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OECD Best Practices for Managing Fiscal Risks

Lessons from case studies of selected OECD countries and next steps post COVID-19

Virtual Meeting, 23 June 2020

This paper takes the OECD Best Practices for Fiscal Transparency and Recommendation of the Council on Budgetary Governance (2015) and research paper “Coping with fiscal risk: Analysis and practice” (OECD/Kopitz, 2014) as a starting point. Based on five case studies of countries that have aimed at developing their fiscal risks frameworks (Australia, Finland, New Zealand, the Netherlands and the United Kingdom), the paper i) looks at fiscal risks’ definition and classification; ii) sets out the components of a comprehensive framework; and iii) examines how to operationalise it. The paper then summarises challenges and key lessons to be considered by countries that wish to increase the resilience of public finances in the wake of the COVID-19 outbreak that significantly increased government’s exposure to the economy, crystallised certain fiscal risks and generated new ones.

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Table of Contents

1 Introduction	3
2 Defining fiscal risks	4
What is a fiscal risk?	4
Fiscal risks should be identified against fiscal forecasts	4
Fiscal risks are virtually infinite and criteria are needed for their identification and disclosure	4
How to classify fiscal risks?	5
Fiscal risks fall under four broad categories	5
Other key characteristics should be identified	6
3 Establishing a comprehensive framework	8
What are the objectives of a fiscal risks framework?	8
How to identify and measure fiscal risks?	9
Approaches for identifying and measuring individual risks	9
Fiscal stress tests	10
How to manage fiscal risks?	11
Prevention and mitigation	11
Provisions and reserves	12
Consideration of fiscal risks in the formulation of fiscal policy	13
How to be transparent and help promoting an informed debate?	13
4 Operationalising the framework	15
Responsibilities of government	15
External oversight of the fiscal risks framework	16
Tools and processes	17
5 Lessons from case studies, challenges and future directions	18
What are the main lessons from this paper?	18
Defining fiscal risks	18
Designing a comprehensive and effective framework	18
Operationalising the framework	19
What are the remaining challenges in managing fiscal risks?	21
Conclusion: future directions	22
References	26

1 Introduction¹

Recent months have shown that global events such as the COVID-19 pandemic create pressures on public finances that are difficult to apprehend and measure in advance. Within OECD countries, most governments have decided to play the role of “insurer of last resort” for firms and households well beyond what they had done a little bit more than a decade ago, when the world economy was hit by the 2008 global financial crisis (GFC). Large fiscal risks have materialised and new ones have been generated. In the wake of these events, should governments and ministries of finance still be concerned about managing their fiscal risks? This paper takes the view that the COVID-19 pandemic makes fiscal risk management all the more important, as the understanding of past and new fiscal risks and mitigation of their potential impact on the economy and society will be crucial for increasing the resilience of public finances going forward.

Against this background, this paper takes the OECD Best Practices for Budget Transparency (OECD, 2002^[1]) and Recommendation of the Council on Budgetary Governance (OECD, 2015^[2]), as well as the research paper “Coping with fiscal risk: Analysis and practice” (OECD/Kopits, 2014^[3]) as a starting point. This paper is based on five case studies which include two pioneer countries in the management of fiscal risks (Australia and New Zealand) and three countries that developed their framework in the wake of the 2008 financial crisis (Finland, the Netherlands and the United Kingdom). This paper identifies the best examples available, which countries that wish to strengthen their fiscal risks framework in the wake of the COVID-19 pandemic may consider. It emphasises that the objective of such frameworks should go beyond disclosure but should comprise the active management of fiscal risks and consider them in the formulation of fiscal policy.

This paper does not aim to detail policy responses to specific risks but rather makes the point that the starting point for resilient public finances is a smart definition of ever-changing and evolving fiscal risks (Chapter 2), a comprehensive framework for their identification, analysis and management (Chapter 3) and sound arrangements for operationalising the framework (Chapter 4). Finally, it summarises challenges and key lessons, and identifies future directions of the OECD Secretariat’s work to advise member countries on managing fiscal risks (Chapter 5). This paper proposes that future work focus on the management of balance sheet risks and guarantees and other contingent liabilities risks that dramatically increased in the wake of the COVID-19 crisis.

¹ This paper was written by Delphine Moretti (Senior Policy Analyst, Public Management and Budgeting division, Public Governance directorate). Discussions and advice from colleagues are gratefully acknowledged, particularly from Andrew Blazey (Deputy Head of Division) and Scherie Nicol (Policy Analyst). Research for case studies was done by Damien Boucher and Flavia Giannini (Junior Policy Analysts). The case studies benefited greatly from comments and suggestions of officials from Australia’s Department of Finance, Finland and the Netherlands’ Ministries of Finance, the United Kingdom’s HM Treasury, as well as Richard Hughes (Resolution Foundation, United Kingdom) and Dirk Kraan (former OECD official, Netherlands). The authors would like thank them for their invaluable insights.

2 Defining fiscal risks

What is a fiscal risk?

Fiscal risks should be identified against fiscal forecasts

The concept of fiscal risks is closely linked to the more general problem of the accuracy of fiscal forecasts that form the basis of medium-term expenditure frameworks.² The 2008 financial crisis put emphasis on having better understanding of uncertainty in forecasts. This includes presenting with the outlook a fan chart reflecting uncertainty with forecasts; inclusion of more variables in the sensitivity analysis; and identifying where significant deviations could come from and what this means for the government's fiscal mandate and longer-term fiscal sustainability.

Fiscal risks is the term used for designating these sources of potential large deviations from the fiscal forecast. They are defined as “the probability of significant differences between actual and expected fiscal performance” (OECD/Kopits, 2014^[3]) or “the possibility of deviations of fiscal outcomes from what was expected at the time of the Budget or other forecast” (IMF, 2008^[4])

As deviations from forecasts, fiscal risks are not the same as fiscal pressures, which are phenomena generally integrated in the forecasts (e.g., ageing). The United Kingdom's Office for Budget Responsibility (OBR) notes for examples that “what constitutes a fiscal risk depends crucially on which potential developments in the public finances you choose to incorporate into the central projection and which you regard as potential deviations” (OBR, 2017^[5]).

The definition of fiscal risks may go further by specifying criteria for including or not, certain parameters in the forecasts. For example, in Australia, fiscal risks are defined as “matters not included in the fiscal forecasts because of uncertainty about their timing, magnitude or likelihood; and the realisation of contingent liabilities or assets” (Commonwealth of Australia, 2019^[6]).

The nature and number of fiscal risks identified by a given country also depends of the forecast against which they are considered. Risks over the short, medium to long term are not the same. For example, today's natural disaster risks will become tomorrow's climate change risks. In the United Kingdom, because fiscal risks are identified against both the medium-term and long-term fiscal forecasts, the last Fiscal Risks Report identified and discussed around 60 large risks to public finances.

Fiscal risks are virtually infinite and criteria are needed for their identification and disclosure

Even within these boundaries, fiscal risks are potentially infinite and some countries explicitly acknowledge that within the definition and criteria for identifying fiscal risks, it may not be possible to cover all potential fiscal risks faced by governments in a single report.

The United Kingdom argues that any definition of fiscal risks should aim to cover significant potential developments in the public finances “that might require a policy response – either before or after the event”

² Most OECD countries use an MTEF, with only 3 countries reporting that they do not make use of this tool (Belgium, Mexico and Norway).

(OBR, 2017^[5]). New Zealand's legislation states that fiscal risks should be disclosed "to the fullest extent possible" (New Zealand Treasury, 2020^[7]). In other words, a definition of fiscal risks should not aim at comprehensive coverage of potentially infinite fiscal risks, but rather aim at supporting policy decision-making and facilitating oversight and accountability.

In addition to the concept of fiscal risks, the terms "stress" or "shocks" is sometimes used. Stress or shock can be defined as an event potentially triggering several risks at the same time or successively, and exerting the largest costs on public finances. Typically, a large economic crisis, whatever its source (e.g., financial crisis, trade war, natural resources shortage, etc.) will trigger fiscal risks in the form of reduced government receipts and additional spending to support the economy and households. Pandemics or large natural disasters are other events that could trigger shocks, with comparable spillover effects from the economy to government revenue and spending. The identification and measurement of these shocks is further discussed below.

