Medium-term fiscal frameworks – how to integrate successfully the risk element in it?

Gonzalo Caprirolo
Outline

1. Financial crisis and sources of risk
2. Fiscal risk and integration in fiscal framework
3. Medium Term Fiscal Framework and Medium-Term Budgetary Framework
4. Managing risk in a MTFF and MTBF
5. Preconditions for an effective risk management framework
6. Incorporating fiscal risk in medium-term policy targeting
7. Conclusions
1. Poor understanding of government‘s fiscal risk exposures

2. Poor understanding of their underlying fiscal position

3. Strengthening of fiscal frameworks and rethinking the role of fiscal policy

4. Need to further integrate risk dimension in fiscal framework (analysis, management, reporting, coordination within government and other players)
Sizable increase in debt since 2008

Drivers

— The collapse in revenues caused by the Great Recession  IMF (2013)
— Fiscal stimulus accounted for about 17 percent up in G-20 Advanced Economies
— Other fiscal interventions (banking system)
Sources of Unexpected Increase in General Government Debt

(Percent of GDP, 2007-2010)

<table>
<thead>
<tr>
<th>Source</th>
<th>Fra</th>
<th>Ger</th>
<th>Neth</th>
<th>Spn</th>
<th>Port</th>
<th>UK</th>
<th>US</th>
<th>Grc</th>
<th>Ire</th>
<th>Ice</th>
<th>Ave*</th>
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<tbody>
<tr>
<td>Underlying fiscal position</td>
<td>1.7</td>
<td>3.2</td>
<td>-2.4</td>
<td>1.8</td>
<td>11.3</td>
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<td>8.1</td>
<td>16.3</td>
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<td>Revisions to 2007 deficit &amp; debt</td>
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<td>-0.1</td>
<td>0.1</td>
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<td>7.1</td>
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<td>9.4</td>
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<td>2.6</td>
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<tr>
<td><strong>Total Unforecast Increase in Debt</strong></td>
<td>14.4</td>
<td>19.5</td>
<td>20.2</td>
<td>24.0</td>
<td>27.8</td>
<td>28.0</td>
<td>29.1</td>
<td>41.7</td>
<td>59.1</td>
<td>67.7</td>
<td>26.4</td>
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</table>

* Source IMF

- **23%** Underlying fiscal position
- **37%** Exogenous shocks
- **18%** Policy changes

GDP-weighted average
### Fiscal impact of financial sector crisis on government debt in 2008-2009

**Table 1: Cumulated financial sector stabilisation operations and their impact on government debt**

(2008-2009; percentage of 2009 GDP)

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<thead>
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<td>Acquisition of shares</td>
<td>Loans</td>
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<td>Netherlands</td>
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<td>Austria</td>
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<tr>
<td>Slovenia</td>
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<tr>
<td>Slovakia</td>
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<tr>
<td>Finland</td>
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<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td><strong>Euro area</strong></td>
<td><strong>1.4</strong></td>
<td><strong>0.2</strong></td>
<td><strong>0.9</strong></td>
<td><strong>0.0</strong></td>
<td><strong>0.0</strong></td>
<td><strong>2.5</strong></td>
</tr>
</tbody>
</table>

Source: ECB
Some lessons from the financial crisis

**Source of risk**
- Exposure to Financial Sector
- Quasi-fiscal Activity by SoEs
- Unreported Flows
- Macroeconomic Shocks

**Issue**
- No recognition of contingent liabilities
- Exclusive focus on general government
- Losses on asset & liability holdings not recognized
- Bias in macroeconomic forecasting

**Policy Measure**
- Recognition of quantifiable contingent liabilities
- Publication of fiscal data for public sector
- Recognition of doubtful debts in summary aggregates
- Alternative macro-fiscal scenario analysis
Post crisis lessons

1. **Need to strike a right balance between fiscal sustainability and stabilization**
   - the role that fiscal rules should play in restricting deficit bias
   - the potential for stabilization policy to limit the severity of economic fluctuations

2. **Review consensus prior to crisis regarding stabilization**
   - automatic stabilizers was the tool for countercyclical policy
   - ineffective discretionary policy to challenges of an effective implementation

