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Managing Fiscal Risks

Case studies of Australia, Finland, the Netherlands, New Zealand and the United Kingdom

Virtual Meeting, 23 June 2020

This paper comprises case studies of fiscal risks management frameworks in Australia, Finland, New Zealand, the Netherlands and the United Kingdom.

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Introduction¹

The five case studies that follow illustrate different approaches for fiscal risks management showing good practices examples that are summarised in the OECD Secretariat's report *OECD Best Practices for Managing Fiscal Risks - Lessons from case studies of selected OECD countries and next steps post COVID-19*.

Australia and New Zealand are two pioneer countries in identifying, disclosing and managing fiscal risks, as required by their legislation from the 1990s. Australia's fiscal risks management framework is highly devolved, emphasising the role and responsibilities of departments and agencies in achieving objectives of transparency over fiscal projections and sound fiscal management.

New Zealand's framework has similar features but is more centralised. New Zealand is also one of the first countries that have realised stress test of the government balance sheet and formally considered the results of these for determining their fiscal policy stance.

Finland, the Netherlands and the United Kingdom have developed their framework for fiscal risks management more recently, as part of the reforms implemented in the wake of the 2008 financial crisis. In all three countries, objectives were both to better shield public finances from future shocks and to manage more strictly going forward a number of contingent liabilities – in particular guarantees – that had crystallised during the previous crisis. These three countries, similar to New Zealand, have also started doing stress tests of the public sector fiscal headlines as part of their fiscal risks management framework.

It is notable that the United Kingdom is the only country in the world where a detailed report on fiscal risks is prepared by the independent fiscal council, the Office for Budget Responsibility (OBR), and a Government response is published to explain how these risks are managed. Finally, 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.

¹ Research for case studies was done by Damien Boucher and Flavia Giannini (Junior Policy Analysts in the Public Management and Budgeting division of the OECD), under the supervision of Delphine Moretti (Senior Policy Analyst in the same division). The case studies benefited greatly from comments and suggestions of officials from Australia's Department of Finance, Finland's Ministry of Finance, the Netherlands' Ministry of Finance and 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.

Australia

Context

Australia has a relatively long history of managing fiscal risks and the requirement on government to manage fiscal risks was strengthened in the late 1990s with the adoption of the *Charter of Budget Honesty Act* (the Charter). The Charter aims at medium term sustainability of public finances and increasing budget transparency in Australia. To do so, the *Charter* states in general terms the principles of sound fiscal management, including a requirement that the Government “manages fiscal risks faced by the Commonwealth prudently [...] includ[ing] risks such as risks arising from erosion of the tax base; and risks arising from the management of assets and liabilities”. Furthermore, the Charter states that the “budget economic and fiscal outlook report” must contain “a statement of the risks, quantified where feasible, that may have a material effect on the fiscal outlook” (Australian Government, 1998^[1]).

Overview of the fiscal risks management framework

Australia’s fiscal risk management framework has two primary objectives, as mandated by law. The first one is to identify the full range of factors that may influence the actual budget outcome in future years and to disclose comprehensively these factors to increase the transparency of the fiscal projections. The second one is to manage and mitigate where possible these risks, in accordance with the principle of sound fiscal management.

The main characteristics of the fiscal risks management framework are summarised in Table 1.1. below. A key characteristic of Australia’s framework is that management of fiscal risks is fully integrated in the annual budget cycle and general requirements for Commonwealth entities’ corporate planning.

Specifically, the annual budget formulation is guided by the *Budget Process Operational Rules*, agreed each year by the Cabinet. These rules reflect the Government’s fiscal strategy and have a number of elements that contribute to risk assessment, including a requirement that Commonwealth entities submit to the Department of Finance an assessment of risks arising from new policy proposals (Commonwealth of Australia, 2016^[2]).

A shared *Risk Potential Assessment Tool* (Commonwealth of Australia, 2016^[2]) helps entities in assessing risks, by guiding them to consider questions such as whether the new policy is a strategic priority for the Government, its financial impact, what are the risks associated with the proposal (legal, financial and operational), the associated mitigation strategy and residual risk.²

² The *Risk Potential Assessment Tool* requires in particular that contingent liabilities such as warranties, guarantees and indemnities; personal injury or property damage arising from implementation; or a highly litigious stakeholder group be identified.

Table 1.1. Australia: Approach for fiscal risks management

<i>Fiscal forecasting and analysis of deviations</i>	The biannual and pre-election <i>Economic and Fiscal Outlooks</i> contain fiscal and economic forecasts, as well as analysis of past deviations from the forecasts used to calculate confidence intervals for key fiscal and economic aggregates.
<i>Risks identification</i>	Commonwealth entities identify the fiscal risks in their area of responsibility and are required to provide information to the Department of Finance and the Treasury.
<i>Risks measurement</i>	Commonwealth entities identify and assess risks when preparing their financial statements and risks are consolidated by the Department of Finance. The Treasury performs sensitivity analysis of key fiscal aggregates to changes in the underlying key macroeconomic forecasts, projections and assumptions.
<i>Disclosure</i>	A Statement of risks is included in the <i>Budget Strategy and Outlook</i> , the <i>Mid-Year Economic and Fiscal Outlook</i> and the <i>Pre-election Economic and Fiscal Outlook</i> .
<i>Prevention/Mitigation</i>	Departments and other entities prevent and mitigate the risks arising from their operations, contingent liabilities and assets.
<i>Provision or reserve</i>	A provision and <i>Advance to the Finance Minister</i> are included in the annual Appropriation Act that can be used in case a fiscal risk crystallises.
<i>Fiscal policy</i>	Fiscal risks are not formally considered for setting fiscal targets. Fiscal strategy aims for fiscal sustainability and accordingly is set in recognition of broad fiscal risks. Current political commitments aim for a balanced budget and the reduction of debt.

Source: Authors.

Stakeholders in fiscal risks management

The Government operates a highly devolved fiscal risks management framework. The Department of Finance holds a central consolidation function for the preparation at least twice a year of a *Statement of risks*, included in the main budget documents and further described below, that is based on information communicated by departments and agencies. This excludes macroeconomic risks, which are dealt with separately by the Department of the Treasury in the main budget documents. The Department of Finance also holds an “advisory role” during budget preparation and works closely with other departments and agencies to discuss and analyse, among other things, the specific risks that fall under their areas of responsibility. Included in the *Statement of risks* is a statement regarding risks associated with unanticipated changes in economic circumstances prepared by the Department of the Treasury, largely focused on tax revenue risks, together with a description of several general risks that can affect tax collections.

Separate from *the Statement of risks*, but also included in the main budget documents, is analysis by the Treasury of fiscal risks associated with uncertainties around the economic outlook, with input by the Department of Finance on the impacts of variations in economic parameters on areas of government spending (see also further below).

Departments and agencies are responsible for the identification and measurement of their fiscal risks, as well as their prevention and mitigation, based on guidance from the Department of Finance

and the Treasury.³ They submit to the Department of Finance and Treasury requested information for the preparation of the *Budget Strategy and Outlook*, the *Mid-Year Economic and Fiscal Outlook* and the *Pre-election Economic and Fiscal Outlook* (Australian Government, 1998^[1]), as well as in-year and year-end financial statements, which include disclosures on contingent liabilities.

Definition and disclosure of fiscal risks

The *Charter of Budget Honesty Act 1998* requires that all factors that could affect fiscal outcomes be disclosed in a *Statement of risks* in the *Budget Strategy and Outlook*, the *Mid-Year Economic and Fiscal Outlook* and the *Pre-election Economic and Fiscal Outlook*. To this purpose, fiscal risks are defined as “general developments or specific events that may affect the fiscal outlook” that are not included in the estimates because of the uncertainty surrounding their timing, magnitude or likelihood.

Fiscal risks are further categorised in general fiscal risks, specific contingent liabilities and specific contingent assets. Specific contingent liabilities and assets are defined as “possible costs or gains to the Australian Government arising from past events or decisions which will be confirmed or otherwise by the outcome of future events that are not within the Government’s control” (Commonwealth of Australia, 2019^[3]).⁴ Loans are also considered as fiscal risks, due to the credit risk that they will not be repaid in full.