How to classify fiscal risks?

Fiscal risks fall under four broad categories

The OECD Recommendation on Budgetary Governance (OECD, 2015^[2]) calls upon governments to "classify by type" their fiscal risks, with proposals formulated in the past on how such classification could be done for example depending on the methodological approach to estimating them (OECD/Kopits, 2014^[3]). Such a classification is important because a long list of fiscal risks would not be easy to understand nor legible for decision-making.

Case studies show that classification of fiscal risks is a shared feature of fiscal risks framework and classification by nature is the most common approach. Beyond risks to the reliability of the forecasts linked to "technical errors" of forecasters, four main categories of risks can be identified in most countries, although the terms or detailed classifications used vary (Table 2.1). These categories are as follows:

1. **Macro-economic risks**, which emanate from either cyclical or structural changes in the economy that would directly affect the government revenue outlook and potentially indirectly influence its spending forecast. Risks in relation to macroeconomic variables include especially growth, the demography, natural resources prices, as well as the financial sector, which may however be identified separately from other macroeconomic risks;
2. **Government policy or programmes risks**, which are risks that tax collection or spending controls won't happen as planned, generating revenue losses or additional spending. Spending and revenue risks are discussed for example in the United Kingdom's Fiscal Risks Report, such as risks in relation to welfare or health spending. Similarly, Finland identifies so-called internal risks, which are risks "associated with the implementation of the Government programme".
3. **Uncertain budgetary claims** (also called contingent liabilities) risks, which encompass all commitments that the government has formally entered into or obligations that the government would not be able to avoid but are not included in the fiscal forecast because they are uncertain or impossible to measure. In Australia, uncertain budgetary claim comprise guarantees (where one party promises to be responsible for the obligations of another party if that party default), indemnities (legally binding promise whereby a party undertakes to accept the risk of loss or damage another party may suffer) or other types of claims (e.g., legal claims, tax disputes, uncalled capital subscription); and
4. **Balance sheet risks**, which are mainly risks associated with assets and liabilities owned by the government, such as equity shareholdings or loans. New Zealand, for example, defines balance sheets risks as "risks affecting the Crown's financial position through changes in the value of its assets or liabilities".

Debt risks, which include interest and foreign exchange rates, may be presented as a separate category or included in one of the categories above.

Finally, some countries identify as fiscal risks expectations over government's interventions or bailouts in case of a crisis, which are called **implicit commitments or contingent liabilities risks**. Finland, for example, identifies "expenditure that the government may be socially or politically obliged to make if a particular event occurs", such as a bailout of a bank or subnational government.

The identification - and indeed measurement and disclosure - of such risks is controversial in that it can crystallise or give ground to claims that have not been legally endorsed by the government and approved by parliament. Recent fiscal packages in the wake of the COVID-19 outbreak however, show that the scale of such implicit liabilities and the need to have an understanding of them, in particular in the event of a large shock, as further discussed below.

Other key characteristics should be identified

International institutions have proposed using more sophisticated classifications of risks, based on characteristics such as measurability; magnitude; probability of occurrence – i.e. probable, possible or remote; government influence on fiscal risks' materialisation – i.e., endogenous or exogenous; and nature of the government's obligation – i.e., explicit or implicit (OECD/Lindwall, 2013^[8]) and (IMF, 2016^[9]). For example, the United Kingdom and Australia are classifying fiscal risks according their likelihood to crystallise and their potential impact on public finances.

Ideally, when choosing a classification of fiscal risks, countries should consider their final objective in terms of fiscal risks management and what is the classification that is most suited to meeting that objective. For example, Australia, presents fiscal risks by department and agency, putting the emphasis on responsibilities and accountability for managing these risks. The United Kingdom uses categories that differentiate between two types of risks. The first category is risks over which the government has no control. The second category comprises risks over which it has "some varying degree of direct control, which helps appreciating fiscal risks that the government is creating for itself through its policies, as opposed to those that might be imposed on him by circumstances. The Netherlands differentiates between explicit and implicit risks for similar reasons.

Ultimately, it should be acknowledged that any classification of risks is necessarily imperfect as risks are rarely isolated and often correlated as evidenced in recent research work (OECD/Schilperoord, et al., 2013^[10]) (IMF, 2016^[9]). One typical example of such correlations is the 2008 financial crisis, which, via its impact on the economy affected public spending and receipts, but also resulted in government guarantees being called upon. It may still be too early to assess the full range of impacts of the COVID-19 outbreak, but is clear already that the pandemic directly generated significant additional health spending, but also a fall in economic activity that affected public receipts and necessitated new policy measures to support firms and households. Such correlations between risks can be explored using stress tests, as further discussed below.

Table 2.1. Case studies: Main categories of fiscal risks identified by countries

	Macro-economic risks	Uncertain budgetary claims	Programme and policy risks	Balance sheet risks
Australia	Real economy (GDP, trade, household consumption) Debt interest	Primary spending (claims, disputes against Departments, indemnities, disaster recovery) Guarantees (contingent liabilities)	Primary spending (policy decisions) Revenue (tax base, tax policy)	Government loans (contingent assets exposed to credit risk)

Finland	Real economy (GDP, trade, inflation, unemployment) Composition of government assets (real assets, financial assets, state holdings in listed companies)	Explicit liabilities (legally binding contingencies arising from government guarantee, callable capital in international institutions, climate or nuclear risks) Implicit liabilities (socially or politically obliging contingencies related to the banking sector, SOEs, local government or environmental damage)	Guarantee schemes (credit risk from export and housing-related guarantees) Revenue (tax base)	Financial liabilities (one-off expenditures, debt-to-GDP) Financial assets (value of financial and real assets)
New Zealand	Real economy (GDP, trade, productivity) Confidence environment (biosecurity threats, volatility of Government's investments, business confidence) Debt interest	Contingent liabilities (uncalled capital, guarantees, indemnities, legal proceeding and disputes) Contingent assets (legal proceedings and disputes) Significant events (natural disasters, international events leading to changes in the external environment)	Primary spending (policy changes) Cost pressures (associated with existing policies and risk of cost variances) Revenue (tax base, tax policy)	Change in the value of assets and liabilities (movement in market or business variables affecting financial assets or property owned by the Government) Direct fiscal costs (actual costs incurred because of a shock) Indirect fiscal costs (changes to future government revenue and expenses consecutive to the economic impact of a shock)
The Netherlands	Debt interest (interest rate, credit, liquidity and foreign exchange)	Explicit conditional risks (public guarantees and public costs for natural disasters and terrorist attacks) Implicit unconditional risks (old age pensions, health care, climate mitigation) Implicit conditional risks (rescue of firms and institutions, medical and agrarian emergency measures, other private costs)	Explicit unconditional risks (automatic stabilisers, i.e. tax revenue and unemployment benefits; interest rate, excess cost of investment projects, technical and legal risks)	N/A
United Kingdom	Macroeconomy (output growth, recession, composition of activities/GDP) Financial sector (bail-out cost, indirect fiscal costs, tax impact) Debt interest	Primary spending (nuclear decommissioning, litigations: clinical and tax) Balance sheet (explicit and implicit guarantees)	Primary spending (welfare, health and adult care, local government, spending control) Revenue (tax base, tax policy)	Balance sheet (value of financial assets, reclassification in or out public sector net debt)

Note: The main categories of risks identified in the most recent fiscal risks report or statement for each country are identified in bold.

Source: Author, based on case studies.

3 Establishing a comprehensive framework

What are the objectives of a fiscal risks framework?

OECD Recommendation of the Council on Budgetary Governance calls for countries to establish mechanisms for identifying their fiscal risks; make explicit the mechanisms for managing them; and consider them in debates about the appropriate fiscal policy stance (OECD, 2015^[2]). Similar advice is provided by other international organisations (IMF, 2016^[9]) (World Bank, 2019^[11]).

In Australia and New Zealand, fiscal risks are explicitly mentioned in primary legislation, which comprises detailed disclosure requirements and obligation for government to manage fiscal risks prudently. This approach entrenches fiscal risks disclosure and management as one of the pillars of transparent and sound fiscal policy and emphasises the need for clarity and accountability on government's choices and trade-offs in this area.

