the historical materialisation of risks associated with court rulings and their fiscal impact

**BREAKDOWN OF OTHER CG CAPITAL TRANSFERS BETWEEN THE STATE AND ITS BODIES (€MILLION)**

| | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|---|---|---|---|
| Central Government | 5,579 | 2,311 | 3,574 | 3,590 | 6,098 | 4,876 | 5,309 | 10,926 | 6,647 | 2,375 |
| State | 2,532 | 788 | 869 | 1,163 | 3,275 | 1,312 | 2,560 | 8,624 | 5,473 | 1,990 |
| Bodies | 3,047 | 1,523 | 2,705 | 2,427 | 2,823 | 3,564 | 2,749 | 2,302 | 1,174 | 385 |

Source: IGAE

**TOTAL, AVERAGE, MINIMUM AND MAXIMUM AMOUNT OF OTHER CG CAPITAL TRANSFERS FOR THE PERIOD 2014-2023 (€MILLION AND WEIGHT OF GDP)**

| | Total 2014-2023 | Weight | Average | Minimum | Maximum |
|---|---|---|---|---|---|
| **Amount (€m)** | **51.285** | | **5.129** | **2.311** | **10.926** |
| **% GDP** | **4,3%** | | **0,4%** | **0,2%** | **0,9%** |
| Court rulings | 10.049 | 20% | 1.005 | 22 | 2.119 |
| Financial sector (DTAs, APSs, SAREB) | 22.577 | 44% | 2.258 | 86 | 3.715 |
| Concessions (Liability Motorway Bailout) | 1.281 | 2% | 128 | 0 | 1.114 |
| Standardised guarantees | 5.146 | 10% | 515 | 0 | 4.200 |
| Other | 12.232 | 24% | 1.223 | 539 | 3.222 |

Source: IGAE

- **In the period 2014-2023, the average amount of Other capital transfers for the CG was about €5bn per annum, equivalent to 0.4% of GDP, with a peak close to €11bn in 2021, accounting for 0.9% of GDP**
- **20% corresponds to court rulings, with an average cost of €1.00bn**

# The analysis of the court rulings highlights the quantitative importance of these disputes and the recurrent errors responsible for their materialisation

## Historical materialisation

**OUTSTANDING COURT RULINGS DURING THE PERIOD 2014-2022**

| Court rulings | Description | €m |
|---|---|---|
| CJEU Jud. 2014, Feb 27th | Regional supplement Special Tax on Hydrocarbons | 1.671 |
| SCJ 2018, October 3rd | PIT of maternity and paternity benefits | 1.371 |
| SCJ 2019, November 13th | Dividend withholding from foreign mutual funds | 740 |
| CCJ 1 July 2020, July 1st | CIT: RDL 2/2016 on instalment payments | 433 |
| NHCJ 2020, February 12th | Energy sold by physical bilateral contracts (ENDESA) | 264 |
| SCJ 2020, October 27th | Compensation for closure of the Castor gas storage facility | 1.454 |
| SCJ 2021, April 15th | Retroactive effect of the Tax on Hydroelectric Production | 1.737 |
| CCJ 2021, October 26th | Tax base of the municipal capital gains tax | 800 |
| NHCJ 2021, October 29th | Offsetting tax loss carryforwards in CIT | 1.317 |
| CJEU Jud. 2022, Jan. 27th | Form 720 declaration of assets and rights abroad | 250 |

**Source**: IGAE and AIReF

## Current situation

**NOTEWORTHY COURT RULINGS WHOSE IMPACT CONTINUES TO THIS DAY**

| Court rulings | Description | €m |
|---|---|---|
| SCJ (2021-2022) | Financing of electricity social voucher (Decree 897/2017) | 642 |
| SCJ 2022, July 14th | Mobile operators' EAT | 1.479 |
| SCJ 2023, February 28th<br>SCJ 2024, January 10th | PIT of Pensioners of Labour Mutual Societies<br>Calculation for pensioners with over 35 years' contributions | 1.700 |
| CCJ 2024, January 18th | Corporate Income Tax Reform (RDL 3/2016) | 1.200 |
| CJEU Jud. 2024 , May 30th | Regional rate of the Special Tax on Hydrocarbons | 6.500 |
| SCJ 2023, November 15th | Parent Retirement Pension Supplement | 994 |

