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

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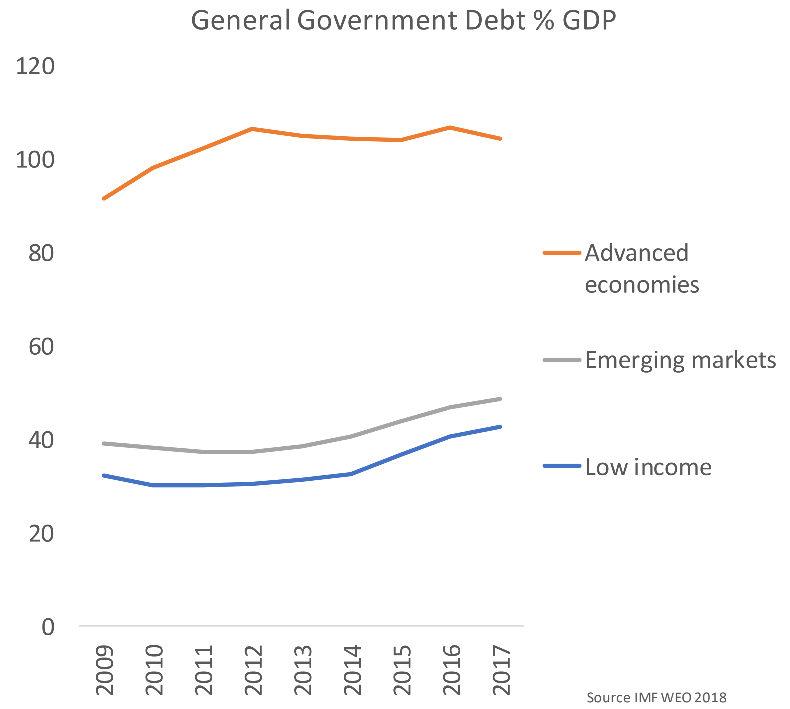
Outline

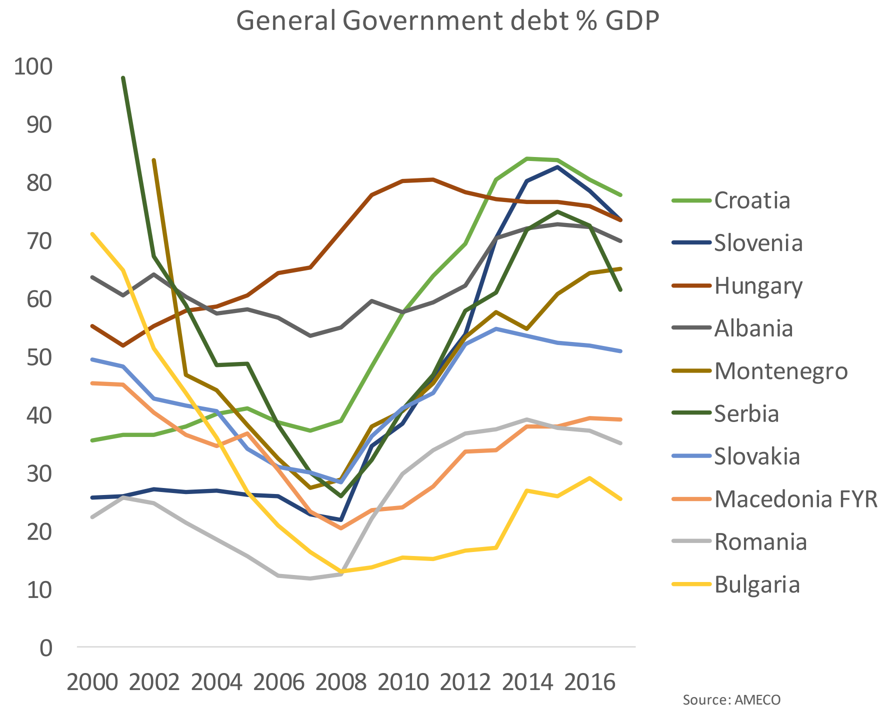
1. Financial crisis and sources of risk
2. Fiscal risk and integration in fiscal framework
3. Medium Term Fiscal Framework and Medium-Term Budgetary Framework
4. Managing risk in a MTFF and MTBF
5. Preconditions for an effective risk management framework
6. Incorporating fiscal risk in medium-term policy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