Other countries studied have less binding and comprehensive approaches. In Finland, extensive disclosure of fiscal risks is not a legal requirement but a practice of successive governments. The United Kingdom has detailed requirements for the disclosure of fiscal risks and a detailed management strategy, but both have been stated in government publications that have no permanent basis. For both countries, current practices could therefore be deviated from in the future. In the Netherlands, although legislation requires that the Central Planning Bureau report fiscal risks, there is no obligation for the government to explain how these risks are managed, except for guarantees.

Table 3.1. Case studies: Legal basis for fiscal risks disclosure and management

	Disclosure of fiscal risks	Management of fiscal risks
Australia	The <i>Charter of Budget Honesty Act</i> requires that the budget economic and fiscal outlook report contain "a statement of the risks, quantified where feasible, that may have a material effect on the fiscal outlook".	The <i>Charter of Budget Honesty Act</i> requires the Government to manage fiscal risks faced by the Commonwealth prudently.
Finland	n/a	n/a
New Zealand	The <i>Public Finance Act</i> requires disclosing "all Government decisions and all other circumstances that may have a material effect on the economic and fiscal outlook".	The <i>Public Finance Act</i> lays out the principle of "responsible fiscal management", comprising the prudent management of fiscal risks facing the Government.
Netherlands	The <i>Sustainable Public Finances Act</i> requires that the Central Planning Bureau report biannually on public finances, including fiscal risks.	n/a
United Kingdom	The <i>Charter for Budget Responsibility</i> tasks the independent fiscal council with producing "a fiscal risks statement setting out the main risks to the public finances, including macroeconomic risks and specific fiscal risks (...) at least once every two years". Further, the government public strategy requires identifying the source, scale and likelihood of risks.	The <i>Charter for Budget Responsibility</i> requires that the government "formally respond to [the independent fiscal council] report" within a year. Further, the government public strategy requires mitigating fiscal risk where cost-effective and consistent with broader policy objectives; provisioning for other risks where possible; accommodating residual risks when setting the overall fiscal policy stance.

Source: Authors, based on case studies.

How to identify and measure fiscal risks?

Approaches for identifying and measuring individual risks

Because fiscal risks are different in nature and constantly evolving, establishing processes for identifying and monitoring them regularly is the basic component of any fiscal risks framework. Case studies show that different approaches are used for identifying and measuring risks falling under each one of the broad categories of fiscal risks defined in Chapter 2. Some common approaches in identifying and measuring fiscal risks identified in case studies are listed below.

- Concerning **technical risks**, the basic requirement is to evaluate, ideally publically, the accuracy of previous fiscal forecasts and ensure that the sources of past errors are clearly identified. Based on a “history repeats itself” assumption, key technical fiscal risks, such as model risks, are disclosed and explained alongside fiscal forecasts. For example, Australia discloses the uncertainty surrounding key indicators underpinning the forecasts by graphically showing confidence intervals based on historical error margins.
- Concerning **macro-economic risks**, identification and measurement is generally under the forecaster’s responsibility. These risks depend indeed on macro-economic developments, parameters and hypothesis that underlie the main or alternative macroeconomic scenarios. They may include terms of global trade, household consumption growth, productivity, market yields, etc. Macroeconomic alternative scenarios or risks may be measured by using sensitivity analyses and by evaluating how they improve or worsen key fiscal headlines of the country, as is the case in Finland.
- Concerning **programme and policy risks** and **uncertain budgetary claims**, sources of information are manifold and the collection and centralisation of information done by the Ministry of Finance as discussed in more detail in Chapter 4. For guarantees, information is sometimes provided by the debt management office or required as part of the monthly budget reporting. The nominal value of guarantees is the measurement method used in New Zealand, Australia, Finland and the Netherlands. Generally, departments and agencies are formally required to identify their programme and policy risks and provide their best estimate of potential additional funding requirement, as is done for example in Australia.
- **Balance sheet risks** are the risks related to assets and liabilities reported in the financial statements. Responsibilities for identifying potential risks in relation to specific assets and liabilities may lie with different ministries and agencies – e.g., risks in relation to recovery of loans might be identified by the debt management office while those in relation to the capital needs for state-owned enterprises might be monitored by the shareholding agency. Other balance sheet risks may be identified. For example, New Zealand, measures potential costs associated with the reconstruction of crucial infrastructure in the event of a natural disaster.
- **Debt risks** are generally identified and monitored by the entity responsible for debt management. The types of risks to be monitored may be laid out in the mandate of the entity responsible for debt management. That is the case, for example, in the Netherlands. The risks monitored by countries studied are, for example, interest rate levels and credit, liquidity and foreign exchange risks. Concerning interest rate levels, measurement often consists of examining the change in interest expenses if the general interest rate level were to rise permanently by one percentage point.

These case studies show however that not all fiscal risks can be measured. When that is the case, virtually all countries consider that transparency requirements impose disclosing at least narrative information. Australia, for example, specifically identifies fiscal risks that are “unquantifiable liabilities” in their statements of fiscal risks.

It may also be the case that identifying and quantifying a risk will create moral hazard for the government or harm its position in litigations or negotiations. Need to avoid disadvantaging the country therefore calls for clearly defined and limited exemptions to providing an evaluation of certain fiscal risks or even disclosing them. New Zealand, for example, exempts from disclosure information that is likely to prejudice substantial economic interests of the country; harm the security or defence of the country or the international relationships of its government; compromise the government in a material way in negotiation, litigation, or commercial activity; or result in material loss of value to the government.

Fiscal stress tests

As noted above, certain events – e.g., economic crisis, pandemic – may trigger simultaneously several fiscal risks and generate a shock to public finances. Shocks are of different nature (e.g., transmission from the economy to public finances or vice versa, short-lived or long, etc.), hence different potential impacts on public finances that four of the countries studied try measuring using fiscal stress tests (Figure 3.2).

Case studies show that, beyond the complex economic and fiscal modelling work underlying fiscal stress tests (OECD/Schilperoord, et al., 2013^[10]), countries have to answer three questions when undertaking such exercises: which shock scenarios will be tested; which fiscal headlines will be scrutinised; and how to factor-in the results of the stress tests in decision making.

Concerning the **scenarios' selection**, countries conduct stress tests of their public finances based on scenarios of likely shocks, such as a global economic downturn or financial crisis, or may focus on topics animating the economic and fiscal policy discussion at the time of the stress test, such as the stress test of a no-deal scenario by the OBR in 2019.

It is notable that, in two countries, shock scenarios are based on those developed by other institutions: for example, the United Kingdom's OBR carried out a stress test in 2017 based on the Bank of England's own annual stress test of the UK banking system. Similarly, Finland first stress test in 2019 was based on a risk scenario used by the European Banking Authority (EBA) for banks.

The OECD Recommendations of the Council on the Governance of Critical Risks underline that governments should enhance efforts to minimise the impact that critical risks may have on public finances (OECD, 2014^[12]). Such a clear link between critical risks and stress tests of public finances is observable only in New Zealand, which has drawn its 2018 stress test scenarios from the national risk registers that support public risk management and planning processes.

Case studies show that **objectives** and **fiscal headlines** scrutinised by each country vary. Objectives stated for the stress tests range from assessing impacts on the government's capacity to meet their fiscal targets (Finland, United Kingdom) to evaluating consequences on the country's capacity to meet its financing needs (the Netherlands and New Zealand). Stress tests and risk analyses in the Netherlands focused also on fluctuations in economic growth and interest rate.

Concerning fiscal headlines, net debt is scrutinised by most countries. Where net debt is not a government fiscal target, the choice for scrutinising this headline seems to be motivated by the assumption that, in the event of a shock, financial assets, even those earmarked for specific purposes, would remain liquid and therefore available for paying off gross debt.

Discussions held with officials as part of the preparation of this paper show that questions remain on how fiscal stress tests can be used to facilitate or even inform fiscal policy. As noted by the UK's OBR, decision makers' perception might be that "putting bad economic news into (...) fiscal models will simply generate bad fiscal news" (OBR, 2017^[5]). In addition, some fear that, in the wake of the COVID-19 outbreak, where previous stress tests have not comprised a pandemic scenario, the exercise could be considered useless for anticipating shocks to public finances and preparing for them.