3. **Emerging consensus post crisis**
   - automatic stabilizers did not play out fully in practice throughout the cycle
   - greater acceptance for discretionary support under well-defined circumstances (e.g. deep economic shocks/constrained monetary policy/spillovers/larger multipliers)

4. **Importance to revamp fiscal policy frameworks**
   - identification of underlying fiscal position
   - understanding and dealing with fiscal risk exposures
   - incorporating explicitly risk dimension in fiscal framework
   - assessment of fiscal space
Striking the balance between constrains and flexibility

1. **Ensure sustainability**
   - tightening fiscal rules and procedures
   - building institutions
   - promoting fiscal adjustment in good times
   - ensuring correction to sustainable fiscal position

2. **Possibility of consistent stabilization policy**
   - Adherence to fiscal rules *to avoid exacerbating business cycle fluctuations*
   - Fiscal space (IMF) defined as the room to raise spending or lower taxes relative to a pre-existing baseline, without endangering market access and debt sustainability
     - role of fiscal rules
     - building buffers
     - long-term adjustment plans in the face of population ageing
   - Fostering stabilization in the EU context
     - collective "escape clause" of suspension of rules in the case of a "severe economic downturn"
     - common fiscal stance euro area
     - investment clause and fostering structural reforms
Inclusion of risk dimension in fiscal frameworks to ensure sustainability and macroeconomic stability

1. Economic shocks can alter fiscal outcomes (reduce/improve revenue or increase/reduce spending in bad/good times) and in bad times limit the capacity of governments to conduct their policies as planned.

2. Comprehensive analysis and management of fiscal risk underpins stable fiscal position and stabilization properties of fiscal policy.

3. There is need to incorporate risk dimension in a systemic way in fiscal frameworks.

4. Multi-year frameworks provide stability and predictability and enhance resiliency of fiscal policy.
What is fiscal risk?

Uncertainty that may cause outcomes to differ from forecasts or expectations due to:

1. Incomplete understanding of the government’s fiscal position

2. Exogenous shocks to the public finances

3. Endogenous changes from government activities and vulnerabilities of fiscal policy settings
Fiscal Risk: Key dimensions

**Risk Analysis and Disclosure**
- Macroeconomic Risks
- Specific Fiscal Risks
- Long-Term Sustainability

**Risk Management**
- Medium term policy orientation
- Budgetary Contingencies
- Asset and Liability Management
- Guarantees, PPPs and Financial Sector
- Natural Resources and Environmental

**Fiscal Coordination**
- Sub-National Governments
- Public Corporations

Source: based on IMF Fiscal Transparency Code
1. Fiscal risk dimension is often **partially integrated into frameworks**, budget documentation, and decision-making

2. “Fiscal risk Management practices are often blunt, ad hoc, and too focused on imposing limits on the creation of exposures. Countries need to expand their toolkits for fiscal risk management and adopt the use of instruments to transfer, share, or provision for risks. In doing so, countries need to weigh the possible benefits from **reducing exposure to shocks against the financial and other costs of the policies that may be needed**“ IMF 2016

3. Code of transparency (IMF), Risk assessment matrix (IMF), Debt Sustainability Analysis (IMF, EC, WB, ESM), Best practices (OECD), Reporting (GFSM2014)

4. Reporting in different publications and approaches (annual budget, separate statement and documents)

5. Approaches to integrate risk dimension in fiscal framework vary and involve an evolving learning process

6. Successful fiscal risk management includes identification, analysis, mitigating, budgeting, and reporting; all dimensions part of a fiscal framework
1. Fiscal policy objectives:
   - **prudent** (keep debt on a sustainable path and manage fiscal risks adequately);
   - **countercyclical when feasible** (mostly but not exclusively by letting automatic stabilizers operate in a symmetric way);
   - **growth-friendly** (to support potential output);
   - **and inclusive** (ensuring that the poor and the middle class share in the growth dividend and can adapt to a changing economy).

