A Literature Review on Fiscal Risks

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***Abstract**. The aim of this paper is to analyze several definitions of the concept of fiscal risk, in order to understand its macroeconomic impact. States that have ignored or dealt superficially with fiscal risks have registered increases in public debt or fiscal crises (Bova et al.,2016), hence the importance of studying this concept. To understand the amplitude of the phenomenon, we note that there was a situation where the materialization of a fiscal risk attracted huge costs for a country, at the maximum level of 56.8% of its GDP (Indonesia). This overwhelming ratio sounds an alarm signal regarding the management of the situations that imply fiscal risks within the economy of each country, but for the beginning it is necessary to reveal the meaning of this notion.*

Keywords: fiscal risk; fiscal obligation; fiscal result; fiscal cost.

JEL Classification: H68; K34.

1. Introduction

Risk is a component of everyone’s life because future is not certain. The decisions we make are not the result of mathematical calculations, as their results have only certain probabilities of concretization according to our intentions. As we live in a society based on tax regulations, fiscal risk influences our decisions as taxpayers, whether we are aware or not. The concept of fiscal risk is the subject of various studies, but from a macroeconomic perspective, on the strength of the impact on the state budget.

2. Microeconomic significance of fiscal risk

Romanian law system specifies that the main subjects of a fiscal legal report are, on the one hand, the state and the administrative-territorial units and, on the other hand, the taxpayer or the payer.

The specificity of the fiscal legal report is given by the existence and administration of the tax receivables and it is carried out, roughly, as follows: the natural and legal persons pay taxes, contributions, tariffs to the representatives of the state and of the administrative-territorial units. Thus, the taxpayers have a fiscal obligation, that is the obligation to pay, to make a payment to the state. Moreover, some authors asserted that complying with tax law is an essential civic duty (Vintila et al., 2013).

The meaning of the word "risk" implies the possibility of a loss occurring. From this perspective, the "fiscal risk" of the taxpayer means the possibility of his fiscal obligation to get increased. The vision of the taxpayer - either natural or legal person - is the same with regard to the fiscal risk: it may entail supplementary debts. In a word, any measure likely to increase the amount payable to the state entails an additional cost.

Consequently, the intention of the taxpayer will be to reduce the fiscal risk, namely to reduce the impact of fiscal obligations on his activity and budget. For instance, Cao et al. (2009) show that one aim of a company is to reduce the tax burden using an appropriate tax planning.

Since the amounts that the taxpayers owe to the state represent receivables of the latter, the fiscal risk for the state is outlined, starting from the previous statements, as the possibility of not collecting the tax claims at the expected level. For the taxpayer, the fiscal risk is an increasing level of taxes, contributions. For the state, the fiscal risk is a decreasing level of these amounts borne by the natural and legal persons. Llau (1992) agrees that macroeconomic fiscal risk is a revenue loss. Or, the activity of public organizations depends on the collection of public receivables (Bene, 2011).

However, the macroeconomic fiscal risk is a much more complex concept, and its sources cannot be reduced to the fluctuations of taxes, tariffs and contributions practiced in a territory. In the following, we will analyze several definitions given to fiscal risk, emphasizing the novelty elements of each.

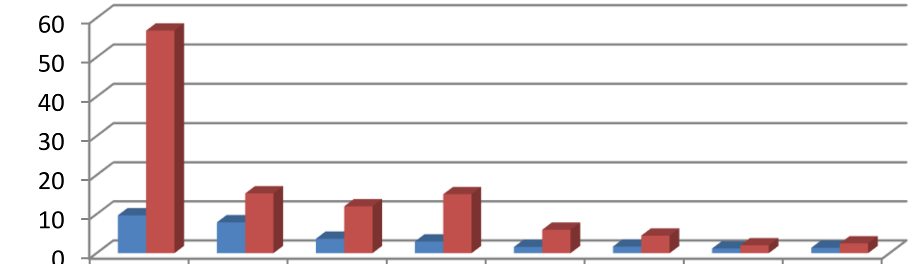
3. Macroeconomic significance of fiscal risk

One of the well known fiscal risk definitions, from a macroeconomic perspective, is: "the possibility of deviations of fiscal outcomes from what was expected at the time of the budget or other forecast (Davis et al., 2008)". The fiscal risks are presented by their consequences, by the budget modification they could produce in the event of their materialization. As we know, not infrequently, the allocation of the amounts from the budget is not entirely according to the plans. Thus, the deviations from the initial plans of using the funds are explained by the existence and concretization of the fiscal risks. In other words, everything causing outcomes deviations can be included in fiscal risks category.