The *Statement of risks* is relatively short and uses a clear analytical presentation. Beyond listing general fiscal risks, specific contingent liabilities and specific contingent assets, the document highlights variations from one statement to the next – that is new risks that are identified, as well as modification or removal of existing risks. In addition, contingent liabilities and assets are categorised as “significant but remote”, “unquantifiable” or “quantifiable”. Only quantifiable risks are measured. As a rule, documentation on fiscal risks is prepared by departments and agencies before consolidation by the Department of Finance, putting the emphasis on sectoral responsibility and accountability for identifying, monitoring and managing these risks.

Macroeconomic risks are considered in the comprehensive economic outlook section of the main annual budget documentation, the *Budget Strategy and Outlook* and the *Mid-Year Economic and Fiscal Outlook*, as well as in the *Pre-election Economic and Fiscal Outlook*. This is complemented by consideration of fiscal risks associated with economic outlook uncertainties in the budget documents’ section on the historical performance of budget forecasts and the sensitivity of budget estimates to changes in the underlying key macroeconomic forecasts and projections.

Key policies for prevention or mitigation of fiscal risks

Concerning prevention and mitigation strategies, although departments and agencies have the responsibility for managing their own risks, the Government has overall “conservative strategies in place to reduce its potential exposure to contingent liabilities” (Commonwealth of Australia, 2019^[4]).

³ The Department of Finance and the Treasury are also in charge of monitoring a range of specific risks falling under their respective areas of responsibility.

⁴ Contingent liabilities are either guarantees (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 contingent liabilities (e.g. legal claims, tax disputes, uncalled capital subscription).

In addition, the annual budget and *Appropriation Act* includes resources that can be used in case a fiscal risk crystallises:

- The Budget includes a *Contingency Reserve* which principally reflects anticipated events that cannot be assigned to individual programs in the preparation of the budget estimates and can include funding for “events or pressures that are reasonably expected to affect the budget estimates” (Commonwealth of Australia, 2019^[4]);
- An *Advance to the Finance Minister* can be used by the Finance Minister in case he “is satisfied that there is an urgent need for expenditure, in the current year, that is not provided for, or is insufficiently provided for [...] because of an erroneous omission or understatement; or because the expenditure was unforeseen” (Australian Government, 2018^[5]).

The Advance to the Finance Minister (AFM) provides for funding as a last resort, and as such has been used sparingly in recent times – only five times in the period from 2013-14 to 2018-19.

To mitigate fiscal risks from economic uncertainties and economic shocks, the Australian Government has for several years set a fiscal strategy aimed at achieving budget surpluses, on average, over the course of the economic cycle. This underlines the Government’s setting of medium term fiscal policy while allowing for flexibility in response to changing economic conditions. The policy elements underlying the strategy have included fiscal discipline by controlling government expenditure – including, until the expectation in the latest *Mid-Year Economic and Fiscal Outlook* (Commonwealth of Australia, 2019^[4]) of a return to budget surplus in 2019-20, reducing expenditure as a share of GDP – and a cap on tax revenue as a share of GDP.

The fiscal strategy is set by the Government in accordance with the legislated principles of sound fiscal management and the requirements on the content of fiscal strategy statements under the *Charter of Budget Honesty Act*. A key element of the Government’s fiscal strategy in 2019 was to focus on strengthening the balance sheet through public debt reduction to ensure the longer-term sustainability of the budget. Paying down public debt ensures that the Government is better equipped to deal with future challenges and reduces the burden of debt on future generations (Commonwealth of Australia, 2019^[4]).⁵

COVID-19 crisis

Since March 2020, the Australian Parliament passed a series of additional standing appropriations and 2019-20 Appropriation Bills to fund COVID-19 response measures. In addition to funding agreed measures, the additional 2019-20 Appropriation Bills increased the Advance to the Finance Minister provisions – now totalling AUD 42 billion compared to a previous amount of AUD 380 million in Appropriation Bill No. 2 (Commonwealth of Australia, 2019^[6]).

Additionally, The Government decided to delay the 2020-21 Budget from 12 May 2020 to 6 October 2020. This was due to the very high level of uncertainty over macroeconomic and fiscal forecasts and related challenges in formulating a new fiscal strategy post COVID-19.

Finally, following the Government’s decision to delay the 2020-21 Budget from 12 May 2020 to 6 October 2020, the Australian Parliament passed 2020-21 Supply Acts. The Supply Acts provide broadly 7/12ths of the 2020-21 annual appropriations to support the ongoing business of Government in the new financial year, which commences on 1 July 2020. For entities and activities

⁵ The Government specified that ““A strong balance sheet provides the Government with flexibility to respond to unanticipated events, such as financial crises or economic shocks. There are a range of measures of the Government’s financial position. All are expected to improve over the forward estimates period and medium term.”

that are expected to have higher expenditure early in the 2020-21 financial year, in particular where this is driven by COVID-19 impacts, additional appropriations were provided in the Supply Acts. The Supply Acts also extend the operation of AUD \$40 billion of the Advance to the Finance Minister provisions into the 2020-21 financial year.

In response to the COVID-19 pandemic, the AFM dollar thresholds have been increased for 2019-20 and 2020-21 in order to manage evolving financial risks. The increased demand on the AFM due to the COVID-19 pandemic has resulted in the AFM being used seven times since March 2020.

At an operational level within Australian Government entities, existing processes and controls have not been changed during the crisis. COVID-19 policy proposals have been subject to the usual level of scrutiny, including in relation to the risks they create, although analyses have been done within a shorter time frame. Existing controls have not been identified as an impediment or delay to response implementation. Rather, there is an awareness of the heightened risk of fraud in the current operating environment and the need for appropriate controls to mitigate this risk.

Finland

Context

Finland's budget system is characterised by a binding medium-term budget framework (*General Government Fiscal Plan*) anchored to a budget balance fiscal target (now established at -0.5% of GDP) and multiyear spending limits for central government (*Central Government Spending Limits*) that allow setting clear course for fiscal policy and maintaining fiscal discipline. This sound budget system was put under stress in 2008, when the financial crisis dramatically hit the Finnish economy, generating in turn a sharp increase of the public deficit and debt and increasing use of guarantees to support households and the economy.

In the wake of the crisis, the National Audit Office of Finland (National Audit Office of Finland, 2011^[7]) and IMF (International Monetary Fund, 2015^[8]) both recommended improvements to reporting and management of government risks and liabilities. These recommendations were endorsed by the Ministry of Finance, whose own analyses conducted in 2015 concluded that Finland's ability to withstand new economic shocks was materially lower than before and established new guidelines for monitoring the growth of government liabilities, including contingent liabilities. (Ministry of Finance of Finland, 2015^[9])

Overview of the fiscal risks management framework

Building on the existing budget system, the rationale for establishing a fiscal risks management framework in Finland was to increase transparency on fiscal risks, in particular the stock of guarantees and other off-budget liabilities and better inform fiscal policy decisions. To this purpose, a report called *Overview of Central Government Risks and Liabilities*, is published since 2016 and discloses consolidated information on central government's fiscal risks. The Ministry of Finance publishes this report on a voluntary basis. The main characteristics of the fiscal risks management framework in Finland are summarised in Table 2.1. below.

The Ministry of Finance is the key stakeholder in the framework and produces the *Overview of Central Government Risks and Liabilities*. To this purpose, the Ministry of Finance monitors and measures directly fiscal risks associated with macroeconomic factors, with tax flows and with a number of liabilities relative, for example, to the European Financial Stability Facility, to export-financing activities or State-owned enterprises.

The Ministry of Finance also relies on information provided by other ministries and agencies, which are required to report government guarantees and collaterals following guidance from the Ministry of Finance. This information is collected in a centralized management system (so-called KoTa) developed by the State Treasury (Ministry of Finance of Finland, 2016^[10]) on a monthly basis for housing-related guarantees and biannually for export-related guarantees and student loans.

As part of the budget preparation, information about state guarantees, warranties and off-budget assets shall be appended to the final accounts. Each ministry shall also submit to the Ministry of

Finance a description of the performance of its activities that includes “a review of the most important changes and risks in the operating environment of the sector” (Ministry of Finance of Finland, 1992^[11]). However, the information contained in this review is not used in the preparation of the *Overview of Central Government Risks and Liabilities*.