2. Based on well-designed fiscal rules safeguarding policy credibility and market access, contributing to building capacity to offset shocks

3. Fostering creation of fiscal room for maneuver (fiscal space) or rebuilding fiscal space to be used when required

4. Integrating risk management to contribute to mitigate undesirable outcomes including procyclicality and limit exposure to fiscal crisis
Overall fiscal framework

**Objective**
- Fix permanent fiscal objectives
- Set multi-year fiscal targets
- Determine multi-year spending plans
- Authorize annual expenditure
- Report actual expenditure

**Instrument**
- Fiscal Responsibility Law
- MTFF
- MTBF/MTPF
- Annual Budget
- Final Accounts

**Content**
- Principles of fiscal management
  - Fiscal rules
  - Transparency requirements
- Macroeconomic objectives and forecasts
  - Fiscal objectives forecasts
  - Fiscal risk analysis
  - Fiscal space/Medium term objective
- Spending allocations/ expenditure ceilings
  - Outputs and outcomes
  - Performance indicators
  - Contingency margins and reserves
- Detailed expenditure appropriations
  - Other budgetary controls
  - Reconciliation with MTEF projections
- Detailed expenditure outturn
  - Reconciliation with budget allocations
  - Explanation of discrepancies

Source: based on IMF/FAD MTBF
Risk Dimension in a Robust Fiscal Framework

MTFF – Medium-Term Fiscal Framework

MTBF – Medium-Term Budget Framework

MTPF – Medium-Term Performance Framework
<table>
<thead>
<tr>
<th>Medium-term Frameworks</th>
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<tbody>
<tr>
<td><strong>Medium-Term Fiscal Framework (MTFF)</strong></td>
</tr>
<tr>
<td>• Arrangements for setting multi-year macro-fiscal objectives &amp; targets (medium term objective)</td>
</tr>
<tr>
<td>• A rolling framework covering the next annual budget plus 2 or more out-years.</td>
</tr>
<tr>
<td>• Fiscal risk analysis/fiscal space assessment</td>
</tr>
<tr>
<td>• Fiscal objectives, targets and rules are respected in budget formulation, approval &amp; execution.</td>
</tr>
<tr>
<td><strong>Medium-Term Budget Framework (MTBF)</strong></td>
</tr>
<tr>
<td>• Mechanism for prioritization, reconciliation and presentation of multi-year expenditure estimates</td>
</tr>
<tr>
<td>• Delivers multi-year aggregate expenditure ceilings &amp; economic classification</td>
</tr>
<tr>
<td>• Developed from an MTFF as part of the top-down.</td>
</tr>
<tr>
<td>• Coordinated with bottom-up budgeting spending agencies.</td>
</tr>
<tr>
<td>• Rolling framework that reflects medium-term strategic priorities &amp; Forward expenditure estimates (ceilings)</td>
</tr>
<tr>
<td><strong>Medium-Term Performance Framework (MTPF)</strong></td>
</tr>
<tr>
<td>• Developed from an MTBF by spending agencies or sectors</td>
</tr>
<tr>
<td>• Expenditure estimates linked to results and outcomes under programs</td>
</tr>
<tr>
<td>• Estimation of cost for implementation of current and new policies, service delivery &amp; capital investments</td>
</tr>
<tr>
<td>• Indicator-based assessments of performance</td>
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</table>
Benefits of frameworks

1. **MTFFs enhance fiscal sustainability and determines role for stabilization by**
   - Taking the future impact of policies into account
   - Placing constraints on fiscal aggregates
   - Taking into account fiscal risk and fiscal space
   - Enticing behavior consistent with fundamental objectives

2. **MTBFs improve allocative efficiency by**
   - Combining policy-making, planning and budget preparation
   - Imparting an inter-temporal dimension to expenditure planning - a forward-looking, strategic and collaborative approach
   - Providing more funding certainty to spending agencies and sectors
   - Improving multi-year policy and expenditure prioritization and costing

3. **MTPFs strengthen technical efficiency by**
   - Emphasizing the importance of program outputs and outcomes
   - Holding spending agencies accountable for results
MTFF and MTBF/MTPF

1. Complementary institutional arrangements

2. Help ensure fiscal discipline by making more explicit the impact of current policies on the government balance in the coming years

3. Facilitate monitoring by providing benchmarks against which budgetary developments can be assessed over time

4. In practice their comprehensiveness and degree of commitment can vary
Medium-term fiscal framework

1. Determines the planning, objectives and targets over multi-year horizon

2. Operationalizes fiscal rule and legislation into a multi-year fiscal strategy, taking into account priorities and objectives, macroeconomic conditions and risks

