

Global Best Practices for Managing Fiscal Risk: An Analysis

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ABSTRACT: Fiscal risk is the situation when the actual fiscal outputs differ considerably from budgeted or other fiscal projections. There can be various reasons for these deviations. For example, recent war between America, Israel and Iran may also act as a potential source of fiscal risk as it will put additional burden on governments public spendings for reconstruction and development. According to IMF report failure to identify, measure, disclose and prepare for such risks has caused additional government obligations, larger public debts and occasionally refinancing difficulties and crises. Considering those facts this study is an attempt to study the concept and types of fiscal risk, to analyze the best practices adopted by countries to manage fiscal risk and finally to provide some recommendations for better policy making in managing fiscal risk. For this purpose, secondary data was collected from working papers of IMF and world bank and research papers conducted on this issue. The study concludes that governments should make efforts to manage and control fiscal risk in order to foster fiscal discipline.

KEYWORDS: Fiscal Risk and Global Best Practices

INTRODUCTION

Persistent debt problem, limited fiscal resources and space had encouraged many countries to adopt practices for analyzing and managing fiscal risk. Fiscal risk often requires disruptive temporary adjustments. According to Serbia's Budget System Law fiscal risks is "short-term and medium-term variations of fiscal variables against the values envisaged in the Budget, financial and or other reports or projections of public finances." Fiscal risks are deviations of fiscal outcomes to what was expected at the time of budget formulation (Odawara, 2025)¹. According to (International Monetary Fund, 2016)² between 1994 and 2013, total economic losses globally from natural disasters were estimated to be in the order of US\$2.6 trillion (equivalent to 4 percent of 2015 world GDP). These large deviation puts a huge burden on public finance.

For example, at the time of Covid -19 pandemic there was huge burden on public finances due to unexpected spending pressures or revenue losses during the fiscal year. According to (International Monetary Fund, 2016)² "Deviations are mainly due to shocks related to deviation of economic growth from expectations, term of trade shocks, natural disasters, calls on government guarantees, unexpected legal claims on the state and other situations can be very disruptive." Many times, government guarantees can also expose governments to significant fiscal risks. Considering these risks many countries are adopting fiscal rules such as debt rules, budget balance rules, expenditure rule and revenue rules. A brief description of these rules is mentioned below-

1. **Debt Rules** – Debt rules are the rules that set an explicit limit on the stock of public debt. For example, Liberia and Poland debt ceiling of 60 percent of GDP.
2. **Budget Balance Rules** – These rules constraints the size of the deficit and thereby control the evolution of the debt ratio and may account for the business cycle structural budget balance rule. For example, Indonesia, Israel, overall deficit ceiling of 3 percent of GDP.
3. **Expenditure Rules** – These rules limit primary, current spending either by putting a ceiling on its growth or on the relevant ratio to GDP. For example, Peru real growth of current expenditure ceiling of 4 percent.
4. **Revenue Rules** – These rules set ceilings or floors on revenue or determine use of windfall revenues. For example, Kenya maintains revenues at 21-22 percent of GDP, France determine ex ante the allocation of higher-than-expected tax revenues. Figure no. i presents a graphical representation of number of countries adopting fiscal rules. The data was based on 2025 update of IMF "Fiscal rules: 1985- 2024" and contains 123 economies database -

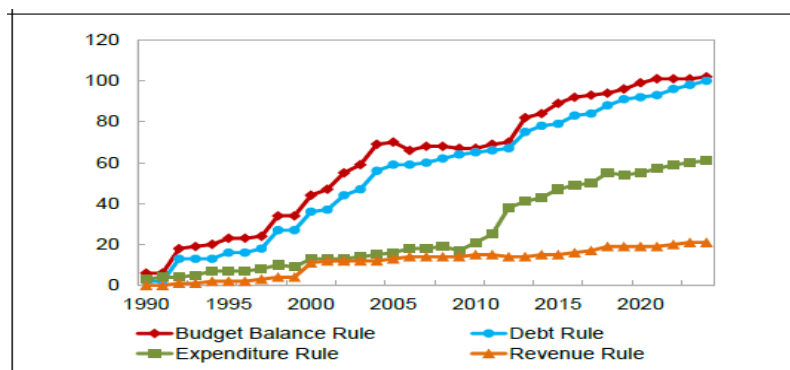


Figure No i- Number of Countries Adopting Fiscal Rules

Source - (Alonso, et al., 2025)³ IMF

From the figure no. i it can be observed that there is an increase in number of countries adopting fiscal rules. The budget balance rule and debt rule each is adopted by over 100 countries indicating that most of the countries rely on ceiling deficit as percentage to GDP. These rules are adopted by EU, Germany, USA, Liberia, Kosovo, Indonesia, Sweden, Poland etc.