Following its 2011 report, the National Audit Office of Finland plays an important role in identifying potential improvements to the framework through its frequent recommendations. For example, the National Audit Office of Finland noted that each agency and ministry is in charge of measuring risks although “assessment requirements have not been clearly determined” (National Audit Office of Finland, 2018^[12]) at the central level. More generally, the National Audit Office underlined in 2018 challenges in reporting certain fiscal risks and integrating their analysis into fiscal policy decision-making. (National Audit Office of Finland, 2018^[12])

Table 2.1. Finland: Approach for fiscal risks management

<i>Fiscal forecasting and analysis of deviations</i>	The <i>Overview of Central Government Risks and Liabilities</i> discusses past deviations from the forecast of GDP, which is the primary factor underpinning the fiscal forecast.
<i>Risks identification</i>	Each entity within central government is responsible for identifying their risks, describing and monitoring them. Ministries and funds report government guarantees and collaterals in a centralized management system (so-called KoTa).
<i>Risks measurement</i>	Measurement of government guarantees is at nominal value. Other risks are not systematically measured.
<i>Disclosure</i>	The annual <i>General Government Fiscal Plan</i> includes a brief description of general risks associated with the fiscal forecast. The <i>Overview of Central Government Risks and Liabilities</i> , published on a voluntary basis, provides a more comprehensive view of fiscal risks threatening public finances.
<i>Prevention/Mitigation</i>	Each public entity is expected to prevent or mitigate its own risks. Concerning guarantees, the general rule is that fees (one-off and annual) should be charged to beneficiaries.
<i>Provision or reserve</i>	The budget contains an unallocated reserve for unforeseen events and a provision for new policies to be included in any supplementary budget.
<i>Fiscal policy</i>	Fiscal risks are not formally considered for setting fiscal targets. Current fiscal targets are a central government deficit of at -0.5% of GDP for 2023 and general government debt-to-GDP ratio below the 60% of GDP. (Ministry of Finance of Finland, 2019 ^[13]).

Source: Authors.

Definition and disclosure of fiscal risks

The classification of fiscal risks used in Finland is presented in Table 2.2. below. Within general risks, internal risks are defined as pressures unaccounted for in the forecasts “associated with the implementation of the Government Programme” and external risks are defined as risks associated with general economic development” (Ministry of Finance of Finland, 2019^[13]). Off-budget liabilities risks are associated with government policies that may generate additional spending when certain events happen, of which State guarantees or loans are a typical example (Ministry of Finance of Finland, 2020^[14]). Balance sheet risks are not formally defined but can be understood as risks that

the commercial value of government assets and liabilities may unexpectedly change (Ministry of Finance of Finland, 2020^[14]).

Table 2.2. Finland: Categories and nature of fiscal risks

Category	Nature of risk	Description
General risks	Internal risks	Pressures associated with the implementation of the Government programme (e.g., one-off expenditure)
	External risks	Pressures closely linked to general economic development (e.g., growth slower than expected)
Off-budget liabilities risks	Open contingent liabilities	Expenditure that the government is legally bound to make if a particular event occurs (e.g., government guarantee)
	Implicit contingent liabilities	Expenditure that the government may be socially or politically obliged to make if a particular event occurs (e.g., bailout of the banking sector and local government).
Balance sheet risks	Financial assets	Decrease of the valuation of central government financial assets (e.g., decrease of the equity value of State-owned enterprises)
	Financial liabilities	Increase of central government liabilities (e.g., pensions)

Source: Ministry of Finance of Finland, 2019^[7], Ministry of Finance of Finland, 2020^[8].

The *Overview of Central Government Risks and Liabilities* is the main source of information on fiscal risks, although information on general risks is also provide in the *General Government Fiscal Plan*. The report, first published in 2015, has been developed regularly, with in particular the inclusion of increasingly detailed information on financial assets and liabilities in successive reports and a stress test of public finances disclosed in the 2019 report. (Ministry of Finance of Finland, 2020^[14]).⁶

The *Overview of Central Government Risks and Liabilities* lists and analyses all categories of fiscal risks in a mostly qualitative way, however nominal value of government guarantees is provided in the report. The analysis of risks associated with balance sheet and off-budget liabilities is particularly developed. A notable feature of the report is an analysis of Government implicit liabilities, in relation to local government, State-owned enterprises, environmental damage and the banking sector (Ministry of Finance of Finland, 2020^[14]). Although implicit contingent liabilities

⁶ In 2015, the report only briefly analysed other risks than those arising from liabilities with dedicated chapters about risks associated with macroeconomic development and with the composition of government asset (real assets vs. financial assets). In 2016, an additional section appeared to describe broadly the risks affecting general government revenue, expense and balance sheet. The description of risks related to liabilities was further improved in the 2017 with a classification of liabilities as either “direct” or “contingent” to analyse the different kinds of risk incurred. Changes made to the 2018 report included more details about risks related to government assets and the addition of a new section about stress test scenario to analyse the impact of a potential shock on government finances. The structure of the 2019 report remained unchanged compared to 2018 but integrated the results of a balance sheet stress test.

relative to the banking sector are analysed in a general manner, more quantitative data is provided about municipal loan stock and municipal guarantees.

The comprehensive analysis of implicit liabilities is motivated primarily by the large size of the banking sector relative to the Finnish economy and by the rapid growth of local governments' loans and guarantees over the past ten years (Ministry of Finance of Finland, 2020^[14]). In case of a crisis, it is expected from the central Government to ensure the continuity of their operations even though no explicit legal obligation exists, which poses an implicit risk to central government finances.

In addition, a chapter within the *General Government Fiscal Plan* outlines the key findings of the *Overview of Central Government Risks and Liabilities* (Ministry of Finance of Finland, 2019^[13]).

Fiscal stress tests

For the first time, the 2018 *Overview of Central Government Risks and Liabilities* included a stress test of general government finances. The stress test quantifies the direct impacts on general government finances caused by weaker overall growth and several of its components such as reduced corporate tax and income tax revenue and higher expenditure linked to unemployment benefits. It also estimates the government exposure to expenditures related to contingent liabilities, especially to export and housing guarantees, and the sensitivity of the value of government financial and real assets.

In 2019, the stress test additionally measures the impact of the shock on the general government balance sheet, i.e., changes in value of government assets and evolution of the debt-to-GDP ratio, including due to the calling of government guarantees. It concluded that government debt and net debt would respectively reach in 2021 almost 70% and 20% of GDP consecutive to the shock, versus 58% and 11% in the baseline scenario (Ministry of Finance of Finland, 2020^[14]).

The stress tests realised in 2018 and 2019 were based on the scenario used by the European Banking Authority for the stress test of the banking sector. First, the impact on Finnish GDP is estimated using Ministry of Finance's forecasts as baseline and Ministry of Finance's estimates for several components of growth that were not explicitly mentioned in the European Banking Authority's scenario. The impacts of the shock on general government finances are then estimated by comparing the previous forecasts made by the Ministry of Finance with the results of the general government scenario model developed by the Ministry of Finance.

Nevertheless, the results of the stress test analysis have not yet triggered specific policy measures aiming at decreasing the exposure of public finances or limiting the volume of off-budget liabilities.

Key policies for prevention or mitigation of fiscal risks

In Finland, the fiscal risks management framework is primarily aimed at the identification and reporting of risks, as a mean for raising awareness of decision makers and there are no mandatory guidelines concerning strategies for the prevention and mitigation of fiscal risks. However, the 2019 *Overview of Central Government Risks and Liabilities* discusses certain prevention and mitigation actions or policies, e.g. in relation to interest rate risk associated with central government debt or credit risk arising from export-related guarantees.

Government guarantees and collaterals have been a particular concern of the Ministry of Finance. To improve the monitoring of the stock and flows, the Ministry developed a centralized management system (KoTa) to collect the information from ministries and government funds. The *Act on State Lending and State Guarantees* defines the default rules that apply to government

guarantees authorised by Parliament: the standard fee structure for guarantees comprises of a one-off fee of at least 0.25% of the capital and an annual fee of at least 0.5% of the capital.

However, guarantee fees can be waived by the Government for special reasons and the Ministry of Finance acknowledges that, in practice, “the Government has deemed special reasons to apply to almost all guarantees [...], effectively turning what was intended as an exception into a rule” (Ministry of Finance of Finland, 2018^[15]).