In the view of other authors, the fiscal risks are "the source of increased financial requirements that a government could face in the future (Brixi & Schick, 2002)". This definition shows the possibility of meeting events which entail additional costs. "Could" implies the lack of certainty about the occurrence of these requirements. The definition specifies that this expense is a responsibility of the Government, as it faces the cover of any costs. Possible effects of fiscal risks are not temporally delimited - the definition does not specify whether medium or long-term consequences can occur, or both (the general phrase "in the future" is preferred). However, this acceptance also suggests exceeding the expenses initially provided in the budget by using the term "increased". Therefore, if the fiscal risks materialize, a different allocation of the amounts is necessary, and even additional amounts in order to remove the imbalance.

The tax risks are explained as well as "factors that can cause a government's fiscal performance to deviate from what was forecast in the medium-term or pose a threat to sustainability over the long-term (HM Treasury, 2018)". This is a complex point of view, which shows the amplitude of the possible consequences, both in the medium and long term. If, in the medium term, the fiscal risks endanger the performant administration provided by each government, in the long term, they can harm the sustainable development. As in the previous definitions, it is shown that the fiscal risks are factors supposing the redirection of certain amounts allocated by the Government. Thereby, the success of the budget execution in its initial form is threatened.

The following diagram summarizes the impact of achieving fiscal risks on the economies of 80 developed and developing countries, for the period 1990 - 2014. The impact is calculated as a percentage in GDP of the fiscal costs caused by the materialization of risks, as average level (first column, where AFC represents the average fiscal cost), as well as maximum level (the second column, where MFC represents the maximum fiscal cost). Cost grouping was done by source of fiscal risks.

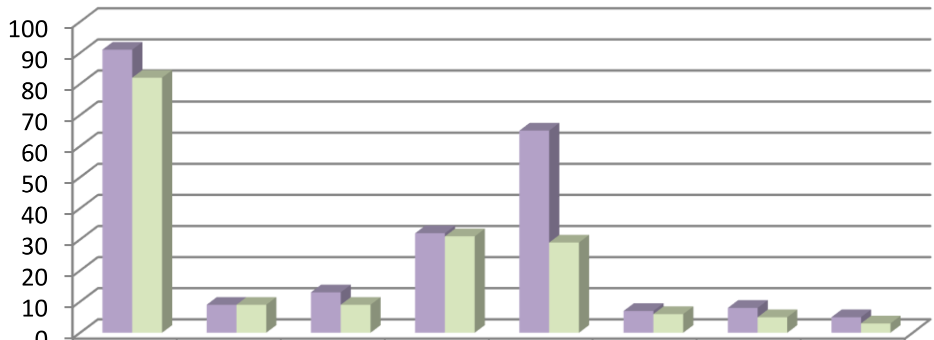


	Financial Sector	Legal	Subnational Government	SOEs	Natural Disasters	Private Non-Financial Sector	PPPs	Other
AFC	9,7	7,9	3,7	3	1,6	1,7	1,2	1,4
MFC	56,8	15,3	12	15,1	6	4,5	2	2,5

Fig. 1 - Contingent Liabilities Realizations by Costs

Source: own representation using data provided by WP/16/14 of International Monetary Fund

The second diagram shows the frequency of occurrence of certain fiscal risks, grouped according to their sources. The first column illustrates the number of events of that type (noted NE), and the second column the number of events that resulted in fiscal costs (noted NEFC).