3. Incorporates assessment of fiscal risk into policy targets and management strategy

4. Incorporates fiscal space in the conduct and implementation of fiscal policy

5. Delivers multi-year aggregate expenditure targets consistent with fiscal objectives and rules
What does an MTBF do?

1. Increase discipline over government expenditures

2. Provides for a **sustainable approach towards managing a country’s finances** by outlining the planned priorities and how revenue and expenditure is to be managed beyond the budget year

3. MTBFs usually **cover the preparation, execution, and monitoring of multiannual budget plans** and contain both expenditure and revenue projections as well as the resulting budget balances

4. **Highlights the costs of existing policies and shows what fiscal space exists for new policies**

5. Improves the link between government priorities and available resources, i.e., planning linked to budgets
## Purpose and benefits of medium-term budgeting

<table>
<thead>
<tr>
<th>What MTBFs Do</th>
<th>How They Do It</th>
<th>Who Benefits</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Strengthen sustainability of finances/reinforce aggregate fiscal discipline</td>
<td>By constraining budget appropriation &amp; execution in future years to levels consistent with the Government’s fiscal objectives</td>
<td>Finance Ministers, Taxpayers, Future Generations</td>
</tr>
<tr>
<td>2. Promote a more strategic allocation of expenditure</td>
<td>By abstracting from the immediate pressures &amp; legal &amp; administrative constraints that impinge upon the annual budget process</td>
<td>Prime Ministers, Planning Ministers, Parliamentarians</td>
</tr>
<tr>
<td>3. Facilitate more efficient inter-temporal planning</td>
<td>By providing greater transparency and certainty to budget holders about their likely future resources</td>
<td>Line Ministries, Agencies, Local Governments</td>
</tr>
</tbody>
</table>
Kay aspects and elements of a MTBF

### Multi-year Spending Limits (discipline)
- Nominal or real price basis
- Fixed or rolling, indicative or binding framework
- Aggregate & ministerial expenditure, program
- Coverage: items to be included or excluded.
- Level of detail: economic, line item expenditure
- Frequency of revision

### Prioritization process (legitimacy)
- Ceilings aligned with national priorities
- Annual or biannual or tri-annual
- Separation of existing and new policies
- Forum for taking hard decisions – role of Cabinet, MoF, spending agencies

### Expenditure Control over Medium-term (commitment)
- Regular updates of expenditure projections
- Margins and Reserves
- Controls around multi-year contracts or commitments
- Budget carry-overs from one fiscal year to the next

### Accountability
- Delivering on previous commitments
- Comparison of forecasts, budget, and out-turn
- Reconciliations-evolution of budget ceilings
- Sanctions for overspending
European Commission: Defining features of MTBFs

— Political commitment
— Planning horizon
— Coverage
— Level of detail (e.g. budgetary impact of alternative macroeconomic scenarios)
— Formulation of targets
— Exclusion of certain items
— Carryover arrangements
— Binding nature
European Commission quality of MTBF: index

1. **Coverage of the targets/ceilings** included in the national medium-term fiscal plans

2. **Connectedness between the targets/ceilings** included in the national **medium-term fiscal plans and the annual budgets**

3. **Involvement of national parliament** in the preparation of the national medium-term fiscal plans

4. **Involvement of independent fiscal institutions** in the preparation of the national medium-term fiscal plans

5. **Level of detail** included in the national medium-term fiscal plans

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Note: The index ranges between 0 (very weak) and 1 (very strong). EU15 refers to the 15 Member States that entered the EU before 2004, while EU13 refers to those that entered after 2004. 

*Source: 2015 vintage of Commission's Fiscal Governance Database.*
Different stages of MTBF development

<table>
<thead>
<tr>
<th>Pre-MTBF</th>
<th>Elementary MTBF</th>
<th>Maturing MTBF</th>
<th>Advanced MTBF</th>
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</thead>
</table>
| 1. Clear legal framework  
2. Budget process and procedures  
3. Effective annual budget | 1. Resource constrained budget  
2. Medium-term focus  
3. Agency expenditure ceilings  
4. Expenditure ceilings are indicative  
5. Link between planning and resource allocation is tenuous | 1. Planning and budgeting directly link to sound medium-term fiscal framework  
2. Budget ceilings are effective and binding  
3. Strategic spending decisions  
4. Focus on outputs and outcomes  
5. Agency and program ceilings  
6. Undertake sector reviews  
7. Refine program costing and project appraisal | 1. Emphasis on performance management  
2. Spending agencies accountable for results  
3. Develop performance indicators  
4. Linking budget allocations to results  
5. Regular spending review |