Although these questions are legitimate, the case study of New Zealand highlights the value of fiscal stress tests in stretching decision makers to consider events that may only be remotely possible and to prepare, even imperfectly, for them: in 2006, New Zealand modelled the impact of a pandemic on the macro-economy.³ This model was used as the basis for analysing the economic impact and Treasury preparedness during the 2009 H1N1 crisis. In New Zealand also, fiscal stress tests have been explicitly used as one of the factors to consider for determining fiscal policy objectives, as described in more detail below.

Table 3.2. Case studies: Characteristics of fiscal stress tests

	Scenarios	Fiscal headlines scrutinized	Frequency
Finland	2018 and 2019: Global financial market disturbance leading to a macroeconomic shock.	Net debt and fiscal headlines of the European Union's Stability and Growth Pact.	One stress test in the annual <i>Fiscal Risks Report</i>
New Zealand	2018: Severe Wellington earthquake; outbreak of foot-and-mouth disease and major international economic downturn.	Net debt and Operating balance before gains and losses (OBEGAL).	At least every four years in the <i>Investment Statement</i>
Netherlands	2011: Financial crisis, a European debt crisis and global economic crisis.	Fiscal headlines of the European Union's Stability and Growth Pact.	Ad hoc (2011, 2015, 2019)
United Kingdom	2017: synchronized domestic and global economic and financial market stress (based on Bank of England scenario); 2019: no-deal Brexit (based on IMF scenario).	Net debt and net borrowing.	One stress test in each biennial <i>Fiscal Risks Report</i> .

Source: Authors, based on case studies.

How to manage fiscal risks?

Prevention and mitigation⁴

Case studies show that all countries have developed approaches to prevent or mitigate certain fiscal risks they are exposed to. Of course, different types of fiscal risks call for different prevention or mitigation actions (e.g. discouraging risky behaviour through regulations; encouraging actors to pool risk; placing limits on the extent of government exposure, etc.) that depend also on the national regulatory framework.

Although this paper does not aim to provide a summary of policy options for managing individual categories of fiscal risks, the case studies highlight a number of policies that have been successfully implemented in the countries studied – e.g., how guarantees and/or contingent liabilities risks are mitigated in the Netherlands and the United Kingdom or how risks in relation to state-owned enterprises are prevented in New Zealand. Other OECD papers have discussed in detail policy to be considered for managing certain fiscal risks - e.g. a recent OECD report on *Fiscal Resilience to Natural Disasters* (OECD, 2019^[13]).

The case study of the United Kingdom is of interest in that it shows how the systematic identification and measurement of fiscal risks since 2017 and definition by the government of a detailed management strategy have triggered decisions on mitigation approaches for a range of fiscal risks in only a few years. They include, among others, the adoption of a framework for the approval of contingent liabilities; a new

³ Netherlands' taxonomy of fiscal risks, dating back to 2011, also identifies pandemics as one of the potential large shocks to the Dutch economy and public finances.

⁴ Prevention should be understood as policies to decrease the likelihood that a risk will materialise while mitigation policies aim at reducing the financial impact of a fiscal risk materialising.

financial oversight framework for the Bank of England and a comprehensive bank resolution regime; the decision to end further sales of student loans; and steps to lower the costs of clinical negligence in the NHS.

It is noteworthy that prevention and mitigation strategies in some countries, involve that principles for taking on certain risks and recovering related costs be specified in the legislative framework. That is the case, for example, in Finland and the Netherlands, where calling large guarantee schemes in the wake of the 2008 financial crisis and subsequent impact on public finances have led to a tightening up of the legislation. In the Netherlands, the government does not take on new contingent liability unless an overriding reason is identified; an external opinion on the level of the premium to be charged to beneficiaries is legally required; and the policy are systematically assessed *ex post* (sunset clause). In Finland, however, escape clauses have limited the efficiency of the new legislation.

Provisions and reserves

All countries studied, with the exception of the Netherlands, maintain a reserve, provision or “fiscal space” in their fiscal plans in case certain risks materialise. Their value has however no linkage to evolutions of the stock of fiscal risks. Where such provisions or reserves are included in the budget, ministries of finance aim to avoid any perception that overspend will be unconditionally funded. They establish therefore strict criteria for accessing these funds and separate reserves can be established for new policies to be decided over the course of the budget execution vs. funding for unexpected events (Table 3.2).

Emphasis is also put on the responsibility of departments and agencies in monitoring and preventing their fiscal risks; allocating funding in their budget if their materialisation becomes probable; and finding resources in their own budget if a risk unexpectedly materialises before they can claim additional funds from the general budget.⁵ For example, New Zealand details three different options available to departments in case of over-spend, as follows: re-prioritisation of funds; using reserves for new expenditures included in the budget and multi-year framework; and policy choices that will allow modulating the amount and timing of funding. In the Netherlands, only the first of these options is available to ministers.

Annual reserves and provisions traditionally included in the budget are however too small to absorb large shocks such as the crisis generated by the COVID-19 pandemic. In all countries studied, reallocation of funds and reserves were used to fund emergency spending during the first weeks of the crisis. However, as the crisis unfolded and the crystallisation of further risks became probable, new reserves were very significantly increased in some countries with the approval of the legislature (*Advance to the Finance Minister* in Australia and *Contingencies Fund* in the United Kingdom) or supplementary budget laws were successively laid before parliament (Finland). In New Zealand, fiscal policy response to past crises included drawing liquidities from the Natural Disaster Fund and suspending contributions to the Superannuation Fund.

Table 3.3. Case studies: Provisions and reserves

	Provision/reserve for unexpected events	Provision/reserve for new policies or programmes	Other
Australia	The budget contains a provision used only in case of an erroneous omission or understatement in the budget or due to unforeseen expenditures realised after the last day it was practicable to provide for it in the budget.	The budget contains an allowance for anticipated events that cannot be assigned to individual programmes (so-called contingency reserve).	n/a

⁵ When there are more than one provision or reserve, one is for funding unexpected events while the other one is for funding new programmes or policies over the course of the budget execution.

Finland	The budget contains a reserve for unforeseen events (0.2% of total expenditure in 2020).	The budget contains a provision for new policies to be defined in supplementary budget (0.6% of total expenditure in 2020).	n/a
New Zealand	Contingencies may be included in departments' budgets for amounts that are still subject to uncertainty at the time the budget is being finalised.	The budget comprises a general operating contingency that provides for operating proposals that arise between budgets (so-called Between-Budget Contingency).	New Zealand has two long-term reserve funds (Natural Disaster Fund and Superannuation Fund).
The Netherlands	n/a	n/a	n/a
United Kingdom	The budget contains a Contingencies Fund (2% percent of the government budget in the preceding year) and reserve for unforeseen expenditure and future costs that exceed the departmental expenditure limits (0,5% of Departmental Expenditure Limits).	n/a	The Treasury maintains a headroom against fiscal rules to absorb modest near-term shocks.

Source: Author, based on case studies.

Consideration of fiscal risks in the formulation of fiscal policy

As already noted by the OECD (OECD, 2019^[14]), a group of countries place emphasis on adopting a prudent fiscal policy stance for accommodating large fiscal risks or shocks. What is a “prudent enough” fiscal policy stance is not a settled debate but the OECD has suggested recently that debt fiscal rules or targets should allow a buffer on top of what is considered a sustainable level of public debt, to facilitate responses to future shocks (Fall, F., et al., 2015^[15]).

While it is obvious that fiscal risks analysis and fiscal stress tests can only be one of the many factors that inform fiscal policy decisions, they can help decision makers in defining fiscal targets or objectives. In New Zealand, in recent years, fiscal targets have been defined by adding a buffer measured with fiscal stress tests to the debt level considered sustainable over the long-term, based on a clear and public framework of analysis. (New Zealand Treasury, 2019^[16]).⁶

In the United Kingdom, the government public strategy for fiscal risks management requires that the government accommodate fiscal risks that cannot be mitigated or provisioned when setting the overall fiscal policy stance. The 2018 government report on the management of the country's fiscal risks did not discuss however how fiscal policy could potentially better accommodate existing fiscal risks. (HM Treasury, 2018^[17]).

How to be transparent and help promoting an informed debate?