Global Financial Crisis and Risks Considerations

1. Poor understanding of government‘s fiscal risk exposures
2. Poor understanding of their underlying fiscal position
3. Strengthening of fiscal frameworks and rethinking the role of fiscal policy
4. Need to further integrate risk dimension in fiscal framework (analysis, management, reporting, coordination within government and other players)

Sizable increase in debt since 2008





Drivers

- The collapse in revenues caused by the Great Recession IMF (2013)
- Fiscal stimulus accounted for about 17 percent up in G-20 Advanced Economies
- Other fiscal interventions (banking system)

Sources of Unexpected Increases in Government Debt

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Sources of Unexpected Increase in General Government Debt

(percent of GDP, 2007-2010)

	Fra	Ger	Neth	Spn	Port	UK	US	Grc	Ire	Ice	Ave*
Underlying fiscal position	**1.7**	**3.2**	**-2.4**	**1.8**	**11.3**	**3.7**	**8.1**	**16.3**	**1.3**	**10.9**	**6.0**
Revisions to 2007 deficit & debt	1.7	1.8	-0.9	-0.1	0.1	1.5	7.1	2.5	1.6	4.0	4.7
Changes to government boundary	-0.7	1.4	-0.2	0.6	9.4	1.9	0.9	11.2	-0.1	2.5	1.1
Cash-accrual adjustments	0.7	0.0	-1.3	1.3	1.7	0.3	0.0	2.6	-0.2	4.5	0.2
Exogenous shocks	**8.4**	**12.8**	**14.2**	**15.4**	**8.1**	**17.0**	**6.3**	**40.0**	**60.2**	**39.5**	**9.8**
Macroeconomic shocks	8.3	4.7	5.2	13.0	4.4	8.9	3.8	38.4	35.7	-3.3	6.0
Financial sector interventions	0.0	8.1	9.0	2.5	3.6	8.1	2.5	1.6	24.5	42.8	3.8
Policy changes	**2.3**	**3.8**	**1.9**	**4.9**	**4.7**	**1.1**	**6.4**	**-8.0**	**-9.9**	**-4.3**	**4.7**
Other factors	**2.1**	**-0.3**	**6.5**	**1.9**	**3.7**	**6.2**	**8.3**	**-6.7**	**7.5**	**21.6**	**5.9**
Total Unforecast Increase in Debt	**14.4**	**19.5**	**20.2**	**24.0**	**27.8**	**28.0**	**29.1**	**41.7**	**59.1**	**67.7**	**26.4**

23%

37%

18%

* GDP-weighted average

Source IMF

Fiscal impact of financial sector crisis on government debt in 2008-2009

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

(2008-2009; percentage of 2009 GDP)

	Measures impacting government debt (2008-2009)					Total impact on government debt in 2008-2009	o/w impact in 2008
	Capital injections		Asset purchases	Debt assumptions/ cancellations	Other measures		
	Acquisition of shares	Loans					
Belgium	4.2	2.1	0.0	0.0	0.1	6.4	6.4
Germany	1.8	0.0	1.7	0.0	0.0	3.5	2.2
Ireland	6.7	0.0	0.0	0.0	0.0	6.7	0.0
Greece	1.6	0.0	0.0	0.0	0.0	1.6	0.0
Spain	0.0	0.0	1.8	0.0	0.0	1.8	0.9
France	0.4	0.0	0.0	0.0	0.0	0.4	0.6
Italy	0.1	0.0	0.0	0.0	0.0	0.1	0.0
Cyprus	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Luxembourg	6.6	0.0	0.0	0.0	0.0	6.6	6.4
Malta	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Netherlands	6.3	1.3	3.5	0.0	0.2	11.3	13.7
Austria	1.8	0.0	0.0	0.0	0.0	1.8	0.3
Portugal	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Slovenia	0.0	0.0	0.4	0.0	3.6	4.1	0.0
Slovakia	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Finland	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Euro area	**1.4**	**0.2**	**0.9**	**0.0**	**0.0**	**2.5**	**2.0**

Source ECB

Some lessons from the financial crisis

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Source of risk	Issue	Policy Measure
Exposure to Financial Sector	No recognition of contingent liabilities	Recognition of quantifiable contingent liabilities
Quasi-fiscal Activity by SoEs	Exclusive focus on general government	Publication of fiscal data for public sector
Unreported Flows	Losses on asset & liability holdings not recognized	Recognition of doubtful debts in summary aggregates
Macroeconomic Shocks	Bias in macroeconomic forecasting	Alternative macro-fiscal scenario analysis

Post crisis lessons

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

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

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

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

Striking the balance between constrains and flexibility

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

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

Inclusion of risk dimension in fiscal frameworks to ensure sustainability and macroeconomic stability

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

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

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

4. **Multi-year frameworks provide stability and predictability** and enhance resiliency of fiscal policy

What is fiscal risk?