Whereas the significant rise was observed in adoption of expenditure rule after year 2010, indicating that many countries are focusing on spending cuts strategies for fiscal consolidation. Expenditure rules are practiced by Brazil, Belgium, Sweden, Peru, Namibia etc. The graph indicates that revenue rules are less commonly used and are practiced by countries like Denmark, Kenya and France etc.

REVIEW OF LITERATURE

Following studies on the issue of fiscal risk provided the in-depth knowledge on importance of fiscal risk and thrown a light on some best practices followed globally to manage the same:

- **(Alonso, et al., 2025)³** – The study was conducted on recent trends and revisions of fiscal rules and fiscal councils since pandemic. For this purpose, data of 120 economies was collected from IMF. The study founded that there is improvement in the legal foundations of fiscal rules, along with a growing role for effective fiscal councils in providing oversight. The authors stated that despite these advancements, compliance remains uneven, with widespread and persistent deviations from deficit and debt rule limits. The paper also introduced new indices to quantify the overall strength of fiscal rules and the institutional quality of fiscal councils. The study revealed a significant cross-country variation and a positive correlation between the strength of rules and fiscal discipline was found.
- **(Odawara, 2025)¹** – According to the author fiscal risk affects primary balance, borrowing requirements, debt/GDP, difficult to forecast, often biased towards the downside, highly correlated for example macroeconomic shocks and contingent liabilities. Author stated that comprehensive analysis and management of fiscal risks can contribute to reducing vulnerabilities to macro-fiscal shocks, enhance debt and fiscal transparency and help to improve debt sustainability analysis.
- **(World Bank, 2017)⁴** – The study was conducted in context of Serbia as it faced substantial fiscal costs from contingent obligations associated with public enterprises as well as unexpected expenditures arising from the catastrophic floods of May 2014. According to the study, examples of important and specific sources of fiscal risk for Serbia include public enterprises, government debt guarantees, and disaster risk. Study recommended that the government should ensure that fiscal risks are properly identified, quantified, monitored, mitigated, and disclosed. Further, collection of all available information and analysis relevant for fiscal risk management is also important.
- **(International Monetary Fund, 2016)²** – According to the study, comprehensive analysis and management of fiscal risks can help to ensure sound fiscal public finances and macroeconomic stability. The study recommended that countries need a more complete understanding of these potential threats to their fiscal position and countries should also enhance their capacity to mitigate and manage fiscal risks. The study emphasized that countries should make greater use of probabilistic forecasting methods when setting long-run objectives and medium-term targets for fiscal policy.
- **(Nina & Petrie, 2013)⁵** – Authors assessed the international trend towards more active disclosure and management of fiscal risk since the early 1990s. According to the study general economic risks and specific fiscal risk are the two types of fiscal risk. Author stated that management of fiscal risks is an ongoing process and identifying fiscal risk is a prerequisite for risk management. The study found that the trend of disclosing fiscal risk among countries at all levels is increasing. According to the authors fiscal risk should be incorporated in the budget and the risk should be allocated, monitored and reviewed. Authors suggested that all countries should be capable for reliable macroeconomic and fiscal forecasting, free from political

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interference, including at least the capacity to estimate budget sensitivity to deviations from forecast levels of key macroeconomic variables.

Objectives of the Study - Following are the objectives of this study-

- To study the concept and types of fiscal risk.
- To analyze the global best practices for managing fiscal risk
- To provide recommendations based on the analysis.