Note: the amount of €642M includes €366M recorded in 2022 and €276M for the outstanding compensation provided in the CSA 2023 account

**Source**: IGAE and AIReF

## Recurrent errors as the main reasons for the materialisation of the court rulings analysed

| | |
|---|---|
| **Inappropriate use of the Royal Decree Law** | **CIT (RDL 2/2016 and RDL 3/2016) and Castor gas storage facility** |
| **Regulatory overreach in relation to the law** | **Tax on Hydroelectric Production and favourable ruling for Endesa on energy remuneration** |
| **Disregard of EU warnings of non-compliance with EU law** | **>Disciplinary regime of Form 720 for the declaration of assets and rights abroad and the regional supplement to the Special Tax on Hydrocarbons** |
| **The same matters are repeatedly challenged on similar grounds** | **Electricity social voucher financing schemes (2009, 2014 and 2017) annulled as discriminatory and regional tax rates of the Tax on Retail Sales of Certain Hydrocarbons incompatible with European regulations (2014 and 2024)** |

# Legal action against the State: AIReF's proposals

**To prevent disputes and reduce the likelihood of unfavourable court rulings**

**Proposal 1: it is proposed that the Ministry of Finance or the competent GG authority should:**

- Strengthen the evaluation of the potential financial and legal impact in the decision-making process before implementing significant changes in fiscal and economic policies (thorough analysis, identification of potential claims and background studies to avoid recurrent mistakes)
- Consult in advance with European bodies and consider international case law to avoid non-alignment with EU law
- Strict use of legal instruments (respect regulatory hierarchies to avoid regulatory overreach and prudent use of the RDL)
- Constant review of laws and other regulations to ensure that they comply with current legislation and case law

**To minimise the impact on the court rulings on the deficit**

**Proposal 2: it is proposed that the Ministry of Finance should:**

- Develop efficient mechanisms to significantly shorten the resolution time for court rulings
- Evaluate the likelihood of success of claims and, if necessary, promptly amend the appealed rule to shorten its period of validity and minimise the corresponding refunds

**To improve the transparency of information on court rulings**

**Proposal 3: it is proposed that the Ministry of Finance should:**

Create a centralised database that integrates all information on the main court rulings that could have a significant impact on the public deficit. This platform should:

- Be regularly updated and accessible to the public
- Understand the monitoring of the main legal proceedings in progress, from their initiation to their final resolution. To this end, it should incorporate the information from the reports of the ministries on the cases that generate the litigation in progress, the State's financial liability, or the facts or circumstances that may give rise to legal, contractual or implicit obligations, as well as the estimate of interest for late payment (Rule 53 of the Instruction on Accounting Procedures for State Expenditure Execution)
- Be completed by a reference to the risks already materialised, their allocation over time and their final impact on the deficit in Spanish national accounting terms