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

1. Incomplete understanding of the government's fiscal position
2. Exogenous shocks to the public finances
3. Endogenous changes from government activities and vulnerabilities of fiscal policy settings

Fiscal Risk: Key dimensions

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Risk Analysis and Disclosure

- Macroeconomic Risks
- Specific Fiscal Risks
- Long-Term Sustainability

Risk Management

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

Fiscal Coordination

- Sub-National Governments
- Public Corporations

Source: based on IMF Fiscal Transparency Code

How is fiscal risk integrated in policy frameworks?

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

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

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

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

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

Fiscal frameworks should support good fiscal policy

1. **Fiscal policy objectives**:
   - **prudent** (keep debt on a sustainable path and manage fiscal risks adequately);
   - **countercyclical when feasible** (mostly but not exclusively by letting automatic stabilizers operate in a symmetric way);
   - **growth-friendly** (to support potential output);
   - **and inclusive** (ensuring that the poor and the middle class share in the growth dividend and can adapt to a changing economy).

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

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

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

Overall fiscal framework

Objective	Instrument	Content
Fix permanent fiscal objectives	**Fiscal** Responsibility Law	Principles of fiscal management Fiscal rules Transparency requirements
Set multi-year fiscal targets	MTFF	Macroeconomic objectives and forecasts Fiscal objectives forecasts Fiscal risk analysis Fiscal space /Medium term objective
Determine multi-year spending plans	**MTBF/MTPF**	Spending allocations/ expenditure ceilings Outputs and outcomes Performance indicators Contingency margins and reserves
Authorize annual expenditure	**Annual Budget**	Detailed expenditure appropriations Other budgetary controls Reconciliation with MTEF projections
Report actual expenditure	**Final Accounts**	Detailed expenditure outturn Reconciliation with budget allocations Explanation of discrepancies

Source: based on IMF/FAD MTBF

Risk Dimension in a Robust Fiscal Framework

MTFF – Medium-Term Fiscal Framework

MTBF – Medium-Term Budget Framework

MTPF – Medium-Term Performance Framework

Medium term frameworks

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

Benefits of frameworks

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

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

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

MTFF and MTBF/MTPF

1. Complementary institutional arrangements
2. Help ensure fiscal discipline by making more explicit the impact of current policies on the government balance in the coming years
3. Facilitate monitoring by providing benchmarks against which budgetary developments can be assessed over time
4. In practice their comprehensiveness and degree of commitment can vary

Medium-term fiscal framework

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

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

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

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

5. **Delivers multi-year aggregate expenditure targets** consistent with fiscal objectives and rules

What does an MTBF do?

1. **Increase discipline over government expenditures**

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

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

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

5. Improves the link between government priorities and available resources, i.e., planning linked to budgets

Purpose and benefits medium-term budgeting

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

Kay aspescts and elements of a MTBF

Multi-year Spending Limits (discipline)

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

Prioritization process (legitimacy)

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

Expenditure Control over Medium-term (commitment)

- Regular updates of expenditure projections
- Margins and Reserves
- Controls around multi-year contracts or commitments
- Budget carry-overs from one fiscal year to the next

Accountability

- Delivering on previous commitments
- Comparison of forecasts, budget, and out-turn
- Reconciliations-evolution of budget ceilings
- Sanctions for overspending

European Commission: Defining features of MTBFs

- Political commitment
- Planning horizon
- Coverage
- Level of detail (e.g.budgetary impact of alternative macroeconomic scenarios)
- Formulation of targets
- Exclusion of certain items
- Carryover arrangements
- Binding nature