RESEARCH METHODOLOGY

This study is analytical in nature, as “analytical research is a research approach where the researcher uses facts or information already available and analyze these to make critical evaluation”⁶. Further, this study is based on secondary sources of data collection like reports, research papers, reports and working papers from International Monetary Fund. These literature and facts were analyzed by the researcher in this study. The collected data was further analyzed using charts, tabular and graphical presentation as per the requirement of the study.

TYPES OF FISCAL RISK – Fiscal risk are of two types which is presented in figure no. ii -

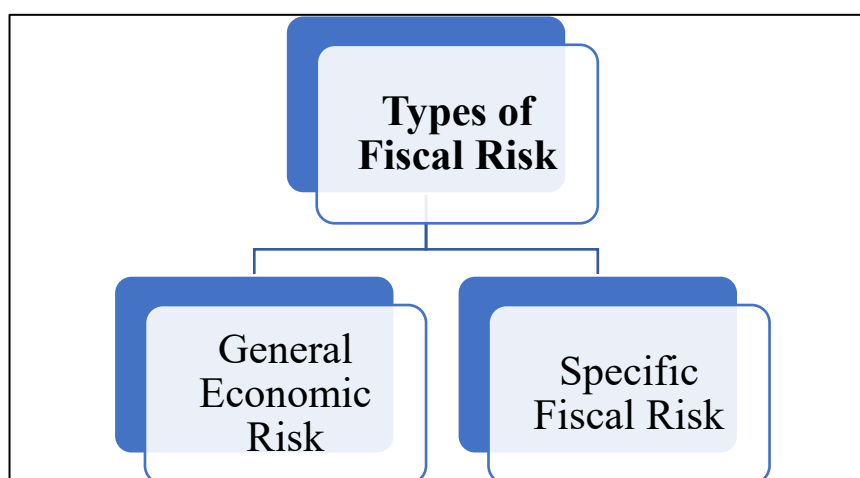


Figure No. ii- TYPES OF FISCAL RISK

Source – Prepared by author, gathered literature from (Nina & Petrie, 2013)⁵

1. **General Economic Risk** – It refers to the exposure of public finance to variations in key economic and other parameters from the levels of those parameters assumed in the forecasts (Nina & Petrie, 2013)⁵. In simple terms when fiscal deficit targets are missed due to macroeconomic shocks for example, a slowdown in economic activity could cause revenue losses and lead to increased spending on unemployment benefits and public debt may shoot up if the exchange rate suddenly depreciates.
2. **Specific Fiscal Risk** – These risks are not related to general forecasting parameters. They are narrower and arise from specific sources, such as the potential costs of guarantees or natural disasters (Nina & Petrie, 2013)⁵. Other examples of these types of risks include the possible need to provide fiscal support to a state-owned enterprise (SOE) or private bank, the risk of tax noncompliance, variance in volume levels like in natural resource production and takeup rates for social assistance programs.

GLOBAL BEST PRACTICES FOR MANAGING FISCAL RISK: Some countries are following the best practices for managing fiscal risk. These are analyzed in this section –

1. **AUSTRALIA** – In Australia decentralized model for managing fiscal risk works, with agencies responsible for managing and reporting on risks through their annual report and contribution to a Fiscal Risk Statement is also published as part of the budget (International Monetary Fund, 2016)². According to (OECD Best Practices for Managing Fiscal Risks, 2020)⁷ based on the “history repeats itself” assumption, Australia discloses the uncertainty surrounding key indicators underpinning the forecasts by graphically showing confidence intervals based on historical error margins. In Australia the budget contains a provision used only in case of an erroneous omission or understatement in the budget or due to unforeseen expenditures realized after the last day it was practicable to provide for it in the budget. The budget also contains contingency reserve for anticipated events that cannot be assigned to individual programs.
2. **CHILE** – Chile is managing fiscal risks from Public Private Partnership (PPP) model. As Chile has had a long history with public private partnerships and a well-developed framework for their management. Under the Chilean framework, there are controls

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in place governing the granting of contracts. The law requires the Ministry of Public Works (MPW) to obtain approval from the Ministry of Finance (MoF) at different stages of contract preparation, including the issuing of bidding documents and the tender process. The MoF requires that all risks associated with the project are identified and that the projects economic and social benefits have been evaluated. The Minister of Finance must also approve PPPs through a supreme decree along with the Minister of Public Works, and this decree requires the approval of the comptroller and auditor-general and President (International Monetary Fund, 2016).²