# 6 Contingency Fund: a mitigation tool

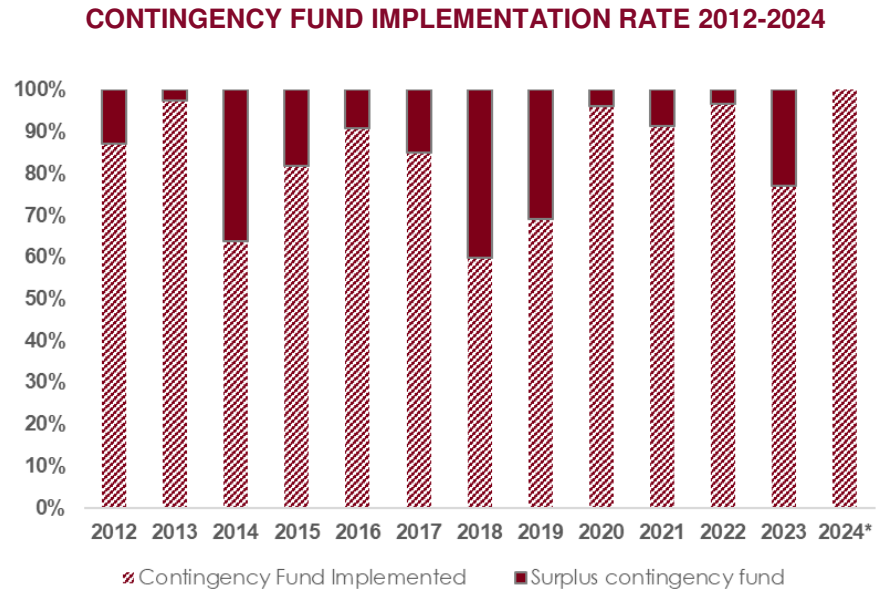
# The Contingency Fund is a useful tool to mitigate fiscal risks and improve budgetary stability

**Design**

- The CF is an appropriation amounting to 2% of the State's non-financial expenditure, recorded separately in the GSB
- It serves to finance the materialisation of risk and is limited to cover non-discretionary, non-deferrable needs that may arise in the course of the fiscal year, provided that there is no adequate budget allocation to address them

**Purpose**

- Its inclusion in the GSB helps to reduce deviations from the initially planned expenditure by absorbing unexpected spending stemming from extraordinary situations, such as natural disasters or the pandemic
- It prevents unplanned excessive increases in expenditure and ultimately facilitates better control of the public deficit

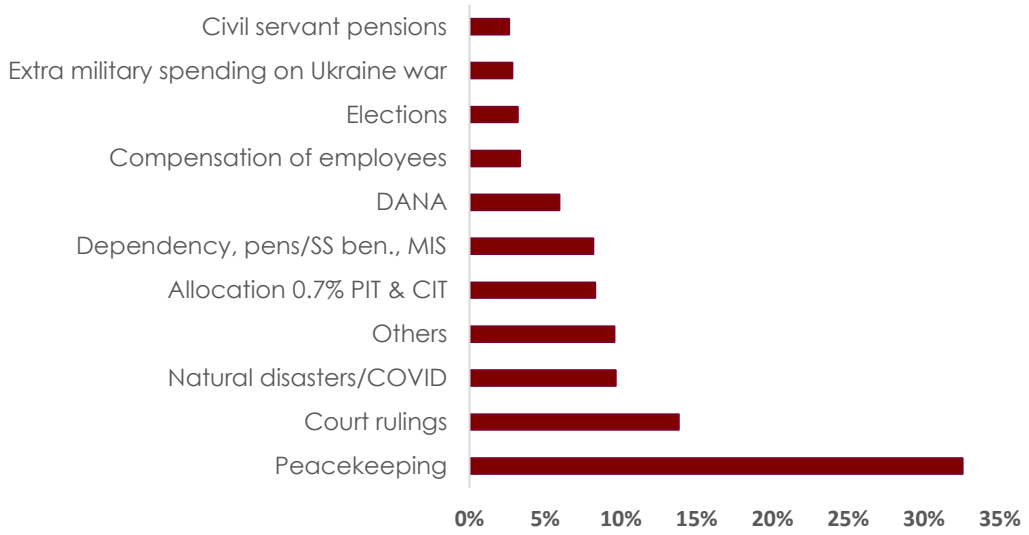



**Source**: IGAE

**The Contingency Fund showed an average implementation of 84% during the period 2012-2024**

# Expenditure financed from the Contingency Fund since 2012

**CATEGORIES OF EXPENDITURE FINANCED BY CONTINGENCY FUND IN THE PERIOD 2012-2024 (PERCENTAGE OF TOTAL FINANCED IN THAT PERIOD)**