European Commission quality of MTBF: index

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

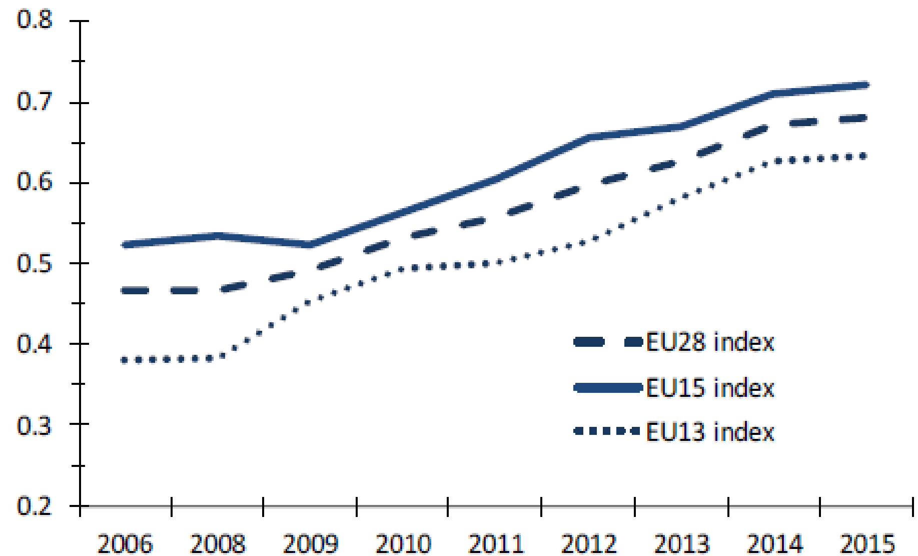
2. **Connectedness between the targets**/ceilings included in the national **medium-term fiscal plans and the annual budgets**

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

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

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

: MTBF index across different country groupings



Note: The index ranges between 0 (very weak) and 1 (very strong). EU15 refers to the 15 Member States that entered the EU before 2004, while EU13 refers to those that entered after 2004.
Source: 2015 vintage of Commission's Fiscal Governance Database.

Different stages of MTBF development

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

Source IMF.Taz Chaponda and Richard Allen Working Paper No. 17/203

Preconditions for effective managment of risk in MTBF

1. Unified budget process
2. Appropriate set of statistics
3. Degree of commitment or binding nature of the framework

Risk arising from anunified budget process

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

Importance of statistics for a robust managment of risks in a MTBF

Practices	Benchmarks		
	Basic	**Good**	**Best**
Fiscal Statistics			
Institutional Coverage	Central government	General government	Public Sector
Frequency	Annually	Quarterly	Monthly
Accounting Basis	Cash	Partial accrual	Full accrual
Balance Sheet	All financial liabilities	All financial assets and liabilities	All assets and liabilities

Risk arising from nature of committment

	Level of strictness in terms of respecting the plans set out in the medium-term planning documents	Member State
1	Ceilings/targets ***are not expected to be changed*** whatever the circumstances (unless a new government comes to power or division of tasks between government levels is changed)	SE, FI
2	Expenditure ceilings ***can only be increased provided that sources of funding*** of the additional expenditure are identified ex-ante	DK, NL
3	Ceilings/targets ***can be adjusted in response to changes in a number of specific parameters*** defined by legislation or other public procedural document (e.g. change in expenditure on pensions, unemployment benefits etc.) and such changes need to be explained publicly	AT, IE, LV
4	Ceilings/targets ***can be changed in a number of situations*** foreseen by legislation or other public procedural document (e.g. in view of a substantial change in the macroeconomic forecast, new government coming to power, extraordinary circumstances, etc.) and such changes need to be explained publicly	BE, BG, EL, HU, IT, MT, PL, RO
5	Ceilings/targets ***can be changed at the discretion of government*** but changes need to be ***explained*** and reputational cost is involved	CY, CZ, EE, ES, FR, LT, LU, PT, UK
6	Ceilings/targets ***can be changed at the discretion of government without*** any public ***explanation***	DE, HR, SI, SK