3. **ICELAND** - In year 2011, the government of Iceland implemented wide reforms to manage fiscal risks from state governments. Fiscal rules were imposed on municipalities, along with improved fiscal oversight arrangements and enforcement mechanisms for non-compliers. The Local Government Act of 2011 introduced in which-
- A three-year rolling balanced budget rule for municipalities and a limit on the ratio of debt and other balance sheet liabilities to revenue of 150 percent,
 - A three-tier system for monitoring municipal finances based on the principle of earned autonomy, in which municipalities breaching fiscal rules are subject to increasing monitoring; and
 - Formation of a Municipal Fiscal Oversight Committee (MFOC), which is an independent body with the power to impose sanctions on municipalities that breached the rules (International Monetary Fund, 2016).²

INDIA – India is an emerging market economy. As per to maintain and promote fiscal discipline, India adopted Budget Balance Rule in 2004 by implementation of Fiscal Responsibility and Budget Management Act. India has adopted fiscal targets that are very similar to those specified in the Maastricht Treaty with setting a target for fiscal deficit to 3% of GDP. The government made an amendment in FRBM Act in year 2018 shifted focus on the total amount of debt owed compared to the total size of the economy (GDP) by aiming to reduce the central debt to GDP to 5 0+- 1% by March 31, 2031 (*International Experience*, 2017)⁷. New practice of medium-term fiscal framework (MTFF) (of three years) starting with the central government can improve compliance with fiscal rules. The Medium-Term Expenditure Framework (MTEF) Statement provides a three-year rolling target for prescribed expenditure indicators along with the underlying assumptions and the risks.

4. **MEXICO** - In Mexico natural disasters is a major type of fiscal risk. According to IMF, between year 1999 and 2011 the costs of post-disaster reconstruction of public assets and low-income housing was averaged at US\$880 million per year. Due to these risks, the Federal Government established an institutional framework for disaster preparedness, mitigation and management. An annual budget provision for FONDEN i.e. a natural disasters Fund to meet the costs of disaster relief and reconstruction efforts for the most frequent types of disasters. The Federal Budget Law requires that a minimum 0.4 percent of the annual federal budget be set aside each year, transferring part of public-sector natural disaster risk to international reinsurance markets and Parametric catastrophe bonds to ensure adequate funds are available in the event of a natural disaster occurring. Mexico was the first sovereign to issue a parametric catastrophe bond in 2006 to cover against earthquakes in three specific zones of the country. (International Monetary Fund, 2016).²

Further, the Fiscal Discipline Law for State Governments (2016) provide a framework for controlling excessive debt accumulation for states and municipalities. In Mexico main fiscal rules are based upon net financing ceiling associated to a traffic light system -

- States in Red – Net Financing Ceiling 0 (balanced budget)
 - States in Yellow – Net Financing Ceiling 5% of non-earmarked revenues
 - States in Green – Net Financing Balance of 15% of non-earmarked revenues
5. **NEW ZEALAND** – In New Zealand individual agencies are primarily responsible for monitoring and provisioning for contingent liabilities and various risks within their functions However, treasury has ultimate authority and control over borrowing, contracting obligations and assessing fiscal risk. The Treasury publishes a regular statement on managing fiscal risks. All explicit fiscal risks are subject to parliamentary approval (International Monetary Fund, 2016). New Zealand also, measures potential costs associated with the reconstruction of crucial infrastructure in the event of a natural disaster. New Zealand has two long term reserve funds viz. Natural Disaster Fund and Superannuation Fund. (OECD Best Practices for Managing Fiscal Risks, 2020)⁸.
6. **NETHERLANDS** – In the Netherlands, a unique practice is followed as debt risks are identified and monitored by the entity responsible for debt management. The types of risk to be monitored may be laid out in the mandate of the entity responsible for debt management. Risks like interest rate levels and credit, liquidity and foreign exchange risks are monitored. The independent fiscal institution also reports biannually, as well as at the start of the mandate of each new government, on the situation of public finances and fiscal risks (OECD Best Practices for Managing Fiscal Risks, 2020)⁸.
7. **SOUTH AFRICA** – South Africa has established a fiscal risk committee with a mandate to identify the major sources of fiscal risk and quantify them as far as is possible, monitor risks and propose mitigating measures, and report on risks both for internal purposes and to the public. The committee meets quarterly and incorporates a wide range of representatives from within the

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National Treasury that are required to report on their area of expertise. It is supported by a secretariat in the Fiscal Policy Department of the Treasury.