**Source**: Ministry of Finance

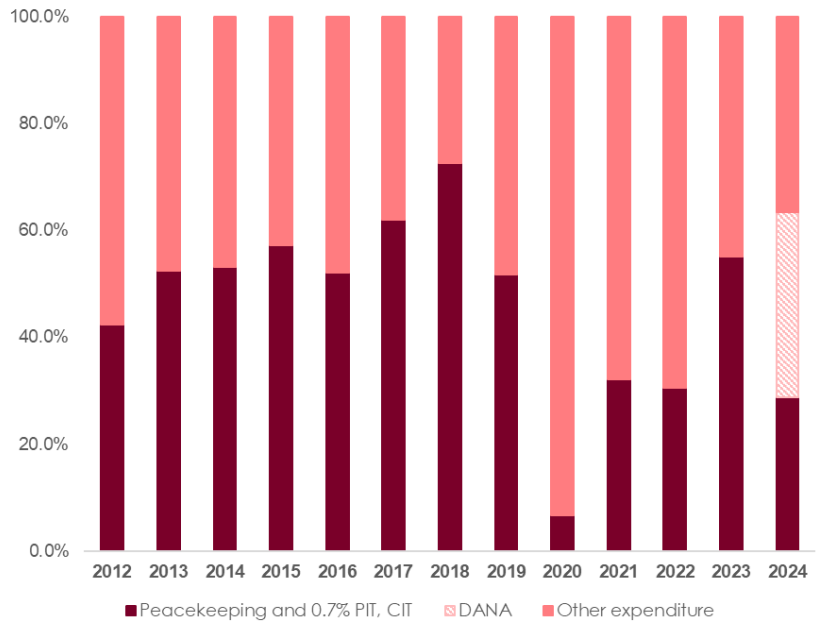
**Most representative expenditure categories by volume and frequency:**

- **Peacekeeping operations:** leads since 2012 in CF budgetary implementation with 33% of the total amount implemented
- **Expenditure on court rulings:** second highest in CF funding at 14%
- **Expenditure arising from natural disasters and COVID-19** absorbed 10% and **DANA** 6%
- **Expenditure on social interest activities through tax allocation:** consumed 8% of CF
- **Other categories of CF-financed expenditure** with a lower weight in the total for the period (social security, elections, etc.)

## Analysis of the main expenditure categories financed by the Contingency Fund

# A significant part of the expenditure financed from the the Contingency Fund is unforeseen and non-discretionary in nature

**PERCENTAGE OF THE ANNUAL CONTINGENCY FUND ALLOCATED TO UNFORESEEN EXPENDITURE**




**Source**: Ministry of Finance

- **Discretionary expenditure accounts, on average, for 43% of the Contingency Fund allocated annually in the GSB**
- **This impact accounted for 73% in 2018 and exceeded 50% in eight other years (2013, 2014, 2015, 2016, 2017, 2018, 2019 and 2023)**
- **Effects of discretionary use of the CF:**
  - **Increases the risk of deviations**: reduces revenue available to address fiscal risks
  - **Compromises budget transparency**: the approved budget does not accurately reflect actual planned expenditure, giving a distorted picture of the amount that will actually be spent at fiscal year-end
- **This practice may jeopardise the effectiveness of the fund as a fiscal risk management tool, limiting its impact on public deficit mitigation**

# Contingency Fund: AIReF's proposals

**In order to improve the effectiveness of the Contingency Fund as a tool to mitigate fiscal risks**

**Proposal 1: It is proposed that the Ministry of Finance should undertake the following actions aimed at restricting its use for discretionary expenditure:**

- Define stricter criteria to prevent the Contingency Fund from being used recurrently to finance discretionary expenditure
- Adequately allocate initial appropriations in the GSB for recurrent discretionary categories, reducing reliance on the Contingency Fund for these items
- Publish regular reports that provide breakdowns of the nature of the expenditure funded, thereby increasing transparency
- Implement a monitoring and evaluation mechanism to ensure that funds are used for non-discretionary and unforeseen expenditure

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