Source: European Commision 2015

Risk in a MTFF: analysis and identification

Sources of risk

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

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

3. **Long-term sustainability**

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

Likelihood of risk

– High, Medium, Low

Time horizon

– Short, Medium, Long

Expected impact

– High, Medium, Low/ quantitaive

Risk mitigation

1. **Fiscal targeting and fiscal space**

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

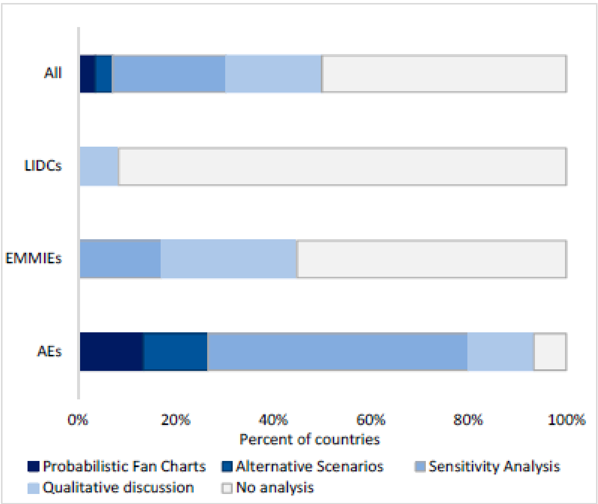
3. **Targeted policies** (reform financial sector, structural reform exchange rate policy)

Current Practices in Fiscal Risk Disclosure and Analysis

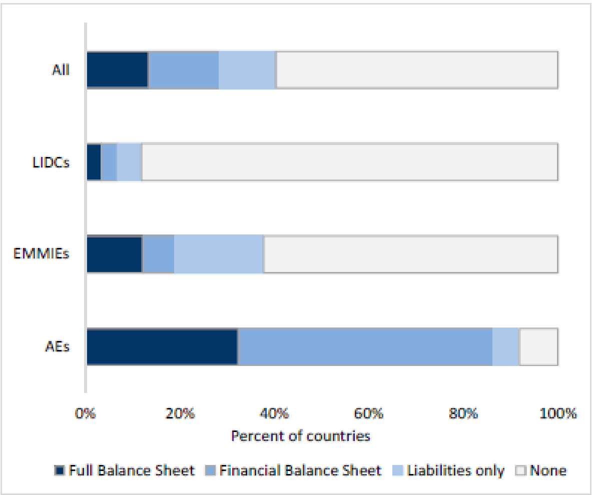
Few countries conduct sophisticated analysis of macro-fiscal risks…

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

a. Macro-Fiscal Risk



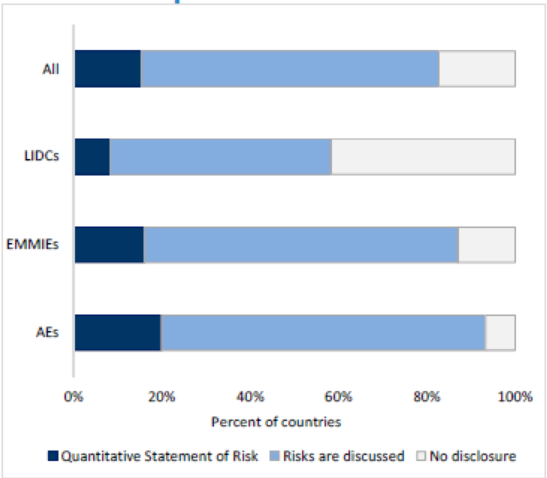
b. Assets and Liabilities



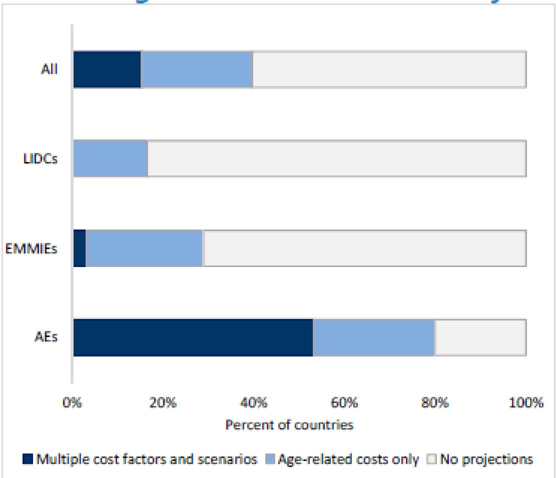
Many countries discuss specific risks but not many quantify their size or probability…