Disclosure of fiscal risks is now a common practice in the countries studied for the paper. However, the means for disclosing fiscal risks, as well as the breadth and depth of information published, is variable. Disclosing information on fiscal risks in the budget documentation is the usual practice, but Finland and the United Kingdom are publishing stand-alone reports. The report published by the United Kingdom's Office for Budget Responsibility is particularly detailed compared to those of other countries.

Disclosure practices generally reflect the different nature of fiscal risks. For example, in Australia and New Zealand, macroeconomic risks are discussed next to the macroeconomic and fiscal forecasts, shining a

⁶ According to the Treasury, net debt would rise by between 5 and 15 percent of GDP under the three stress tests scenarios done in 2018 and would go as high as 20 percent in case of a major shock. These estimates have led to a view that “a net debt buffer of at least 20 percent of GDP below [the] upper net core Crown debt limit of 50 to 60 percent of GDP would be reasonable based on the current state of the evidence”.

light on uncertainties surrounding the Government outlook and impacts on key fiscal headlines. Other fiscal risks in relation to the implementation of governments' programmes, policies or guarantees are presented separately, with their nominal value disclosed where possible.

The United Kingdom's practice of publishing two reports is unique amongst OECD countries. The Office for Budget Responsibility's report presents and analyses fiscal risks and "highlight issues" with them. The Government's response is published in a separate report (*Managing fiscal risks*), which presents their fiscal risks management strategy and how "issues" are addressed. This emphasises that the disclosure and management components of a fiscal risks framework are equally important. In the Treasury's own words, in doing so, the government aims to provide "a mechanism for Parliament and the public to assess the adequacy of the government's strategies for managing these risks and hold it to account for their implementation" (HM Treasury, 2018_[17]).

Ultimately, a fiscal risks statement or report should be about providing clear and legible addition to the material that is helping to promote an informed debate about the resilience of public finances. A long narrative description of fiscal risks would be difficult to navigate and to use and do little to achieve this objective. Therefore, the definition of fiscal risks, their classification, the choice of numerical thresholds for disclosure, discussed above, should aim to avoid information overload.

Tables and visualisations can also help improve the understanding of key messages. The United Kingdom's OBR provides a "risk matrix" differentiating existing and new risks and showing their potential financial impacts and probability of occurrence appears promising. Australia identifies in a separate table of its Statement of risks any new fiscal risk since the previous update. Such practices are important in that they increase the understanding of how economic developments, government policies, etc. have generated new risks for public finances, which is equally important for accountability and oversight to the knowledge of the stocks and nature of existing fiscal risks.

4 Operationalising the framework

As noted in a previous OECD paper (OECD/Kopits, 2014^[3]), operationalising a fiscal risks framework that requires the collection and analysis of information on a wide variety of risks requires clear allocation of responsibilities among various actors, organisation and efficient information sharing within government. Although case studies highlight a variety of practices for operationalising fiscal risks frameworks – e.g., depending on whether the ministry of finance or independent fiscal institution prepares the fiscal forecast, whether the budget system is centralised or decentralised, etc., this chapter discusses best examples of how to operationalise a fiscal risks framework.

Responsibilities of government

As underlined in the Chapter 3, responsibilities for identifying, measuring and managing risks vary depending on the type of risks considered. The ministry of finance generally monitors and manages macroeconomic risks, while line ministries and agencies often have the responsibility to monitor and manage fiscal risks associated with their own activities. Debt risks are typically a responsibility of the debt management office. A typical example of this decentralised type of organisation is Australia.

The ministry of finance generally has a centralisation and oversight role in the fiscal risks framework. Based on case studies, the ministry of finance usually carries some or all of the following responsibilities:

- provision of guidance to other stakeholders on fiscal risks' identification, measurement, cost-benefit analysis, reporting, etc.;
- review and/or approval of fiscal risks generated by new policy or programme proposals from line ministries and other public entities;
- consolidation of information on fiscal risks reported by other public entities and monitoring of the flow and stocks of fiscal risks;
- analysis of fiscal risks, including potentially identifying interrelationships between different types of risks;
- definition of a management strategy;
- reporting to decision makers and the legislature on fiscal risks and how to manage them.

It is important to note that either the Ministry of Finance (New Zealand and Australia) or independent fiscal institution (the United Kingdom and the Netherlands) may be in charge of preparing the macroeconomic and fiscal forecasts and reporting fiscal risks. Where this is a responsibility of the independent fiscal institution, the Ministry of Finance may remain responsible for reporting certain specific risks to the legislature and the management of fiscal risks. For example, in the Netherlands, the independent fiscal institution also reports biannually, as well as at the start of the mandate of each new government, on the situation of public finances and fiscal risks, but the ministry of finance publishes a contingent liabilities statement with the budget.

It is important to note that within the ministry of finance, line ministries and other public entities, fiscal risks identification should rely on a variety of professionals. Economists, spending and tax analysts, finance professionals, etc. can all contribute to the identification and management of risks, due to their complementary knowledge of specific policy areas or access to certain information. For example, finance

professionals that compile the balance sheet will have a good understanding of potential risks generated by past activities of the government, by recording provisions in relation to litigations or assets depreciations, while economists and budget analysts will generally have a forward-looking approach to fiscal risks.

A success factor for comprehensive identification and management of fiscal risks is therefore to enhance co-ordination of actors involved in the fiscal risks framework, possibly through regular meetings. This is for example the case in the United Kingdom, where a *Fiscal Risks Group* has been established within the Treasury. The Fiscal Risks Group operates under the supervision of the Treasury Executive Board and, ultimately, the Chancellor. It supervises work done by other specialised groups within the Treasury (spending risks, tax risks, and balance sheet risks groups). It meets monthly and reports to the Executive Management Board on a quarterly basis.

External oversight of the fiscal risks framework

Independent fiscal institutions, through their forecasting and surveillance functions, may have the responsibility of identifying, measuring and reporting all or certain fiscal risks (Netherlands and United Kingdom) or expressing a view on fiscal risks reporting and analysis done by the government (Finland).⁷ The value of giving a specific responsibility to the independent fiscal institutions in the fiscal risks management framework lies primarily in preventing that the government refuses to acknowledge certain risks or avoid measuring them for political reasons.

Case studies show that supreme audit institutions have an important role to play in the fiscal risks management framework. They for example review processes and channels for identifying certain risks or assess the quality of the financial reporting framework, which is one of the sources of information for fiscal risks identification and measurement. The National Audit Office of Finland, for example, realised a number of reviews in past years and formulated recommendations on how to improve the framework, both in terms of methodologies and reporting.

Supreme Audit Institutions also provide recommendations concerning the management of certain risks. The United Kingdom's National Audit Office produced a series of reports on the management of the public sector balance sheets, contributing to the identification and design of management approaches for certain types of risks.

Officials interviewed for the preparation of this paper underlined that, for fiscal risks management to be fully part of the budgeting culture, it is important that the legislature exercise active oversight in this area. This depends, among other factors, of the quality and legibility of the information provided by government, analytical support provided by the parliamentary budget office and supreme audit institution, but also ownership by parliamentary committees, which might be challenging due to the technical and sectoral nature of most fiscal risks.

Interviewees noted that ideally the legislature should be involved *ex ante*, concurrent and *ex post*:

- *ex ante*: the legislature may specify detailed transparency and management requirements for the government, define principles for the government formally taking over certain risks, or set ceilings for certain contingent liabilities, in particular for guarantees as is the case for example, in the Netherlands;
- concurrent and *ex post*: the legislature should monitor the evolution of the stock of fiscal risks and hold government accountable for its management strategy and implementation. Such oversight is

⁷ In the former case, it will identify certain risks, such as macroeconomic risks, based on its own analyses but may have rely on government for information on certain categories of fiscal risks.

of course facilitated when the government publishes a full report on its management of fiscal risks, as is the case in the United Kingdom;

- finally, the legislature could question the government on whether and how fiscal risks have been considered for setting the fiscal policy stance and objectives.

Tools and processes

Establishing appropriate processes in relation to all aspects of the fiscal risks management framework and skills is crucial to the successful implementation of the framework. These processes should insure that:

- identification and management of fiscal risks is done in all public entities in accordance with government overall principles on fiscal risks disclosure and management;
- authorisation is systematically sought from the ministry of finance or other monitoring bodies where required by legislation or regulations;
- reporting on fiscal risks is comprehensive, reliable and timely.