Source IMF. Taz Chaponda and Richard Allen Working Paper No. 17/203
Preconditions for effective management of risk in MTBF

1. Unified budget process
2. Appropriate set of statistics
3. Degree of commitment or binding nature of the framework
# Risk arising from an unified budget process

<table>
<thead>
<tr>
<th>Issue</th>
<th>Explanation</th>
<th>Typical Challenges</th>
</tr>
</thead>
<tbody>
<tr>
<td>Budget Coverage</td>
<td>No large extrabudgetary funds</td>
<td>Large Social Security and Health Funds</td>
</tr>
<tr>
<td>Budget Fragmentation</td>
<td>All expenditure authorized together</td>
<td>Budget split between current and capital</td>
</tr>
<tr>
<td>Earmarked Revenues</td>
<td>Limited earmarking of revenue to expenditure</td>
<td>Fuel surcharges for road maintenance</td>
</tr>
<tr>
<td>Standing Commitments</td>
<td>No input commitments that can conflict with overall ceiling</td>
<td>Laws requiring fixed budget transfer to specific purposes</td>
</tr>
<tr>
<td>Parliamentary Approval</td>
<td>Limited scope for Parliament to amend budget</td>
<td>Parliament can increase without finding reductions</td>
</tr>
<tr>
<td>Supplementary Budgets</td>
<td>Supplementary budgets are rare or expenditure neutral</td>
<td>Supplementaries are significant and impact policy</td>
</tr>
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Importance of statistics for a robust management of risks in a MTBF

<table>
<thead>
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<th>Benchmarks</th>
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<td></td>
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<td>Fiscal Statistics</td>
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<td>Institutional Coverage</td>
<td>Central government</td>
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<td>Frequency</td>
<td>Annually</td>
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<td>Accounting Basis</td>
<td>Cash</td>
</tr>
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<td>Balance Sheet</td>
<td>All financial liabilities</td>
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<td></td>
<td>Level of strictness in terms of respecting the plans set out in the medium-term planning documents</td>
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<td>-------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>1</td>
<td>Ceilings/targets <em>are not expected to be changed</em> whatever the circumstances (unless a new government comes to power or division of tasks between government levels is changed)</td>
</tr>
<tr>
<td>2</td>
<td>Expenditure ceilings <em>can only be increased provided that sources of funding</em> of the additional expenditure are identified ex-ante</td>
</tr>
<tr>
<td>3</td>
<td>Ceilings/targets <em>can be adjusted in response to changes in a number of specific parameters</em> defined by legislation or other public procedural document (e.g. change in expenditure on pensions, unemployment benefits etc.) and such changes need to be explained publicly</td>
</tr>
<tr>
<td>4</td>
<td>Ceilings/targets <em>can be changed in a number of situations</em> foreseen by legislation or other public procedural document (e.g. in view of a substantial change in the macroeconomic forecast, new government coming to power, extraordinary circumstances, etc.) and such changes need to be explained publicly</td>
</tr>
<tr>
<td>5</td>
<td>Ceilings/targets <em>can be changed at the discretion of government</em> but changes need to be <em>explained</em> and reputational cost is involved</td>
</tr>
<tr>
<td>6</td>
<td>Ceilings/targets <em>can be changed at the discretion of government without any public explanation</em></td>
</tr>
</tbody>
</table>

Source: European Commission 2015
Risk in a MTFF: analysis and identification

Sources of risk

1. **Macroeconomic Risks**: Economic shocks (e.g., rapid changes in world commodity prices, global recessions, natural disasters, systemic financial crisis)

2. **Endogenous Fiscal Risks** (e.g., Assets and liabilities, contingent liabilities; public enterprises; ppp; levels of sub-government)

3. **Long-term sustainability**

4. **Interdependence between fiscal risks** (fiscal flow and stock variables); stress test (solvency, liquidity, financial burden)