Concerning mitigation, to offset the impact of certain small risks materialising (e.g. calling of a guarantee), the yearly budget contains an unallocated reserve for unforeseen events and a provision for new policies to be included in any supplementary budget (Ministry of Finance of Finland, 2019^[13]). Their total amount represents approximately 0.8% of the yearly expenditure ceiling defined for 2020.

COVID-19 crisis

On 16 April, the General Government Fiscal Plan for 2021-2024 was released. Having invoked the exceptional circumstances clause set out in the EU's Stability and Growth Pact, the General Government Fiscal Plan only presented a medium-term projection for general government finances based on an independent forecast and did not include the Stability Programme usually provided to the European Commission at that time of the year.

The Government submitted three supplementary budget proposals to the Parliament, referring successively to prevention and preparation measures related to COVID-19, easing the financial situation of Finnish companies, fixed-term and targeted measures to combat the health and economic effects of COVID-19, etc. The Government also proposed a large State guarantees scheme, on which fees have been waived, as has been the case for some other guarantees schemes in the past.

Netherlands

Context

Since the 1990s, the Netherlands have used a budget framework based on multi-annual expenditure ceilings, whose basis is the current Government's independently costed pre-election programme. This system is generally considered an efficient tool for delivering national fiscal objectives that have traditionally aimed at keeping public debt at sustainable levels over the long term, in the context of an aging population and decreasing natural resources rent. Another important component of the framework is that all fiscal and budget plans are based on independent macroeconomic and fiscal forecasts (Vierke and Masselink, 2017^[16]).

In the wake of the 2008 financial crisis, the Dutch Government explored how to better shield the country's public finances against future shocks, beyond existing budgetary tools. The *Study Group on Fiscal Space* was commissioned to analyse the risks to Dutch public finances and published a report providing a number of recommendations for better handling these risks (Study Group on Fiscal Space 13th Report, 2010^[17]).⁷

The Dutch government responded with its own report in September 2011, *The government finances stress test: a risk analysis of Dutch public finances*. Following this initial work, the Dutch government set up a Risk Commission comprising representatives of the Ministry of Finance, line ministries and Central Bank to review all its existing loans, guarantees and financial sector support and provide proposals to limit a further increase in such contingent liabilities. The Risk Commission's work led to the adoption of a new framework that introduced a ceiling for the overall level of contingent liabilities, criteria for taking on new contingent liabilities and strengthened transparency requirements vis-à-vis the Parliament. (Hofmans and van den Coevering, 2014^[18]).

Overview of the fiscal risks management framework

As at today, the Dutch fiscal policy framework can be said to have three broad objectives: the sustainability of public finances, with sound fiscal and budgetary management, including after the 2013 reforms in relation to the EU-wide two and six packs; the effective use of tax money; and macroeconomic stabilization⁸. The main characteristics of the framework for managing fiscal risks are described in Table 3.2. below.

⁷ The Study Group on Fiscal Space was established in 1971 and is composed of senior civil servants from ministries, the independent fiscal council (*Netherlands Bureau for Economic Policy Analysis*, or CPB) and the Central Bank.

⁸ See the budgetary rules adopted by the current cabinet:

<https://www.rijksoverheid.nl/documenten/kamerstukken/2017/11/03/bijlage-1-bij-startnota-%E2%80%93-begrotingsregels-2018-2022>

Table 3.1. Netherlands: Approach for fiscal risks management

<i>Fiscal forecasting and analysis of deviations</i>	Fiscal forecasts are published twice a year in the <i>Central Economic Plan</i> and <i>Macro Economic Outlook</i> , along with two shorter and adjusted projections.
<i>Risks identification</i>	Fiscal risks identification is the responsibility of a range of actors responsible for identifying and monitoring risks that fall under their competency.
<i>Risks measurement</i>	Macroeconomic and financial risks are measured through alternative scenario analysis under unchanged policy and stress tests.
<i>Disclosure</i>	Information on fiscal risks is provided with the medium-term projections and the annual Budget (especially guarantee-related).
<i>Prevention/Mitigation</i>	The risk management policy for contingent liabilities includes a ceiling and preventing the government from taking on new contingent liabilities except in case of overriding reasons.
<i>Provision or reserve</i>	The Netherlands does not have provisions or reserves. Unforeseen expenditures shall be funded by the reallocation of existing resources.
<i>Fiscal policy</i>	Fiscal risks are not formally considered for setting fiscal targets. The government follows a trend-based fiscal policy, setting expenditure ceilings for the central government, social contributions and healthcare, and a revenue ceiling to control the total tax burden (OECD, 2019 ^[19]).

Source: Authors.

Stakeholders in fiscal risks management

The independent fiscal council, the *Netherlands Bureau for Economic Policy Analysis* (CPB), is responsible for producing independent macroeconomic and fiscal forecasting, before any general election and as part of the annual budget cycle.⁹ Alongside the fiscal forecast, the CPB identifies risks that could cause deviations, in relation to macroeconomic developments in particular.

A range of actors, such as ad hoc commissions and permanent independent organisations, are responsible for identifying and managing specific fiscal risks on which they are competent. For example, the Netherlands Environmental Assessment Agency (PBL) evaluates environmental and spatial policies and identify connected risks. Financial sector risks are identified and managed through supervision by the Dutch Authority for the Financial Market (AFM).

The Ministry of Finance monitors a number of specific risks. For example, the Dutch State Treasury Agency is responsible for debt management and funding, in particular for risks related to interest rate, credit, liquidity and foreign exchange. The Ministry of Finance is also in charge of producing a consolidated statement of government contingent liabilities (direct and indirect guarantees), which is published yearly alongside the budget.

⁹ The CPB has a more comprehensive role than comparable institutions in other OECD countries. This includes e.g. providing the official estimates on economic growth and purchasing power, analysis of the sustainability of Dutch public finance, costs-benefit analysis of major infrastructure projects, analysis of the economic effects of the election plans of Dutch political parties and all kinds of analyses on the Dutch economy and the role of the government.

Definition and disclosure of fiscal risks

The *Study Group on Fiscal Space*'s report provides a detailed taxonomy of fiscal risks threatening Dutch public finances, including in case of a severe shock to the economy such as a large natural disaster or terrorist attack (Table 3.1.). The report identifies a number of key characteristics for individual risks: each risk can be explicit or implicit and conditional or unconditional, as shown in Table 3.1. below. The report makes the point that fiscal risks shall be managed using different tools depending on these characteristics.

Table 3.2. Netherlands: Taxonomy of fiscal risks

	Unconditional (costs are incurred but size is uncertain)	Conditional (cost are incurred only if uncertain event occurs)
Explicit risk (ex ante obligation)	Automatic stabilisers (tax revenue, unemployment benefits) Interest rate risk Excess costs (infrastructure) investment projects Technical and legal fiscal risks Mortgage interest risk (via mortgage deduction)	Financial sector: public guarantees, public backing of private guarantees Public costs of infrastructure to counter natural disasters and terrorist attacks
Implicit risk (no ex ante obligation, but high chance that risks will still be born by government ex post)	Old age pensions Care (health and long term) Climate mitigation	Financial sector: rescue of firms and institutional units which are "too big to fail" Medical emergency measures (including pandemics) Agrarian emergency measures (animal diseases) Private costs of natural disasters and terrorist attacks

Source: Study Group on Fiscal Space 13th Report, *Risks and certainties* (2010).

The CPB discusses potential risks to its short-term (published biannually), medium-term (covering the next four years and published biennially) and long-term projections (in *Ageing Reports* covering the next 40 years and published every four years) in the relevant reports. The risks identified range from international economic and political developments (such as trade conflicts, the consequences of Brexit and the current coronavirus crisis) to domestic sources (i.e. the housing and labour market and the pension sector). The CPB also publishes an annual report outlining the risks in relation to financial sector (CPB, 2019^[20]).

The Budget Memorandum, presented on the Budget Day in September to the House of Representatives along with the national budget and the tax plan, describes the financial and economic situation of the Netherlands, explaining the plans of the cabinet for the coming year and the associated spending plans. The Budget Memorandum contains an annex (Annex 12 in the 2020 Budget) that provides a list and short analysis of the Government's contingent liabilities – i.e., the Government direct guarantee schemes and indirect ones. Indirect guarantee schemes are those provided by public entities that the Government could be obliged to take over (Central Government website, 2019^[21]). In 2019, the Government deepened its analysis of explicit and implicit contingent liabilities using the guidance and methodology of the IMF.