Another best practice of South Africa includes a relatively well-developed oversight framework for monitoring state-owned enterprise (SOE) performance. The Public Financial Management Act (PFMA) and Treasury Regulations require that SOEs should submit corporate plans annually, covering a period of three years and outlining the strategic objectives agreed with the government, key performance indicators for assessing the entities performance, a risk management plan, and a financial plan. The financial plan must include - projections of revenue, expenditure and borrowings, asset and liability management, capital expenditure programs and dividend policies. The PFMA sets controls on borrowing and contingent liabilities of SOEs (International Monetary Fund, 2016) ².

8. **SWEDEN**- In Sweden a well-developed framework for managing guarantees works. There are controls on the issuance of guarantees, decisions to issue guarantees are integrated into the budget process and guarantees require Parliamentary approval. The Swedish Debt Management Office (DMO) is responsible for assessing the risks of guarantees and pricing the guarantee fee that will cover the risk. It also monitors changes in risk over the life of the guarantee. The DMO uses a variety of techniques to estimate the expected loss of the guarantee including reference to rating analysis, option pricing, and simulation models (International Monetary Fund, 2016) ².
9. **UNITED KINGDOM** – United Kingdom has established a fiscal risk group within His Majesty's treasury to identify and monitor fiscal risks. The group is chaired by the Treasury Chief Economist and comprised of senior treasury officials (including the tax department, spending areas, International, and financial stability department). It produces a dashboard of fiscal risks, with estimates of total exposure and rankings using the traffic light system (International Monetary Fund, 2016).² A unique practice of the U.K. is that the United Kingdom Office of Budget Responsibility publish an in-depth fiscal risk report every two years, in addition to its regular semi-annual reporting on risks around the medium-term forecast. The report presents the analysis of fiscal risk and fiscal risk management. The budget contains reserve for unforeseen expenditure and future costs that exceed the departmental expenditure limits.

Although these countries follow best practices despite that overall balance of few countries namely India, South Africa and U.K. were found in high deficit. Overall balance is one of the important indicators of fiscal monitor by IMF. This can be seen in table no 1 and figure no ii -

Table No. 1 Trends of Overall Balance (Difference between Total Expenditure and Total Revenue)

Countries	2022	2023	2024	2025	2026
Australia	-2.21	-1.26	-2.25	-2.78	-2.43
Chile	1.36	-2.27	-2.82	-2.78	-2.47
Iceland	-3.82	-2.32	-3.71	-2.77	-1.14
India	-9.23	-8.37	-7.85	-7.44	-7.41
Mexico	-4.32	-4.3	-5.78	-4.86	-4.37
New Zealand	-3.96	-3.22	-3.21	-3.86	-3.92
Netherland	0	-0.37	-0.94	-1.84	-2.66
South Africa	-4.25	-5.6	-5.67	-5.78	-4.87
Sweden	1	-0.63	-1.5	-1.41	-2.42
UK	-4.6	-6.05	-6.06	-5.38	-3.9