A basic requirement is to make sure that relevant actors in all public entities have an appropriate knowledge of the concept of fiscal risks and understanding of requirements for their disclosure and management, using shared methodologies and reporting tools. For example, in Australia, a *Risk Potential Assessment Tool* is used across government to evaluate a range of risks for all new spending proposals.

The Risk Potential Assessment Tool requires an estimation of the “financial exposure” associated with the new spending proposal, with consideration of “any contingent liabilities that may accrue to government as a result of implementation”. Managers are required to specify “whether the proposal is likely to require additional funding” and “whether all costs have been considered”. The value of such an approach resides also in the fact that fiscal risks are considered systematically as part of the budget formulation process. It also encourages entities in thinking of fiscal risks not only in terms of certain types of operations, such as guarantees, but more widely as part of their overall risks management framework.

Another example is the United Kingdom, where a comprehensive guidance was established in relation to contingent liabilities that aim at providing an overview to all public sector actors of the approval process and assist officials in the application of this process by providing a number of tools, including checklists.

Concerning reporting, certain fiscal risks may be reported regularly in dedicated systems as is the case in Finland for guarantees or as part of the monthly financial reporting as in New Zealand. There is value in reporting certain fiscal risks as part of the “traditional” reporting cycle in that it conveys the message that the same level of quality and reliability than for the accounts is expected in this area.

In the area of reporting, interviews show that progress is still needed, with for example limited use of cost accounting for consolidating all costs associated with the realisation of certain fiscal risks or shocks, such as natural disasters. Although no country currently holds a comprehensive database of fiscal impacts from the realisation of fiscal risks, New Zealand’s government has committed to developing a mechanism for more systematic reporting of *ex ante* and *ex post* public spending on disaster risk management (OECD, 2019^[13]).

5 Lessons from case studies, challenges and future directions

What are the main lessons from this paper?

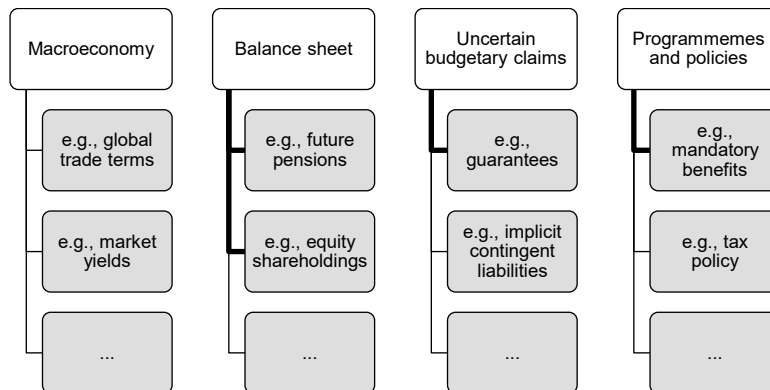
Defining fiscal risks

Fiscal risks are commonly defined as “potential deviations from the government forecasts”. In addition, to have the potential to support a transparent identification of fiscal risks, the definition should: i) clarify against which fiscal outlooks they should be assessed, ideally both the medium and long-term forecasts; ii) specify criteria for scenario and events to be included or excluded from the forecasts, iii) define a threshold for disclosure.

The definition of fiscal risks should also specify broad categories for fiscal risks’ classification. These categories should include macroeconomic risks (including debt risks), balance sheet risks, uncertain budgetary claims (explicit and implicit) and government policy or programmes risks (Figure 5.1).

Further, the definition should require that other key characteristics of fiscal risks that will facilitate decision making on management approaches be identified, such as their potential magnitude and probability of occurrence.

Figure 5.1. Taxonomy of fiscal risks



Source: Authors.

Designing a comprehensive and effective framework

The objectives of the fiscal risks framework should ideally be set out in legislation. Objectives should include the identification, measurement and disclosure of fiscal risks but also their management by the government. The management strategy should be defined in a public document and comprise principles and/or requirements for taking over certain risks, guidelines on prevention and mitigation approaches, and indication of how fiscal risks and fiscal stress tests will be considered in fiscal policy formulation.

Approaches for identifying and measuring fiscal risks vary depending on the category of risks considered. To identify and measure risks comprehensively, information should therefore be collected from a variety of sources, both within and outside of the ministry of finance. Circumstances in which fiscal risks cannot be measured should be identified and explained and should not deter countries from disclosing them.

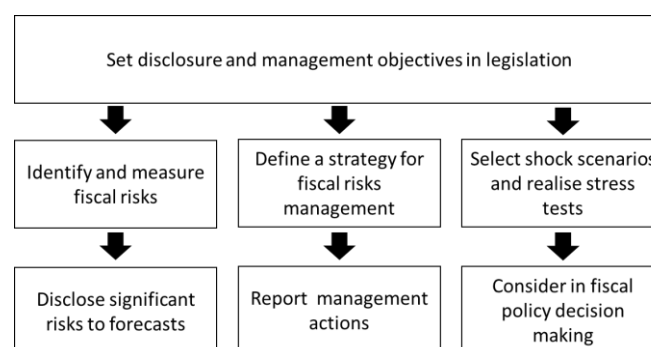
Stress tests that analyse correlations between various fiscal risks and potential impacts of large shocks on public finances should be undertaken on a regular basis. In doing so, countries should provide a rationale for which fiscal aggregates will be scrutinised, drawing lessons from the most recent shocks where balance sheet instruments such as loans and guarantees have been increasingly used as economic policy tools by governments. Stress tests should also allow identifying the government's potential, implicit contingent liabilities, which depend among other factors on the capacity the economy as a whole to absorb the shock in first instance.

Selecting forward-thinking multidimensional shock scenarios is crucial for the credibility of stress test exercises. There would be value, going forward, in defining and disclosing the approach for selecting shock scenarios. Consideration should be given in particular to testing critical risks identified in national risks registers, e.g., pandemic, large natural disaster, disruption of energy facilities, etc.

A consolidated view of fiscal risks and results of fiscal stress tests should be available to decision makers and the public. To make this information legible and reader-friendly, visualisations should be used as much as possible to highlight key messages – e.g., using clear classifications; showing new risks since the last update in a separate section or table; or preparing a risk matrix showing how fiscal risks compare in terms of their likelihood of occurrence and potential scale.

Beyond providing comprehensive information on fiscal risks and results of stress tests, transparency requirements should include disclosing the government's strategy; information on actions taken for managing significant individual risks, ideally in a dedicated statement or report; as well as a discussion of potential fiscal policy implication.

Figure 5.2. Components of a fiscal risks management framework



Source: Authors.

Operationalising the framework

There is no one-size-fits-all institutional organisation for fiscal risks management. In particular, the identification and measurement of fiscal risks may fall under the responsibility of the ministry of finance or independent fiscal institution depending on which institution is in charge of preparing the fiscal forecasts.

In all cases, comprehensive identification, measurement and management of fiscal risks should involve a large range of professionals within government. Specifically, economists, spending and tax analysts, finance professionals, risks managers, etc. should all contribute with their complementary knowledge of specific policy areas, access to information and analytical skills.