Fiscal stress tests

The CPB conducted risk analyses in 2011 and 2015. A number of economic scenarios were identified and the effects on the Dutch economy and public finances were examined. The Dutch government responded to the Study Group on Fiscal Space with its own report in September 2011, *The government finances stress test: a risk analysis of Dutch public finances*. The report discusses risks emanating directly from developments in the economy as well as risks resulting from guarantees and other government interventions in the event of a crisis. The report also analyses a number of scenarios of major shocks (a financial crisis, a European debt crisis and a global economic crisis) and correlations between risks, and emphasised the need to better prevent these risks going forward as such shocks would lead to a substantial deterioration of Dutch public finances (Ministry of Finance, 2011^[22]).

Additional fiscal stress tests were conducted recently by the Ministry of Finance, including measuring implicit contingent liabilities of the government and published in the Budget Memorandum 2019¹⁰. Fluctuations in economic growth and interest rate were at the centre of those analyses and fiscal stress tests. In addition, the 2020 Stability Programme included sensitivity analyses with respect to growth and interest rates.

Key policies for prevention or mitigation of fiscal risks

From 2015, the Government has adopted a new policy for loans, financial interventions, guarantees and other contingent liabilities (Hofmans and van den Coevering, 2014^[18]). In compliance with so-called 'no, unless' policy, the government does not take on new contingent liabilities (including indirect guarantees, loans and participation to financial interventions) unless there is an overriding reason to do so. In addition, a sunset clause obliges the government to assess policies involving contingent liabilities five years after the start of their implementation. A ceiling sets annually a maximum level for contingent liabilities, in particular guarantees. Finally, an external opinion on the level of the premium to be charged to beneficiaries of government guarantees is requested in case of large and complex risks.

Prevention and mitigation strategies exist for other fiscal risks. Natural disasters risks, for example, are an area of focus in the Netherlands, as the country is particularly exposed to flooding. Accordingly, the Delta programme was developed to protect the Netherlands against flooding. It is presented every year by the Delta Programme Commissioner and is financed by the Delta Fund, a separate item on the central government budget which provides resources for flood protection in the future and for ensuring freshwater supply. In 2015, the Netherlands adopted a risk-based approach for the flood risk management policy: protection levels are based on the probability and impact of flooding. The focus is thus on prevention, rather than insurance. Importantly, in 2018 the Water Crises Control in Security Regions (WAVE2020) programme was launched, with the aim to set a new contingency plan to control the impact of a flood disaster (Delta Programme Commissioner website, 2019^[23]).

Concerning those fiscal risks that cannot be prevented or accommodated, the policy, as shown in Table 3.2, is to fund additional spending by a reallocation of resources across budget lines or budget chapters. Large shocks to the economy are accommodated by running a prudent fiscal

¹⁰ See Appendices Budget Memorandum 2019, pages 387 to 393:
<https://www.rijksoverheid.nl/documenten/begrotingen/2018/09/18/bijlagen-miljoenennota-2019>

policy that, by declining public debt, is expected to provide sizeable fiscal space to be used by decision-makers in times of stress for the economy (Ministry of Finance, 2013^[24]).

COVID-19 crisis

The government decided on 17 March 2020 a package of emergency measures to deal with the economic consequences of the corona virus. In the weeks that followed, various additional emergency measures were decided upon. Given the exceptional situation, in addition to reallocations of resources across budget chapters, the government decided to adjust the expenditure ceiling of EUR 20 billion to allow for the extra expenditure (specifically, the “regular” expenditure ceiling will not apply to the expenditures from the emergency package). Emergency measures will also generate less income from taxes and contributions in the short term (deferral of taxes).

Guarantees have been granted as part of the economic support measures and stocks of government guarantees will consequently increase sharply. Ceilings of existing national government guarantee schemes have been increased as part of the COVID-19 crisis response, but no new schemes have been approved. The channelling of new government interventions in existing schemes has allowed maintaining usual processes and safeguards. The principle of ‘no, unless’ remains in place, although its implementation has shifted from correcting market failure to providing direct support to the economy. Where previously most guarantees were ex ante budget-neutral because of the risk premium, most crisis-related guarantees have estimated budgetary costs, which are submitted to Parliament in supplementary budgets.

The CPB has made public on March 26, 2020 a study with four scenarios outlining the possible impact of the COVID-19 pandemic on the economy and fiscal position in 2020/2021 according to the length and scope of disruption to normal economic activity, taking into account the support measures already announced by the government.

New Zealand

Context

In the late 1980s, New Zealand adopted the *Public Finance Act* (New Zealand Treasury, 1989^[25]), the core legislative framework within which New Zealand’s Government can borrow or spend public money. In 1994, the *Fiscal Responsibility Act* (New Zealand Government, 1994^[26]) clarified some of the principles of the *Public Finance Act*, as well as strengthened disclosure requirements in order to increase the transparency and scrutiny of the budget process. The two laws were merged in 2004, to form the current version of the *Public Finance Act* (New Zealand Treasury, 2020^[27]).

The *Public Finance Act*’s objectives include providing long-term focus to budgeting; facilitating parliamentary scrutiny of economic and fiscal plans; and increasing transparency. The latter shall be achieved mainly by disclosing intentions and objectives of the Government concerning fiscal policy and producing regular economic and fiscal updates against the stated intentions and objectives.

The *Public Finance Act* also lays out the principles of “responsible fiscal management”. They comprise reducing and maintaining debt at “prudent levels”; achieving positive net worth for government; ensuring predictability and stability in tax rates and the prudent management of fiscal risks facing the Government (New Zealand Treasury, 2020^[27]). The Government can depart from these principles, but has to provide detailed explanations to Parliament in such cases.

Overview of the fiscal risks management framework

Legislation requires that fiscal risks facing the Crown be both managed “prudently” and “disclosed to the fullest extent possible” (New Zealand Treasury, 2020^[27]). To achieve these objectives, New Zealand has established a comprehensive and detailed framework (Table 4.1.), including guidelines for preventing and mitigating fiscal risks. For those risks that cannot be prevented or mitigated, the Government’s approach consists in maintaining debt at prudent levels and holding a healthy level of net worth, to increase the Crown’s resilience to shocks (New Zealand Government, 2018^[28]).

Table 4.1. New Zealand: Approach for fiscal risks management

<i>Fiscal forecasting and analysis of deviations</i>	The <i>Economic and Fiscal Updates</i> contain economic and fiscal forecasts. The analysis of deviations is performed in a separate report as part of the <i>Analysis of the Treasury’s Macroeconomic and Tax Forecast Accuracy</i> .
<i>Risks identification</i>	The Treasury relies on four main avenues for fiscal risks identification: its own fiscal risks monitoring system, the review of previous risks, consultations with agencies and review of the minutes for budget negotiations.

<i>Risks measurement</i>	Each agency measures its specific fiscal risks under the Treasury's guidance and monitoring. The Treasury measures general and balance sheet risks.
<i>Disclosure</i>	The biannual and pre-election <i>Economic and Fiscal Updates</i> disclose general, specific and balance sheet fiscal risks.
<i>Prevention/Mitigation</i>	Each Department prevents and mitigates specific fiscal risks through re-prioritisation of funds, budget allowances or policy choices. The Debt Management Office manages risks to the government's overall balance sheet.
<i>Provision or reserve</i>	The Between-Budget Contingency provides for urgent funding. Contingencies at the level of Departments can also be used to finance known cost pressures whose amount are subject to uncertainty at the time of the finalisation of the budget. In addition, New Zealand has two long-term reserve funds: the Natural Disaster Fund and Superannuation Fund that aims at mitigating the long-term effect of ageing population.
<i>Fiscal policy</i>	New Zealand does not have legislated numerical fiscal rules but the Government is legally required to state its fiscal strategy. Results of fiscal stress tests were formally considered to determine the country's most recent fiscal target.

Source: Authors.

Stakeholders in fiscal risks management

Reporting entities participating in fiscal forecasting include Departments (such as ministries or customs service), Offices of Parliament (such as the Controller and Auditor-General), the New Zealand Superannuation Fund, the Reserve Bank of New Zealand, State-owned enterprises (that report quarterly to shareholding ministries), and other Crown entities (such as the Accident Compensation Corporation) (New Zealand Treasury, 2019^[29]). These reporting entities are responsible for identifying their specific fiscal risks, as well as managing prudently as required by legislation.