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

c. Specific Fiscal Risks



d. Long-Term Fiscal Sustainability



Source IMF "Analyzing and managing fiscal risks—best practices" 2016

Risk Disclosure and Management of Risk in a MTBF

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Risk disclosure

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

Risk management options

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

Size and location of margins/reserves in MTBF

	Implicit Margins		Explicit Margins		Total Contingency
	GDP forecast	other economic assumptions	within expenditure estimate	within budget balance	% of total spending
Canada	MoF uses ave of ind. forecast	MoF adds 0.5 to 1% to interest rates and runs through model	Contingency reserve of 1.5 to 2% of total spending	MoF targets a surplus of 0.1% of GDP despite balance rule	3.5 to 4%
United Kingdom	MoF uses GDP forecast 0.25% below trend	7 other economic assumptions explicitly 'cautious'	Reserves and margins equal to 0.75 to 1% of total spending	MoF targets ave. surplus of 0.2% of GDP despite Golden Rule	2.5 to 3%
Sweden	Budget based on central assumptions for GDP and other macro variables		Budget margin within expenditure ceiling rising from 1.5 to 2.5% of total spending	None	1 to 2.5%
Netherlands	Deficit target & expenditure ceiling in CA & Budget based on cautious economic scenario in which GDP 0.5 to 1% below outturn		Central contingency reserve of 0.1% of total spending	Most recent CA targets structural surplus of 1% of GDP	1 to 2%
Australia	Budget is based on central economic assumptions	Conservative bias in forward estimates of 0.5-1.5% of spending	No central contingency reserve	None	0.5-1.5%
Ireland	Budget based on central assumptions for GDP and other macro variables		0.03% contingency margin in budget year	0.2% of GDP overachievement against 3% deficit target in 2014	0.03 - 0.5%

Source: IMF Medium-term Budget Frameworks

Policy targeting as a means of incorporating risks approach in policy formulation (MTFF)

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

- **Providing room for cooping with macroeconomic shocks** given deficit and debt sustainability rules and constraints
- **Providing room for discretionary policy** taking into account, market access and debt sustainability conditions
- **Mitigating the long-term fiscal risk** related to population ageing (i.e. saving now for the future)

Medium-term fiscal objectives: Overall fiscal anchor

Country	National objective	Supranational objective	Statutory base		Coverage		Time-frame	
			Political	Legal	Central	General	Annual	Multi-year
Australia	Balance, Debt	---	X			X		X
Brazil	Expenditure, Debt	---		X	X		X	
Chile	Balance	---	X		X			X
Canada	Expenditure, Balance, Debt	---	X		X		X	
France	Expenditure	Balance, Debt	X	X	X	X		X
Indonesia	Balance, Debt	---	X		X		X	
Japan	Expenditure	---		X	X			X
Mexico	Balance	---		X		X		X
Netherlands	Expenditure	Balance, Debt	X		X	X		X
Switzerland	Balance	---		X	X			X
UK	Balance, Debt	Balance, Debt	X			X		X

Source IMF. Fiscal Frameworks

Medium-term objective in the EU context: risk mitigation

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

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

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

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

MTO formula

$$MTO = \max(MTO^{ILD}, MTO^{MB}, MTO^{Euro/ERM2})$$

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

Where

$$MTO^{ILD} = \underbrace{\text{Balance}_{\text{debt stabilizing at 60\% GDP}}}_{\text{(i)}} + \underbrace{\alpha * \text{Ageing Costs}}_{\text{(ii)}} + \underbrace{\text{Effort}_{\text{debt-reduction}}}_{\text{(iii)}}$$

I. budgetary balance that would stabilise the debt ratio at 60% of GDP

II. budgetary adjustment covering a fraction of the present value of future cost of ageing

III. additional debt-reduction effort for countries with gross debt above 60% of GDP

Reporting

1. Ex-ante disclosure of risk- Statement of fiscal risk (part of annual budget; separate statement, different document)
   - Coverage of institutions
   - Coverage of flows
   - Coverage of stocks

2. Ex-post disclosure of risk materialization (Final accounts)
   - Revisions to macroeconomic parameters
   - Impact of discretionary actions
   - Shocks

Institutional Arrangements for Fiscal Risk Management

1. **Establishing a risk management policy.** Pre-conditions under which they are prepared to take on specific fiscal risks

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

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

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

Conclusions

Center of Excellence in Finance

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

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

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

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

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

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

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