**Likelihood of risk**
- High, Medium, Low

**Time horizon**
- Short, Medium, Long

**Expected impact**
- High, Medium, Low/quantitative
Risk mitigation

1. Fiscal targeting and fiscal space

2. Instruments for managing fiscal exposures
   - Direct controls, ceilings, or caps (e.g. limits on guarantees and control their issuance. Limits on liabilities of subnational governments)
   - Regulations, incentives, and other indirect measures financial sector exposures (e.g. imposing leverage ratio), performance targets on SOE boards, risk-related fees to beneficiaries of government credit guarantees
   - Risk transfer, sharing, or insurance mechanisms reinsure or securitize their credit guarantee portfolio
   - Provisioning explicit deposit insurance funds to guard against financial crisis risks

3. Targeted policies (reform financial sector, structural reform exchange rate policy)
Current Practices in Fiscal Risk Disclosure and Analysis

Few countries conduct sophisticated analysis of macro-fiscal risks...

...while even fewer examine the impact of macro trends and policy on government balance sheets

a. Macro-Fiscal Risk

Many countries discuss specific risks but not many quantify their size or probability...

...while relatively few non-advanced countries publish long-term projections

c. Specific Fiscal Risks

d. Long-Term Fiscal Sustainability

Risk Disclosure and Management of Risk in a MTBF

**Risk disclosure**

1. Macroeconomic risk scenario analysis (budgetary impact of alternative scenarios)
2. Disclosure of risk materializing in MTBF period
3. Fiscal impact of announced policies (fiscal and structural reform)

**Risk management options**

1. Conservative assumptions
2. Cautions design against the possibility of worse-than-expected outcomes
3. Contingency reserves or margins
   - MoF managed reserves
   - Spending agency managed reserves
4. Well defined corrective actions in case of deviation from plans
Size and location of margins/reserves in MTBF

<table>
<thead>
<tr>
<th></th>
<th>Implicit Margins</th>
<th>Explicit Margins</th>
<th>Total Contingency</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>GDP forecast</td>
<td>other economic assumptions</td>
<td>within expenditure estimate</td>
</tr>
<tr>
<td>Canada</td>
<td>MoF uses ave of ind. forecast</td>
<td>MoF adds 0.5 to 1% to interest rates and runs through model</td>
<td>Contingency reserve of 1.5 to 2% of total spending</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>MoF uses GDP forecast 0.25% below trend</td>
<td>7 other economic assumptions explicitly ‘cautious’</td>
<td>Reserves and margins equal to 0.75 to 1% of total spending</td>
</tr>
<tr>
<td>Sweden</td>
<td>Budget based on central assumptions for GDP and other macro variables</td>
<td>Budget margin within expenditure ceiling rising from 1.5 to 2.5% of total spending</td>
<td>None</td>
</tr>
<tr>
<td>Netherlands</td>
<td>Deficit target &amp; expenditure ceiling in CA &amp; Budget based on cautious economic scenario in which GDP 0.5 to 1% below outturn</td>
<td>Central contingency reserve of 0.1% of total spending</td>
<td>Most recent CA targets structural surplus of 1% of GDP</td>
</tr>
<tr>
<td>Australia</td>
<td>Budget is based on central economic assumptions</td>
<td>Conservative bias in forward estimates of 0.5-1.5% of spending</td>
<td>No central contingency reserve</td>
</tr>
<tr>
<td>Ireland</td>
<td>Budget based on central assumptions for GDP and other macro variables</td>
<td>0.03% contingency margin in budget year</td>
<td>0.2% of GDP overachievement against 3% deficit target in 2014</td>
</tr>
</tbody>
</table>

Source: IMF Medium-term Budget Frameworks
Policy targeting as a means of incorporating risks approach in policy formulation (MTEF)

Defining an overarching policy objective/target that mitigates main risks to fiscal sustainability and provides room for macroeconomic stability by:

— **Providing room for coping with macroeconomic shocks** given deficit and debt sustainability rules and constraints

— **Providing room for discretionary policy** taking into account, market access and debt sustainability conditions

— **Mitigating the long-term fiscal risk** related to population ageing (i.e. saving now for the future)
### Medium-term fiscal objectives: Overall fiscal anchor