The Treasury centralises information on specific fiscal risks and their management by reporting entity. These fiscal risks are reported by all entities within central government on a monthly basis in the IFMIS operated by the Treasury. In addition, the Treasury identifies measures and manages certain specific risks, such as those coming from State-owned enterprises, and general risks stemming from Government's decisions, or macroeconomic circumstances. A specific unit within the Treasury, the Debt Management Office, is in charge of aggregating information on assets and liabilities across the Government and manages risks to the government's overall balance sheet.

Definition and disclosure of fiscal risks

Legislation defines fiscal risks as "all government decisions and other circumstances known to the Government that may have a material effect on the fiscal outlook, but that are not certain enough in timing or amount to include in the fiscal forecasts" (New Zealand Treasury, 2019^[29]). This definition includes risks that are subject to written reports to responsible ministers as well as decisions that have been deferred (New Zealand Treasury, 2004^[30]). Treasury guidance further specifies the disclosure requirements for fiscal risks as opposed to the inclusion of the fiscal impacts of decisions in agencies' forecasts (New Zealand Treasury, 2018^[31]).

The Treasury further classifies fiscal risks into three broad categories and types (Table 4.2.):

- So-called “specific fiscal risks”, which are risks in relation to Government decisions falling under the portfolio of activities of individual ministries and agencies;
- Balance sheet risks, which are risks affecting the Crown’s financial position through changes in the value of its assets or liabilities; and
- General risks, which are global risks to the economy or public finances.

Table 4.2. New Zealand: Categories and nature of fiscal risks

Category	Type	Description
Specific fiscal risks	Policy changes	Potential decisions likely to be taken by the Government related to both new policy and existing policy settings.
	Cost pressures associated with existing policies and risk of cost variances	Changes in demand or pricing that impact the cost of delivering services under existing policy settings.
	Contingent liabilities and assets	Potential costs or income that depend on whether particular events occur.
Balance sheet risks	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 (e.g., cost to rebuild infrastructure).
	Indirect fiscal costs	Changes to future government revenue and expenses consecutive to the economic impact of a shock.
General risks	Deviation from key assumptions and judgements	Any deviations from the key assumptions and judgements used for the economic and fiscal forecasts that have flow-on impacts for the fiscal forecasts.
	Other uncertain events	Significant events relating to changes in the external environment (e.g., natural disasters, international events).

Source: New Zealand Treasury, 2019^[5].

Fiscal risks are discussed alongside the economic and fiscal forecasts in the *Economic and Fiscal Updates*. Disclosures provide information about risks on a greater frequency than the annual budget because they are released biannually and ahead elections as the *Budget Economic and Fiscal Update*, the *Half Year Economic and Fiscal Update* and the *Pre-Election Economic and Fiscal Update*.

General and balance sheet fiscal risks are described in the chapter on *Risks and Scenarios*, which also comprises the description of uncertainties for the economic and fiscal outlooks, as well as the alternative scenarios for the economic outlook. General risks, which are measured and can be presented in graphs, include changes to economic assumptions (implied by major adjustments in international financial markets, weaker trading partners’ growth, migration, etc.), natural disasters, biosecurity threats or volatility of Government’s investments given the business environment. Balance sheet risks include risks in relation to financial assets and liabilities, including debt, and are described in a qualitative manner. (New Zealand Treasury, 2019^[29])

A full separate chapter is dedicated to *Specific Fiscal Risks* in the *Economic and Fiscal Updates*. Disclosure of specific risks is required only above a materiality thresholds of NZD 100 million. Specific fiscal risks are presented by ministerial portfolio. They are classified by nature and their status compared to the previous *Economic and Fiscal Update* is specified (unchanged, changed or new). Their impact on revenue, expenses or capital expenditures is briefly described and quantitatively assessed when possible.

As for the contingent liabilities and assets, which are among specific fiscal risks, they are further categorised as quantifiable or unquantifiable. Contingent liabilities considered to be remote (less than 10% chance of occurring) are excluded from the reporting. Moreover, only contingencies involving amounts of over 100 million NZD are separately disclosed and detailed, the rest being aggregated in the “other” category (Table 4.3.).

Table 4.3. New Zealand: Contingent liabilities categories

Category of contingent liabilities	Type
Quantifiable	Uncalled capital
	Guarantees and indemnities
	Legal proceedings and disputes
	Other
Unquantifiable	Indemnities
	Legal claims and proceedings
	Other

Source: New Zealand Treasury.

Fiscal stress tests

Balance sheet risks are further analysed with stress test scenarios in the *Investment Statement*, published by the Treasury at least every 4 years (New Zealand Treasury, 2018^[32]). It aims at testing medium-term fiscal resilience of the Government balance sheet by accounting for the impact on net debt of the Government, the potential change of value of Government assets and liabilities, as well as for direct and indirect fiscal costs such as direct cost to rebuild infrastructure or changes of future government revenue.

Three separate scenarios were analysed in 2018: a severe Wellington earthquake, an agricultural disease outbreak and an international economic downturn. These scenarios were selected to cover a broad range of shocks that could affect New Zealand over the medium term and were drawn from risk registers prepared to support public risk management and planning processes. (New Zealand Treasury, 2018^[32]).

Finally, research realised for preparing this paper included looking at whether countries studied had identified pandemic as one of their fiscal risks and put in place prevention or mitigation strategies. That is the case in New Zealand: in 2006, in the context of the H5N1 epidemic, the Treasury of New Zealand published a paper modelling the potential economic impact of a severe pandemic in New Zealand and discussing consequences in relation to the public debt target and role of prevention policies (New Zealand Treasury, 2006^[33]).

This paper was followed by other reports in 2009 related to the H1N1 epidemic that discussed the impact on budget forecasts and the Treasury preparedness (New Zealand Treasury, 2009^[34]) (New Zealand Treasury, 2009^[35]). In 2011, the Treasury of New Zealand listed pandemics and health

emergencies as one of the major economic shocks that have the potential to disrupt government finances (New Zealand Treasury, 2011^[36]).

Key policies for prevention or mitigation of fiscal risks

As noted above, each entity within central government is expected to monitor and prevent, where possible, fiscal risks from crystallising. An example of such policies is the State-Owned Enterprises Continuous Disclosure Rules, which obliges SOEs to continuously report on any matter that may affect their commercial value (New Zealand Treasury, 2015^[37]).

Further, the *Budget Economic and Fiscal Update* (New Zealand Treasury, 2019^[29]) details three different options for each Ministry to manage their risks: re-prioritisation of funds; using budget allowances for new expenditures included in the budget and multi-year framework; and policy choices that will allow modulating the amount and timing of funding.

For residual risks, the strategy stated in the *Economic and Fiscal Update* is to maintain net debt at prudent levels and hold a healthy level of net worth. What constitutes a prudent level of net debt is determined based on a framework which determines the ‘upper limit of debt’ and the additional a buffer needed for a ‘prudent level of debt’. (Fall, F., et al., 2015^[38])

Results of fiscal stress tests were formally considered to determine the country’s most recent fiscal target (New Zealand Government, 2019^[39]).¹¹ Specifically, under the three stress tests scenarios done in 2018, the Treasury estimated that net debt would rise by between 5 and 15 percent of GDP in case of a crisis and would go as high as 20 percent in case of a major shock. These estimates 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” (New Zealand Treasury, 2019^[40]).

The Treasury further notes that “a strong balance sheet helps by absorbing the impact from risks so that the wider economy does not need to adjust immediately, at a greater economic cost. A strong balance sheet also provides the Government with fiscal space and choices about how it can respond to shocks” (New Zealand Treasury, 2019^[29]) During the most recent shocks faced by the country, the balance sheet was used as part of the fiscal policy response - e.g., the Natural Disaster Fund was drawn on and contributions to the Super Fund suspended. (New Zealand Treasury, 2019^[40])

COVID-19 crisis

Besides Budget legislation, Imprest Supply Act 2020 (passed on 25 March), which authorised the Government to spend up to NZD 52 billion and Section 25 of the Public Finance Act 1989 (permanent legislative authority for emergencies) have provided the Government with Parliamentary authority to incur

¹¹ The last stress test realised in 2018 concludes that “the stress testing presented in this Statement be broadly tolerant to large but plausible adverse shocks, in the form of a major earthquake, a widespread agricultural disease outbreak, or an international economic downturn”. (New Zealand Treasury, 2018^[32])

COVID-19-related expenditure.^{12,13} Consequently, expenses relating to COVID-19 have been classified into three categories and handled accordingly:

- Reprioritisation of Baselines – If the expenditure could be met from existing baselines, approval was granted by Joint Ministers or the Cabinet.
- Expenses incurred in emergencies – When section 25 of the Public Finance Act was invoked (subject to certain criteria), the Minister of Finance approved expenses to meet this emergency.
- Expenses approved by Cabinet – If approval is required to incur expenses but it is not within scope of Section 25 of the Public Finance Act, Cabinet approval was required.