	Financial Sector	Legal	Subnational Government	SOEs	Natural Disasters	Private Non-Financial Sector	PPPs	Other
NE	91	9	13	32	65	7	8	5
NEFC	82	9	9	31	29	6	5	3

Fig. 2 - Contingent Liabilities Realizations by Number of Episodes

Source: own representation using data provided by WP/16/14 of International Monetary Fund

By far, the most significant fiscal costs had sources in the financial sector. The global economic crisis triggered at the end of 2007 is one of the examples that explain the high share of these costs in GDP, given the effects of the recession on the affected states. The second diagram shows that the financial sector is also the source of the most frequent fiscal costs. The number of such events is also the highest: since the interdependence between national economies also implies the transmission of negative economic trends, a financial crisis in a state will not limit its consequences at state's borders. Between 1997 and 2001, Indonesia experienced an unprecedented situation. Given the coexistence of the Asian crisis and the national banking crisis, it was necessary to restructure the banking system that generated tax costs at the historical level of 56.8% of GDP and also meant the closure of over 60 banks. The experience of this state shows that the effects of the crises must be handled with caution and the fiscal risks carefully analyzed before they occur.

Regarding natural disasters, the first diagram shows that their production does not generate a very high impact on GDP, in general the value reaches 1.6% of GDP, and the maximum was 6% of GDP, a much lower percentage than the financial sector had. It could be considered that nature is not a compulsory factor to consider for tax risk planning. However, we observe in the second diagram, the frequency of occurrence of natural disasters occupies the second position, after the financial sector. If there are disasters, even if they do not generate very high costs, the fact that they occur frequently requires increased attention and measures capable of limiting if not their production, at least of their damages.

Among the obligations provided by law or by contracts (to which the term "legal" corresponds in the charts), we mention the state guarantees for different loans of the public administration, guarantees for different credits promoted by the state fiscal policy in certain periods, insurance schemes for supporting certain industries, etc. Their impact depends very much on the level of the obligation assumed, but also on the probability of materializing the respective events that could attract public expenditures.

Efficient administration and ensuring the competitiveness of state-owned companies in the business environment is the solution for reducing losses in this sector. As the private sector is evolving rapidly, state-owned companies must also find the resources to remain competitive and ensure a stable portfolio of customers, so that frequent fiscal risks in this area do not result in significant fiscal costs.

Public-private partnerships (PPPs), whose purpose is to combine the expertise and experience of the private sector with the infrastructure needs of the public sector (the Fiscal Council of Romania, 2014) to make efficient investments, are not yet an important source of tax costs. This is explained on the one hand, by the fact that not all states frequently use such partnerships, but also by the clauses established at the time of the conclusion of these contracts, so by the responsaibility assumed.

Returning to Romania, in the 2013 Annual Report of the Fiscal Council of Romania, the fiscal risks are explained as "factors outside the governmental control that can cause different fiscal results from the initial forecasts". This definition agree that the fiscal risks generate deviations compared to what was predicted, differences in the way of spending the amounts from the Budget. According to the statement, the sources producing fiscal risks are not among those controlled by the Government. This information reduces, to some extent, governmental responsibility for any effects.

Focusing primarily on macroeconomic attributions of the Government in a country, Petrie (2013) shows, on the contrary, that the Government is required to find solutions regarding fiscal risks. This belief implies the full responsibility of a government. The difficulty of this attribution is emphasized by Hanson et al. (2019): it entails "large government outlays at times when other programs in the government's portfolio also require large outlays". Thereby, it happens that the fiscal risks are superficially tackled.

Macroeconomic fiscal risks can be managed by a specific institution. An alternative is that a fiscal council manages fiscal risks and its independent activity "can enhace credibility, comprehensiveness, and accountability (Hughes, 2018)".

If the management of the factors that determine fiscal risks does not fall within the compulsory tasks of each government, the governmental responsibility exists, required by the results of the fiscal risks, by their effects.

4. Conclusions

The concept of fiscal risk is difficult to reduce to a single definition, since the factors that determine it or the areas in which the effects are felt (in the case of its materialization) may differ, from one state to another. Also, there is no uniform practice of managing fiscal threats, as neither the analysis of possible threats is the attribution of the same type of institution. Among the characteristics of the fiscal risks are the uncertainty of their materialization; the possible medium and long term consequences; effects that may endanger the budget execution as it was foreseen; negative effecs on the sustainability of the economy. The appropriate forms of tax risk management can widely vary from country to country, depending on their sources. In any case, ignoring fiscal risks can become a fiscal risk itself.

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