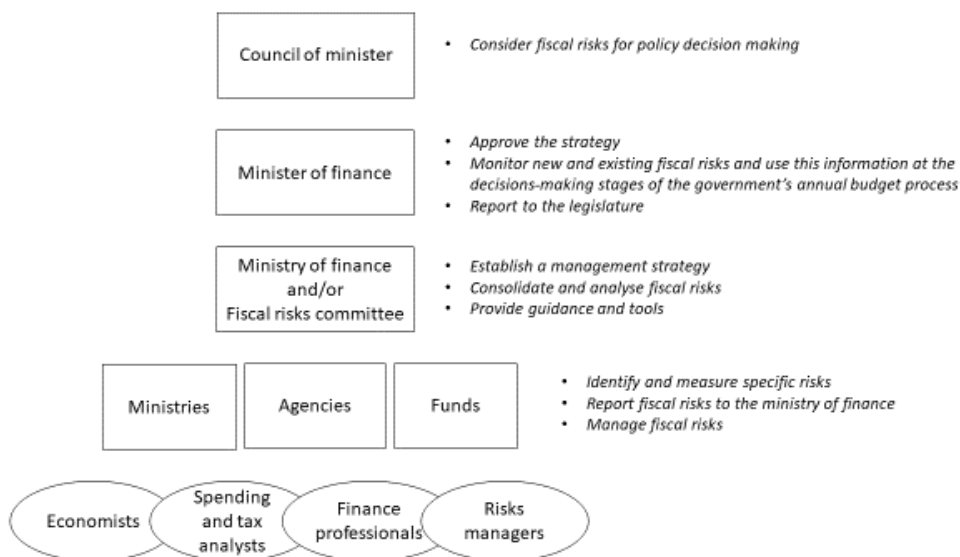
The responsibility for successfully operationalising the fiscal risk management framework lies with government. The mobilisation of a large range of professionals across government implies that clear and legible guidance and tools should be made available by the ministry of finance on how to identify, measure, report and eventually manage individual risks – e.g., checklists for identifying fiscal risks arising from new policies or financial operations, IT solutions for regular reporting of risks, etc.

As underlined by a number of officials interviewed, successful operationalisation of a fiscal risks framework also involves centralisation of information and regular communications with ministers or, in other words, making sure that fiscal risks are not identified and measured just to be ignored but, on the contrary, to be managed.

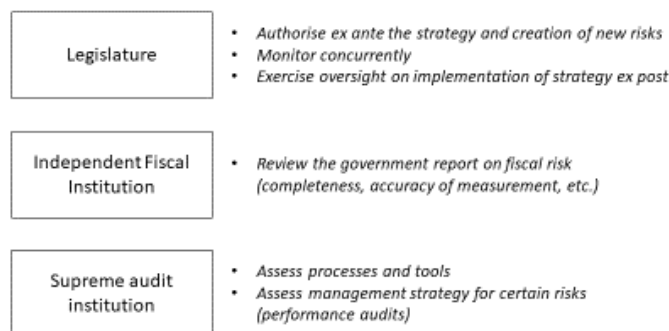
Awareness of decision makers on fiscal risks and issues with the resilience of public finances highlighted by fiscal stress tests is higher in particular when analysis of fiscal risks is done at senior level in government (e.g. a committee reporting directly to the minister of finance) and disclosure requirements are comprehensive allowing oversight by the legislature and independent fiscal institution.

Figure 5.3. Institutional responsibilities for fiscal risks management

a. Government



b. External oversight



Note: responsibilities would not be similar in countries where the independent fiscal institution does the forecast and fiscal risks report.

Source: Authors.

What are the remaining challenges in managing fiscal risks?

Overall, case studies prepared for this paper show fiscal risks frameworks – that is, the identification, analysis and management of fiscal risks – have the potential to support better budgetary management and fiscal policy, as well as improving transparency and accountability on governments decision making.

Case studies show obvious achievements in three areas:

- Fiscal risks' disclosure alongside fiscal forecasts has increased transparency on how the forecast are prepared – that is, specifically, on what is excluded from them – decreasing the discretion of governments in this area and facilitating the external oversight of the legislature and fiscal watchdogs;
- Fiscal risks' reporting has imposed greater rigor in the way managers elaborate their policy proposals and prepare their spending forecasts – that is thinking not only of spending that is certain or likely, but also of what could go wrong in the course of the policy implementation, and preparing for it as best as possible as shown in particular by the case studies of Australia and New Zealand;
- Fiscal risks' management has developed since the 2008 financial crisis, with the case studies highlighting actions taken in Finland, the Netherlands and the United Kingdom for better monitoring and preventing risks from contingent liabilities in particular.

However, challenges are equally obvious:

- Firstly, research conducted for the preparation of this paper highlighted difficulties in making fiscal risks' management a priority for decision makers working within a three to five year political mandate, considering that fiscal risks are uncertain, potentially long-term and costly to prevent or mitigate;
- Secondly, questions remain as to whether impacts of large shocks on public finances can be measured reliably with fiscal stress tests and factored into fiscal policy decision-making, considering that governments are increasingly acting as insurers of last resort for the economy;
- Thirdly, the COVID-19 crisis highlighted limits of existing mitigation strategies in the event of a large shock. In all countries studied, fiscal packages largely exceeded resources available through reallocations of appropriations and existing budget reserves. Emergency budgetary legislation had therefore to be passed to allocate new resources to the government, including sometimes increasing provisions that allow the finance ministry to make spending decisions without *ex ante* approval by parliament.

The question of the political cost vs. benefits of disclosing and managing fiscal risks is a legitimate one. The 2008 financial crisis and COVID-19 pandemic have shown however, that fiscal risks do materialise and tomorrow's risks, if ignored, are likely to become today's problems. The shock caused by the pandemic may be a tipping point in that comprehensive requirements and detailed strategies for managing fiscal risks, from being perceived as a constraint, may become one of the tools that decision makers will use to evidence how they are building up the resilience of public finances. In other words, fiscal risks framework could become "safeguards" for decision makers, helping them to demonstrate how they handle existing fiscal risks and explain the choices and trade-offs to avoid creating new ones.

Concerning fiscal stress tests, it was mentioned during interviews conducted for the preparation of this paper that more needs to be done in using stress tests for identifying and measuring potential implicit liabilities of governments. Specifically, by assessing how the entire economy of a country, both households and businesses, would react to a given shock, stress tests should help in measuring if and how the government would be constrained to absorb the shock beyond any pre-existing legal guarantee or commitment (OECD/Schilperoord, et al., 2013^[10]). This, in turn, should allow anticipation and transparency – that is assessing current policies and establishing principles or guidelines that could be referred to in an emergency situation.

The challenges mentioned above will have to be overcome if resilience becomes a policy priority for decision makers within government, as part of the effort to create a more shockproof global economy.⁸ We should therefore not be too quick to claim that the COVID-19 pandemic has sounded the death knell of fiscal risks management, as it actually makes their identification, analysis and management all the more important for the following reasons:

- With a highly uncertain economic environment, forecasting the economy and public finances will become increasingly challenging. Having a clear understanding of existing and new risks to the fiscal forecast will be crucial for decision makers to draw realistic spending plans;
- With fiscal risks at an all-time high, managing them will be a core task of decision makers, e.g. monitoring the stock of guarantees, credit risk on government loans, commercial value of equities held by the government and taking timely and appropriate decisions in relation to the management of related risks;
- With unprecedented fragile public finances, fiscal responsibility and discipline in ministries, departments and agencies will involve not only meeting their expenditure targets but also managing existing and emerging risks linked to the amplification of both on- and off-balance government assets and liabilities, in the form of debt, acquisition of equity in strategic firms, loans, guarantees, etc.;
- With difficult budgetary trade-offs ahead, the legislature will need comprehensive information on fiscal risks and their management to exercise oversight and conduct an effective debate over budgetary decisions, including reserves and “space” in fiscal plans.

Conclusion: future directions

This paper provides good practices examples on frameworks for fiscal risks management, which is a prerequisite for resilient public finances. However, beyond the establishment of a sound framework, countries urgently need to define or scale up policies to monitor and mitigate large fiscal risks generated by the COVID-19 crisis. These risks include:

- **Macroeconomic risks:** virtually all governments that published macroeconomic and fiscal forecasts during the last months have underlined significant uncertainties to a number of assumptions used in preparing these outlooks and these uncertainties will continue for a potentially long period. Uncertainties include the continued effects of the COVID-19 pandemic on the global and national economies, unemployment levels, etc. as well as risks of a resurgence of the pandemic in countries where it has slowed and wide range of approaches that governments could consider in such a case. Such uncertainties affect fiscal forecasts in many ways, including estimations of future tax revenue;
- **Programme and policies risks:** governments of OECD countries have implemented a wide range of policies to respond to the COVID-19 crisis (OECD, upcoming). In most countries, if initial responses have focused on providing additional resources to the health sector, government responses have progressively included large packages of support measures targeting certain businesses and workers as well as vulnerable households, depending on national circumstances. As the economic disruption from COVID-19 may still be in its early stages, uncertainties around the costs of these policies are significant and measures considered initially as temporary could be perpetuated;
- **Uncertain budgetary claims risks:** very large guarantee schemes have been established in most countries as part of the COVID-19 response (Table 4.1), well beyond what had been done during the previous global crisis in 2008. Risks that these guarantees will be triggered will create very