¹² Imprest Supply is an approval from Parliament to incur expenditure in advance of a subsequent appropriation, when the Executive will make full details of the spending available for Parliament's scrutiny. Cabinet, or in some specified cases, joint Ministers, must approve expenditure that is to be incurred under Imprest Supply. The process for doing so is set out in the Cabinet Office Circular - Proposals with Financial Implications and Financial Authorities.

¹³ Separate from the imprest supply authority, the Minister of Finance may approve expenditure to meet an emergency or disaster, whether or not there is any other authority available for the purpose, under section 25 of the Public Finance Act 1989. A state of national emergency was declared on 25 March and, on 27 March, the Government exercised its ability to use section 25. Although Parliament does not specify the amount or type of expenditure that can be incurred under this provision, it may be used only to meet the emergency. Given the nature of this authority, the Treasury (and the Audit Office) expect it to be used only as a last resort for emergency expenditure needed immediately (that is, when government departments cannot wait for Cabinet approval to use imprest supply).

United Kingdom

Context

The UK's current framework for fiscal policy and budgeting comes from the *Budget Responsibility and National Audit Act*, adopted in 2008 in the wake of the financial crisis. This Act was an effort to increase the credibility of the government's fiscal forecasts and clarity of its fiscal targets. It provides for the Government to publish a *Charter for Budget Responsibility* explaining its "formulation and implementation of fiscal policy and policy for the management of the national debt." The act also sets up an independent fiscal council, the OBR, to prepare economic and fiscal forecasts underlying the Government budget and assess whether its fiscal objectives are being met.¹⁴ In 2016, following an assessment of the UK's fiscal transparency practices (IMF, 2016^[41]) noting that reporting on fiscal risks was incomplete and fragmented, the Charter for Budget Responsibility was updated to task the OBR 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". Interestingly, the Charter specified that the government would "formally respond to this report" within a year (HM Treasury, 2017^[42]). The OBR also produces a Fiscal Sustainability Report, in which it analyses the fiscal consequences of both past and future government activity, setting out long-term projections for spending, revenues and financial transactions and assessing their implications for public debt. The Fiscal Risk Report and the Fiscal Sustainability Report are published in alternating years.

Overview of the fiscal risks management framework

Within the broad requirements of the Budget Responsibility and National Audit Act and Charter for Budget Responsibility, the framework for fiscal risks management in the United Kingdom has been designed in collaborative manner by the OBR and the Treasury over the last years, including by conducting consultations with experts and international institutions.¹⁵ The main characteristics of the fiscal risks management framework are summarised in Table 5.1. below.

¹⁴ The 2011 Budget Responsibility and National Audit Act specifies that "the Treasury may from time to time modify the Charter (...). When the Charter is modified the Treasury must lay the modified Charter before Parliament."

¹⁵ The OBR published in 2016 a discussion paper entitled "*What should our Fiscal Risks report cover?*" that sought answers on a number of key questions in relation to existing and good practices on fiscal risks definition, classification, etc. Before publishing its own first response to the OBR's report, the Treasury conveyed roundtables of experts, including from national fiscal institutes, the IMF and OECD.

Table 5.1. United Kingdom: Approach for fiscal risks management

<i>Fiscal forecasting and analysis of deviations</i>	The OBR produces fiscal and economic forecasts twice a year in its <i>Economic and Fiscal Outlooks</i> , which are used as official forecasts, while long-term projections are published in the <i>Fiscal Sustainability Report</i> . The OBR assesses its own forecasting performance in an annual <i>Forecast Evaluation Report</i> , in which it compares past forecasts against outturn data, explaining any deviations and errors.
<i>Risks identification</i>	A Fiscal Risks Group within the Treasury was created in the mid-2000s, to identify and assess risks related to government's fiscal objectives. The Treasury coordinates its work with the other bodies competent for sector-specific risks (see below).
<i>Risks measurement</i>	The OBR assesses the likelihood of the risk and its potential impact on both stock and flow measures of the public finances, focusing particularly on macroeconomic risks (emanating from either cyclical or structural changes in the economy) and specific risks (stemming from particular sources such as government guarantees).
<i>Disclosure</i>	Fiscal risks are mainly and comprehensively disclosed in the OBR's <i>Fiscal Risk Report</i> . Some risks to medium-term forecasts are mentioned also in the <i>Economic and Fiscal Outlooks</i> and sensitivity analysis on long-term projections are presented in the <i>Fiscal Sustainability Report</i> .
<i>Prevention/Mitigation</i>	The government's strategy to manage fiscal risks follows five steps: (i) identify the source, scale and likelihood of the risk; (ii) disclose the risk; (iii) mitigate the risk; (iv) provision for risks that cannot be mitigated but with relatively certain size and timing; and (v) accommodate residual risks (HM Treasury, 2018 ^[43]).
<i>Provision or reserve</i>	The budget contains a <i>Contingencies Funds</i> (2% of the previous year budget) and a reserve to deal with unforeseen expenditure and future costs exceeding the so-called departmental expenditure limits (0,5% of Departmental Expenditure Limits).. On certain occasions, a so-called special reserve was created (e.g., military operations in Afghanistan or the 2013-14 winter floods).
<i>Fiscal policy</i>	Fiscal risks are not formally considered for setting fiscal targets. At Spring Budget 2020 it was announced that the Treasury will review the fiscal framework to ensure it remains appropriate for the macroeconomic context, while ensuring the sustainability of the public finances (HM Treasury, 2020 ^[44]).

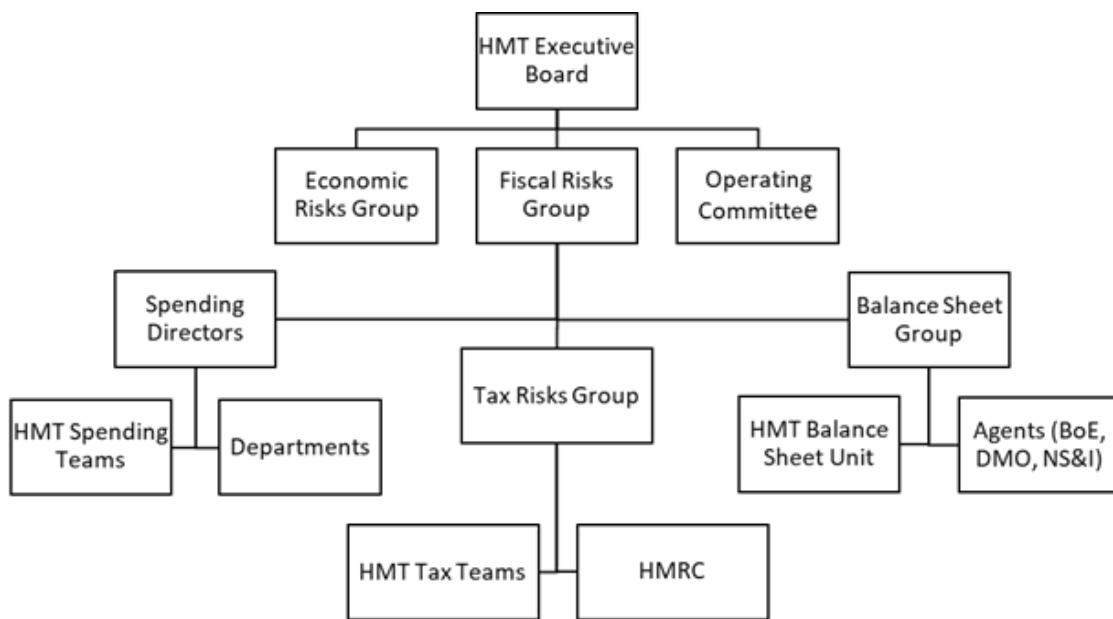
Source: Authors.

