

Debt risks assessment and reduction of probable effects on public debt structure

Dear Mr. Chairman!

Dear members of the Working Group!

First and foremost, I would like to express our gratitude to the Mexican and Ukrainian colleagues for the fact that despite the global crisis and well-known problems, we haven't neglected the plan of the Working Group activities. And I'm delighted to greet all of you on behalf of the Accounts Chamber of the Russian Federation.

The global financial and economic crisis happened to prove again the importance and extreme urgency of the issues the INTOSAI Working Group on Public Debt is dealing with.

According to the decisions taken at the latest summit of the Working Group (on the Fiji Islands, 2008) and to the working plan of the Accounts Chamber of the Russian Federation for 2009, we have conducted thorough analysis within the research "Debt risks assessment and reduction of probable effects on public debt structure".

The problem was studied according to the approaches accepted in the world practice and in the corresponding documents of the International Monetary Fund, International Bank of Reconstruction and Development and the Working Group on Public Debt. They touch upon the structure of risks and their economic contents enlarged due to the current trends in the debt sphere both in Russia and throughout the world.

The results of the survey held are reflected in the Analytical Summary on the assessment of risks within the public debt management in the Russian Federation that was accepted by the Board of the Russian Accounts Chamber on September, the 18th and directed to the Working Group.

The world experience, the recent and the current economic crises have showed that the significant influence of the debt risks on the vulnerability of the budget system causes the necessity to manage risks inherent to the public debt liabilities.

The realization of debt risks may have considerable impact on the stability of the budget system, the debt volume and the budget expenditures.

Here are a few examples of certain indicators that reflect such risks in the Russian Federation in 2008 and in the first half of 2009.

(Slide 1)

The significant rise of different types of the debt risks during this period is connected with the development of the crisis that caused the following consequences:

- The realization of price risks and unplaced liabilities risks that in the 2nd half of 2008 triggered the rejection of new borrowings and finally the failure on the borrowings already made to the extent stipulated;
- The realization of refinancing and liquidity risks having caused the necessity to use the Reserve Fund resources to compensate the borrowings resources and since it was impossible to refinance the public debt on acceptable terms;
- The realization of monetary risks and consequently the increasing volume of the external public debt in rubles and the costs of the debt repayment;
- The realization of inflation risks that resulted in the increase of the public debt commodity obligations the value of which depends on consumer goods prices.

Thus, in the current economic situation the necessity of the debt management system is urgent especially for the countries intending to expand borrowings both on internal and external markets.

Therefore, it's reasonable to view at some current and anticipated indicators for 2010-2012 that characterize the debt situation in the Russian Federation. Let's look at the slide.

(Slide 2)

The public debt is expected to increase by 3,5 times at the end of 2012 in comparison with the beginning of 2007, and the net amount of the debt – to exceed 8,5 trln rubles.

Due to the debt growth the total expenses concerning the debt repayment in 2012 may amount to 1,5 trln rubles. To compare – the same indicator in 2007 was 0,7 trln rubles.

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So, taking into account the expected 3-times increase in the borrowings including those made on the external markets, the consequences of the debt risk

realization can be far more serious.

The research we've made in the debt sphere shows that the system of debt risk management should involve the overall study of all the risks existing, their determination, assessment and control.

In view of all that and the approaches to risks accepted in the world practice we have worked out the classification of the main types of public debt risks **(slide 4)**:

1. According to the way of risk impact (direct and indirect)
2. According to risk origin (internal and external)
3. According to the system (within the system and specific ones)
4. According to the type and extent of impact (economic, political; permanent and crisis).

We have also analyzed basic and specific risks typical for the public debt liabilities, different ways of studying liability structure in order to define risk level. And we suppose that it's essential to take well-grounded decisions concerning the public debt management. We suggest the following classification **(slide 5)**:

- a) Minimum risk is the risk close to zero typical for public bonds with high credibility
- b) Acceptable risks is the risk that does not exceed the expected amount and does not require special management

This kind of risk is hedged without special measures and instruments.

- c) Extreme risk is the risk when there appears a high probability of the rapid increase in the expenditures on repayment and debt service and also the threat of worsening conditions of placing liabilities.

It's the case when it's necessary to take special managing measures concerning borrowings, resources of financing public deficit, expenses on debt service, debt instruments and hedging.

- d) Unacceptable risk is the risk when the expenses on debt service and repayment as well as placing new borrowings become unacceptable. This risk requires using reserve funds (if available) or reducing budget

expenses.

Beyond that point there is a catastrophic risk that is the risk of huge borrowings on unfavourable terms when there is the crisis of budget liquidity, lack of reserve funds and overall recession. It means that extraordinary management solutions are on the agenda.

Preparing the summary we have examined the volume and structure of the debt in order to determine risks, ways of risk minimization and reveal the factors that make it much more difficult to manage risks.

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We can divide these factors into 2 groups: objective and subjective ones.

Objective factors are:

- High rate of uncertainty typical for risks that goes up in crises;
- Failure to forecast major economic events in the world.

Subjective factors are:

- Lack of legislation concerning public debt management and risk management;
- Absence of priorities in debt strategy;
- Insufficient criteria concerning the assessment of debt management efficiency.

Having studied all these issues we have realized that the creation of the risk management system should lead to: minimizing system risks in the debt sphere, reducing the impact of subjective factors, “early risk alarm”, as well as revealing threats to debt stability that come from external and national financial markets.

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In conclusion I would like to draw your attention to our findings:

1. Significant influence of the debt risks on the vulnerability of the budget system causes the need to manage risks.
2. Risk management system as a part of public debt management should be involved both in the debt strategy and in the control of debt instruments. This system should be aimed at the objective assessment and efficiency of

management solutions in the debt sphere.

3. Taking into consideration the urgency of the issues stated above, particularly within the framework of the current world crisis, so the Working Group on Public Debt has to elaborate common recommendations concerning the debt risk assessment and management.

It makes me think that the results of our analysis can be used while preparing such recommendations.

Thank you for your attention.

Nikolay Surikov.