Source- (IMF Fiscal Monitor Dataset, 2026)⁹

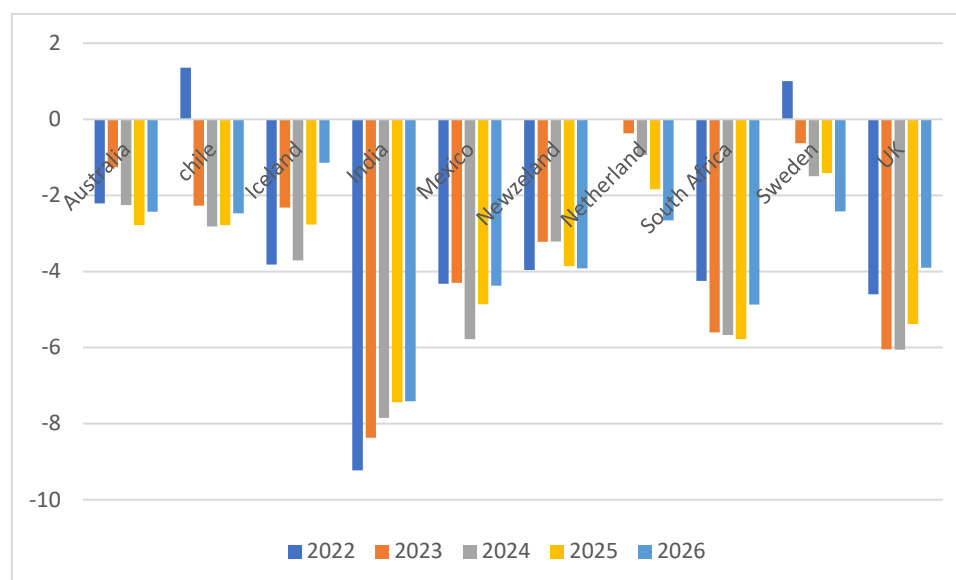


Figure No. iii Trends Overall Balance (Difference between Total Expenditure and Total Revenue)

Source- Table no. 1

Table no. 1 and figure no. ii the trends of overall balance of these countries for last five years is presented. Overall balance measures the difference between total revenue and total expenditure indicating the borrowing requirement of the countries. From the above-mentioned countries: Australia, New Zealand, South Africa, United Kingdom, has no statutory numerical ceiling however requires transparent fiscal strategy and sustainable fiscal management. However, Netherlands and India fiscal deficit rule is 3% and 60% debt to GDP for general government. The trend of last five years of those countries following best practices indicates that Australia, Chile, Iceland, Mexico, Netherlands and Sweden are showing better performance as compared to India, South Africa and U.K. In Year 2026 Chile and Sweden had a surplus balance indicating the positive response of their best practice model of reducing fiscal risk.

RECOMMENDATIONS AND CONCLUSION

After analyzing the current trends and scenario of fiscal rules and international best practices adopted by many countries, here are some recommendations that may help in managing fiscal risk and fostering fiscal discipline. However, there is no “one size fits all” approach for fiscal risk management. Each country face different kinds and issues related to fiscal risk. Although these best practices will help in framing the guidelines regarding fiscal risk management -

- 1) Along with Government (Ministry of Finance) fiscal risk identification and management should rely on a variety of professionals like economists, tax consultants, finance professionals etc. due to their complementary knowledge of specific policy areas.
- 2) To improve the accuracy and consistency of such macroeconomic and fiscal forecasting government should use of the latest techniques and developing the technical capacities of personnel involved in the forecasting and budgeting process.
- 3) Fiscal risk should be incorporated in the budget and a separate contingency fund should be created with consideration of fiscal risk. (like in UK)
- 4) An institutional arrangement by establishing a separate institution for fiscal risk analysis and management. (like in New Zealand, Australia, United Kingdom, South Africa)
- 5) Identifying, analyzing, managing and controlling fiscal risk and setting targets at decentralized level of government including municipalities. (like Australia and Iceland)
- 6) Responsibility of debt management through its identification and monitoring upon separate entity. (like in Netherlands)
- 7) Presentation of report on fiscal risk before general public and well-developed oversight framework for monitoring performance of state-owned enterprises. (like South Africa)
- 8) Formation of separate fund for fiscal risk associated with natural disaster management and a well-defined net financing ceiling for states in the form of traffic light signal. (like in Mexico and New Zealand)
- 9) Organizing quarterly or semiannually meetings and report should be presented before parliament. (like in U.K.)
- 10) A well-developed framework for assessing government guarantees to reduce fiscal risk. (like in Sweden)
- 11) Management of fiscal risks associated with public-private partnerships (PPPs). (like in Chile)

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These recommendations will help to address and detect fiscal risk. However, the rules should be transparent and simple to communicate. As too many regulations complicate fiscal management and make it difficult for the central government to monitor and enforce the rules. Prudent macro-fiscal forecasts (including for revenues) and a suitable margin to absorb unanticipated shocks will provide the flexibility to fiscal policy and impart credibility to it.

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