Stakeholders in fiscal risks management

The OBR is responsible for producing a fiscal risks report at least once every two years, which identifies and measures fiscal risks in an objective, transparent and impartial way. The Treasury is responsible for the management of fiscal risks, although the identification, and disclosure of certain specific may fall under its responsibility if required by law. The working relationship among the OBR, Treasury and other bodies involved in fiscal risks management is stated in a Memorandum of Understanding, which clarifies each institution's responsibility, the coordination of the forecast process and information sharing (OBR, 2017^[45]). A Fiscal Risk Liaison Group, chaired by the OBR and comprising Treasury representatives, sets the timetable for the departments' contributions on which the OBR's Fiscal Risks Report is based.

Within the Treasury, three sub-committees supervised by the Treasury's Executive Management Board identify and analyse specifically economic, fiscal and operational risks (Figure 5.1.). In particular, the Fiscal Risk Group coordinates the work on the identification of fiscal risks; assesses their likelihood and potential impact; and proposes mitigation strategies. The Fiscal Risk Group meets once a month to collect the analysis of separate Treasury's risk management groups on sector-specific risks, and then reports to the Executive Management Board with quarterly reports. It is to be noted that, in 2016, a Balance Sheet Group was established to report to the Fiscal Risk Group on risks to the government's holding of assets and liabilities.

Figure 5.1. United Kingdom: Institutional responsibilities for fiscal risks management organisation



Source: HM Treasury, 2018^[4].

Responsibility for the identification and management of specific risks lies with relevant departments or agencies, which are expected to do “active surveillance of fiscal risks” and report to the Treasury (HM Treasury, 2018^[43]).¹⁶ Fiscal risks surveillance should be done as part of the management of operational risks, for which guidance is provided in the Government’s *Orange Book*¹⁷.

¹⁶ For example, risks around infrastructure and major projects are addressed and monitored by the recently established Infrastructure and Projects Authority. The Ministry for Housing, Communities and Local Government follows a framework to manage risks associated with its financial portfolio, in particular the credit risks associated to loan, guarantee and equity products. The Debt Management Office analyses risks in relation to interest rate, refinancing, inflation, liquidity and executive risks.

¹⁷ The *Orange Book* was last updated and published in February 2020 (<https://www.gov.uk/government/publications/orange-book>).

The National Audit Office (NAO) also plays a role in assessing risks faced by departments, making recommendations on how to improve the use of public money through value-for-money assessments presented to Parliament. In 2016, the NAO published a report examining provisions, contingent liabilities and guarantees in the Whole of Government Accounts, shedding light on the risks and benefits to the public finances and discussing the management strategy concerning assets and liabilities adopted by the government (National Audit Office, 2016^[46]).

Definition and disclosure of fiscal risks

Fiscal risks are defined as “a potential deviation from the 5-year-ahead central forecasts for public sector spending, receipts, borrowing and debt contained in the Economic and Fiscal Outlooks and from the corresponding 50-year-ahead projections in the Fiscal Sustainability Report” (OBR, 2017^[47]). The OBR also considers the fiscal risks arising from pressures on spending (such as ageing and health costs) which may have an impact on fiscal sustainability, independently of whether they are recognised in the forecasts.

The OBR’s Fiscal Risks Report represents the most comprehensive disclosure effort on fiscal risks within OECD countries: the two reports published in 2017 and 2019 identify around 60 fiscal risks for the UK’s public finances over the medium to long term, measure them with few exceptions, and present them in a broad categories as follows: macroeconomic and financial sector, revenue and spending, balance sheet and debt interest. The reports go further by classifying the risks in a detailed matrix by size (low, medium or high impact) and likelihood (from very low to very high probability of crystallisation). The report includes several visualisations providing contextual information and facilitating the understanding of the scale and evolution of key fiscal risks.

The most recent Fiscal Risks Report includes new sections on fiscal risks stemming from the shadow banking system, the setting of fiscal policy and climate change. In trying to assess and quantify climate-related fiscal risks, the OBR used the framework developed by the Bank of England, which started to evaluate climate-related risks to financial stability in 2015. Climate-related fiscal risks include, amongst others, spending increases for climate change adaptation and mitigation strategies and legal challenges generating future costs.

The level of disclosure on fiscal risks management in the UK is unique in that HM Treasury is required to formally respond to the fiscal risks report produced by the OBR within a year. By HM Treasury’s own words, the report “provides 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”.

The last report published in 2018, called *Managing fiscal risks*, outlines the government’s frameworks for managing fiscal risks (further described below), describes the actions that government is taking to manage individual risks and outlines further actions the government is taking to strengthen its framework. A complete fiscal risk register with the corresponding responsible department is also included. The report does not discuss the appropriateness of the fiscal policy course and objectives in light of fiscal risks identified by the OBR (HM Treasury, 2018^[43]).

Fiscal stress tests

The OBR’s Fiscal Risks Reports include chapters showing the effects of a stress test, based on a bespoke stress scenario in each report: a synchronised global and domestic economic and financial shock in 2017 and a no-deal Brexit scenario in 2019. Stress tests are based on

macroeconomic scenarios prepared by other independent international and national institutions such as the Bank of England (for the 2017 macroeconomic shock stress test) and IMF (for the No Deal Brexit stress test in 2019). Impacts of the shock scenarios are assessed for the following fiscal aggregates: public sector receipts, expenditures, net borrowing and net debt.

Key policies for prevention and mitigation of fiscal risks

Traditionally, the budget comprises a Contingencies Fund regulated by the Miscellaneous Financial Provisions Act 1946 and held by the Treasury. It may be used for emergencies or expenditures that were not included in the budget. The Contingencies Fund Act 1974 sets the size of the fund as two percent of the amount of the government budget in the preceding year.

Beyond this Contingencies Fund, the government's strategy to manage fiscal risks follows five steps, as follows:

- “Identify the source of risk, the scale of fiscal exposure, and the likelihood of crystallisation. (...);
- Disclose the fiscal risk to Parliament and the public to raise awareness and ensure accountability for management of potential threats to public funds. (...);
- Mitigate fiscal risks where this can be done cost-effectively and without detracting from wider policy objectives. Risk mitigation tools can include discouraging risky behaviour (e.g. through financial regulation), encouraging actors to pool risk (e.g. through institutions like the Pension Protection Fund), or placing limits on the extent of government exposure (e.g. through limits on the issuance of export guarantees);
- Provision for risks that cannot be mitigated but whose size and timing is relatively certain. (...);
- Accommodate those risks whose size or timing is too uncertain to explicitly provision for in advance. (...)” (HM Treasury, 2018_[43]).

Since the publication of the first Fiscal Risks Report, the Government considers that it has enhanced its capacity to monitor and manage fiscal risks, including more transparent reporting on the balance sheet and better management of contingent liabilities with a new approval regime for contingent liabilities. For example, in March 2020, the Treasury published a report in which it outlines how the government, acting as insurer of last resort, manages contingent liabilities with the objective to reduce the associated risk and how it can improve this role. The four typologies of contingent liabilities identified are financial guarantees, explicit government insurance, legal cases and purchaser protections. The first two categories are covered by the government's insurer of last resort function (HM Treasury, 2020_[48]). In April 2020, the Treasury has updated and published the Green Book, which provides guidance on how to appraise and evaluate policies, projects and programmes.

Other key risk management reforms included a new financial oversight framework for the Bank of England and a comprehensive bank resolution regime. In 2017, the Treasury launched the Balance Sheet Review to assess government's management of assets and liabilities and identify opportunities to reduce balance sheet risks. The government also decided to end PFI schemes and the sale of student loans, and took steps to lower the costs of clinical negligence in the NHS, tackle tax avoidance, evasion and non-compliance and reduce the issuance of inflation-linked government debt (HM Treasury, 2018_[43]).

COVID-19 crisis

The Contingencies Fund Act 2020 allowed the Contingencies Fund to be topped up with a further 48% of 2019-20 spending so that UK Government could make immediate payments from it. The government's proposal for the Finance Bill 2019-21 includes an increase in public spending and a £12bn emergency fiscal stimulus to counter the shock of the COVID-19 pandemic and is currently progressing through the House of Commons.

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