<table>
<thead>
<tr>
<th>Country</th>
<th>National objective</th>
<th>Supranational objective</th>
<th>Statutory base</th>
<th>Coverage</th>
<th>Time-frame</th>
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</thead>
<tbody>
<tr>
<td></td>
<td></td>
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<td>Political</td>
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<td>General</td>
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<tr>
<td>Brazil</td>
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<tr>
<td>Chile</td>
<td>Balance</td>
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<td>X</td>
<td>X</td>
<td>X</td>
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<tr>
<td>Canada</td>
<td>Expenditure,</td>
<td></td>
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<tr>
<td></td>
<td>Balance, Debt</td>
<td></td>
<td></td>
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<tr>
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<td>Indonesia</td>
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<tr>
<td>Japan</td>
<td>Expenditure</td>
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<td>X</td>
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<tr>
<td>Mexico</td>
<td>Balance</td>
<td>---</td>
<td>X</td>
<td>X</td>
<td>X</td>
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<tr>
<td>Netherlands</td>
<td>Expenditure</td>
<td>Balance, Debt</td>
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<td>X</td>
<td>X</td>
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<td>Balance, Debt</td>
<td>Balance, Debt</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
</tbody>
</table>

Source: IMF. Fiscal Frameworks
Medium-term objective in the EU context: risk mitigation

1. Provides constrained space to mitigate risk of external shocks (i.e. safety margin with respect to the 3% of GDP government deficit ratio)

2. Reduces the risk of unsustainable debt dynamics and fosters room for fiscal maneuvering (debt stabilizing balance (60% debt-to-deficiency ratio) and speed of convergence)

3. Reduces risk of fiscal impact of population ageing (pre-financing of the cost of ageing)

4. Reduces the risk of procyclical policy (the objective is defined in structural terms (excluding the effect of business cycle fluctuations and one-off and other temporary measures))
MTO formula

\[ \text{MTO} = \max(\text{MTO}^{\text{ILD}}, \text{MTO}^{\text{MB}}, \text{MTO}^{\text{Euro/ERM2}}) \]

1. \( \text{MTO}^{\text{ILD}} \) - implicit and explicit liabilities
2. \( \text{MTO}^{\text{MB}} \) - minimum benchmark to cope with cyclical fluctuations
3. \( \text{MTO}^{\text{Euro/ERM2}} \) - maximum deficit for Euro and ERM2-Member states 1% of GDP

Where

\[
\text{MTO}^{\text{ILD}} = \text{Balance}_{\text{debt stabilizing at 60\% GDP}} + \alpha \times \text{Ageing Costs} + \text{Effort}_{\text{debt-reduction}}
\]

(i) budgetary balance that would stabilise the debt ratio at 60\% of GDP
(ii) budgetary adjustment covering a fraction of the present value of future cost of ageing
(iii) additional debt-reduction effort for countries with gross debt above 60\% of GDP
1. Ex-ante disclosure of risk- Statement of fiscal risk (part of annual budget; separate statement, different document)
   - Coverage of institutions
   - Coverage of flows
   - Coverage of stocks

2. Ex-post disclosure of risk materialization (Final accounts)
   - Revisions to macroeconomic parameters
   - Impact of discretionary actions
   - Shocks
1. **Establishing a risk management policy.** Pre-conditions under which they are prepared to take on specific fiscal risks

2. **Defining clear accountabilities.** Line ministries entities should be responsible and accountable for identifying, estimating, analyzing, and monitoring specific fiscal risks that fall within their functions

3. **Establishing a central risk oversight body.** There is a strong case for centralizing monitoring and management of overall fiscal risk in a single body

4. **Establishing central controls over major risks.** Approval contracts that expose the government to fiscal risks should be vested in a central authorizing entity
Conclusions

1. Fiscal risk dimension is often partially integrated into frameworks, budget documentation, and decision-making

2. Fiscal risk management practices are often blunt and ad hoc

3. Reporting in different publications and approaches (annual budget, separate statement and documents)

4. There is progress in attempting to incorporate risk in fiscal policy: Code of transparency (IMF), Risk assessment matrix (IMF), Debt Sustainability Analysis (IMF, EC, WB, ESM), Best practices (OECD), Reporting (GFSM2014)

5. There seems need for a systemic integration of risks dimension in fiscal frameworks

6. There are important preconditions for an effective risk framework (i.e. unified budget process; appropriate set of statistics; degree of commitment)

7. Medium term fiscal policy targeting and effective fiscal framework not only incorporate fiscal risk in policy design but mitigate risk arising from fiscal policy