⁸<https://www.oecd.org/naec/events/systemic-linkages/building-resilient-systems-in-21st-century.htm>

significant uncertainties around expenditure forecasts in the future. In addition, as COVID-19 further impacts a number of sectors in the economy, guarantees pre-existing to the COVID-19 crisis, such as export guarantees, may be called. Finally, implicit contingent liabilities are likely significant and rising as government are clearly expected to act (and have already acted in some cases) as insurers of last resort during this crisis;

- **Balance sheet risks:** in the wake of the global financial crisis, the government's balance sheet had already become an important instrument of government policy in the form in particular of financial sector asset purchases and concessional loans to certain households and businesses (IMF, 2018^[18]). In most countries, similar instruments have been used as part of the COVID-19 crisis response and, although data is not available yet, it is likely that government balance sheet will balloon on a larger scale than what was experienced ten years ago. Risks in relation to these assets and liabilities will be high in coming years – e.g., uncertainties over the repayment of loans provided to businesses and households and value of government shareholdings in corporations hit by the crisis.

Against, this background, future OECD work will consider how to support the effective management of certain categories of fiscal risks. Contingent liabilities, in particular guarantees, and balance sheet risks are two areas will deserve particular attention going forward, as noted above.

Concerning balance sheet instruments, the measurement of these assets and liabilities and their active management, which has been a regular topic for experience sharing at meetings of the OECD network of Financial Management and Reporting officials, will become increasingly important. After the COVID-19 crisis, governments cannot be mere users of financial instruments but will have to “investors” that actively monitor and manage their portfolio of assets and liabilities. That is true in particular for such financial assets as loans and shareholding equities, which, if not managed, may become significant fiscal risks. Questions that the OECD Secretariat will cover include:

- On **monitoring**: how can governments review and analyse their balance sheet, with a focus on financial assets and liabilities generated by the COVID-19 crisis?
- On **management strategies**: what are the approaches in OECD countries for the management of government loans, shareholding assets and other financial assets and liabilities?
- On **oversight**: what information and performance measures should be provided by government on the results of their management strategies, including impacts on the types and scale of related risks to public finances?

Concerning guarantees, a review of existing frameworks and policies, some of which were developed in the wake of the 2008 financial crisis will be needed. Questions should include:

- On **monitoring**: whether specific monitoring and management mechanisms are needed for monitoring COVID-19 related guarantees, e.g., the creation of dedicated agency and refinement of forecasting methods?
- On **prevention**: whether existing frameworks that impose limits on the creation of guarantees and contingent liabilities have stood during the COVID-19 crisis and, if not, how they could be strengthened or adapted in case of emergency situations including for managing implicit contingent liabilities?
- On **mitigation**: whether cost-recovery approaches for guarantees, where they exist, are appropriate for COVID-19 related guarantees and which other management strategies countries could explore, including selling back to the private sector?
- On **oversight**: whether dedicated reporting and analysis would be needed for the legislature and public, including on the performance of the government's strategy in recouping public financing by taxpayers of economic support measures?

Table 5.1. OECD countries: COVID-19 related guarantee and loans schemes

	Guarantees schemes	Loans schemes	Estimated value as percentage of GDP
Australia	Coronavirus SME Guarantee Scheme	n/a	1.1%
Austria	Federal Development and Financing Bank's Guarantee framework	n/a	1.9%
Belgium	Federal government's guarantee scheme; - Regional governments' additional guarantees for business loans	n/a	9.4%
Canada	Loan Guarantee for Small and Medium Enterprises (Export Development Canada)	Canada Emergency Business Account (Export Development Canada); Co-Lending Programme for Small and Medium Enterprises (Development Bank of Canada)	3.0%
Chile	Increase of FOGAPE's guarantee line	n/a	0.5%
Czech Republic	Loan guarantees for loans from commercial banks to SMEs	Interest-free loan programme for SMEs	0.2%
Denmark	Increase of funds for state-guaranteed loans to SMEs and large companies; Specific guarantee to the airline SAS; Increase of funds for the Danish Travel Guarantee Fund	Increased access to student loans	3.0%
Estonia	KredEx and Rural Development Foundation's guarantees	Extra loans for businesses facing liquidity problems; Business and capital financing loans for rural companies	9.5%
Finland	Additional financing to Finnvera (Finnish guarantee agency)	n/a	4.4%
France	State guarantee on loans to businesses; Guarantee scheme specifically designed for export firms	n/a	13.7%
Germany	Expansion of guarantee framework	KfW Quick Loan Programme for SMEs; Promotion of venture capital for start-ups	25.3%
Greece	Hellenic Development Bank's guarantee scheme	Subsidized State loans to SMEs	1.7%
Hungary	State guarantees to micro, small, medium and large companies	Government-backed loans to micro, small, medium and large companies	5.1%
Iceland	n/a	n/a	n/a
Ireland	COVID-19 Credit Guarantee Scheme	COVID-19 Business Loans; COVID-19 Working Capital Scheme; Future Growth Loan Scheme	0.8%
Israel	Loan guarantees for SMEs - Loan guarantee fund for large firms	n/a	1.7%
Italy	Italian export credit agency's additional guarantees to banks; Italian export credit agency's additional export-related guarantees; Italian export credit agency's additional guarantees to SMEs; Additional funds granted to the SMEs Guarantee Fund; Additional State guarantee for the Deposits and Loans Fund	n/a	43.2%
Japan	n/a	Expansion of the government's low or zero interest loan programmes for SMEs	8.2%
Korea	Guarantees for SMEs	Loans for SMEs	0.2%
Latvia	Loan guarantee programme to restructure companies' existing investment loans or short-term loans	Subsidised loan scheme for companies affected	3.4%
Lithuania	Expansion of state guarantees	n/a	4.7%
Luxembourg	State guarantees on new bank loans; Support to the export of companies	Provision of loans in co-operation with private banks and the National Credit and Investment Company	6.0%
Mexico	n/a	Targeted loans to state workers; Housing loans	n/c

Netherlands	- Relaxation of the rules for the guarantees of businesses - Guarantees for credits of agricultural companies	n/a	0.3%
New Zealand	Guarantee loans for businesses administered by commercial banks.	Loan facility to Air New Zealand; Loan facility to the aviation sector	2.7%
Norway	State guarantee scheme for new bank loans to SMEs suffering losses; Reinstatement of the Government Bond Fund to increase liquidity or larger companies; State guarantee scheme for airline companies	Innovation grants and loans related to start-up, innovation, restructuring, internationalisation and development	3.3%
Poland	n/a	Extension of bank working capital loans and liquidity funds (possibility for companies to obtain a capital increase or financing in the form of bonds)	0.3%
Portugal	State-backed credit guarantees	n/a	1.5%
Slovak Republic	Loan guarantees to banks	n/a	0.6%
Slovenia	Private sector loan guarantee mechanism	n/a	5.1%
Spain	Instituto de Crédito Oficial's new line of guarantees for the financial sector; Instituto de Crédito Oficial's new line of guarantees for the tourism sector	Increase of Instituto de Crédito Oficial's existing lines of credit to companies and self-employed workers.	9.5%
Sweden	Expansion of Swedish Export Credit Agency's credit guarantee framework; State credit guarantees to airlines	n/a	1.2%
Switzerland	Federal Council's guarantee programme; Federal Council's government guarantee scheme for airlines and aviation-related businesses; Federal Council's loan guarantee programme for startups (in cooperation with the cantons)	n/a	6.2%
Turkey	Increase of the limit of the Treasury-backed Credit Guarantee Fund for SMEs	n/a	0.8%
United Kingdom	Guarantees to the business sector (Coronavirus Business Interruption Loan Scheme, Coronavirus Large Business Interruption Loan Scheme); Trade Credit Insurance: temporary guarantee of business-to-business transactions	Bounce Back Loans for small businesses	15.9%
United States	Loan guarantees in support for distressed businesses	Grants and loans to businesses	4.5%

Source: Authors estimates, based on data collected by the OECD (OECD, upcoming)

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