



Designing a Credible Fiscal Baseline

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Objectives

- Adapt output to audience.
- Basics of good reporting.
- Effective presentation of the fiscal baseline.

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Match output with audience

- [My assumption: you are the macro-fiscal team in MoF.]
- **Assess the attention span and appetite for technical details.**
 - If **Minister or senior policymaker**:
 - Short memo (1-3 pages) with an appendix table or a chart,
 - Avoid the use of jargon: e.g. say “strong revenue collections” not “buoyant revenues”, say “prudent projection assumptions,” not “conservative estimates of elasticities.”
 - Exception: Minister is a prominent economist who enjoys technical chats.
 - If **outside experts** (IMF or World Bank teams, investment bankers):
 - Longer note, PowerPoint, more jargon. [assume this is the case here]
 - Always prefer charts (possibly with captions) to tables.
 - If **budget department (in the context of budget preparation)**:
 - Establishing credibility of the forecast is key. Focus on revenue (they know more on expenditure; elicit their reaction);
 - Greater focus on risk and alternative scenarios to show the forecasts are prudent → this helps when things go well: “no room for complacency.”

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Before you start

- Have a “**story**,” an overarching theme that both fits current and medium-term macroeconomic and fiscal performance and naturally lead to policy implications → strengthens the sense of overall consistency of the analysis (or dispels the sense of doing “elevator economics.”).
- **Examples:**
 - External or fiscal sustainability concerns,
 - Unbalanced growth (external vs. domestic), link to credit developments and asset price concerns.
 - Divergence from “natural” peer countries (particularly, competitiveness,...).
- In the same vein:
 - make sure you rely on eye-catching charts that support the story.
 - Avoid billions to prefer numbers in ratios to GDP or (real) growth rates.
 - KISS: “keep it simple and stupid” → busy people like the comfort of linear thinking → go to the point using gradual steps.
 - Avoid unsubstantiated statements made to merely please your audience... they’ll figure it out sooner or later.

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Contents and logic

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Recent macroeconomic developments

- A fiscal **baseline** is prepared at **unchanged policy** but including existing policy commitments (“economic budget”) → first step is to describe exogenous influences on the budget.
- **Current macroeconomic context:**
 - Growth and its determinants (focus on the real and external sectors, possibly financial [e.g. if the lack or excess of credit in the economy is a determinant of growth performance]).
 - Prices (CPI, wages, interest rates).

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Impact on fiscal performance

- Start with the most endogenous part of the budget: revenues.
 - Impact of recent macro (prices and quantities) trends on revenue performance,
 - Assess strength of revenue performance (buoyancy). [Guess (by deduction) changes in compliance or enforcement effort, notably by comparing to past trends in buoyancy.] Discuss eventual impact on composition (e.g. continued trend decline in trade taxes vs. consumption tax)
- Assess expenditure realizations (w.r.t. to budgeted amounts), disentangling endogenous factors (e.g. inflation) from other factors.
- Budget balance and change in public debt.

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Short-medium term developments

- Describe the **main drivers of the macroeconomic forecast**: recovery from slump, strong private spending boosted by easy financial conditions, external demand, continued stimulating or restrictive policy stance ,...
- **Implications for tax bases** (even if GDP is used for revenue forecast, it is important to have a sense of any composition effect in GDP).
- Discuss (at adequate level of technicality) the revenue forecasting **methodology** (elasticity, ERT, adjustments for one-offs or base effects) and choice of relevant parameters for short and medium term (often 5 years).

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Short-medium term developments

- Broad assumptions underlying expenditure trends. Reflect existing medium-term commitments.
- Implications for deficits, debts and financing.
 - In particular, think about using the appropriate balance concept that truly supports your story (e.g. if sustainability: use primary balance).
 - Is there a specific public debt threshold one should feel uncomfortable to cross? Form a view on how low is safe.

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Risk analysis

- Forecasting is by nature **uncertain** → risk analysis must be integral part of the exercise.
- Two **distinctions**:
 - broad distribution of risks vs. tail events.
 - Risks to the baseline (exogenous shocks) vs. risks from the baseline (e.g. unsustainable trends in gross financing needs).

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Risk Analysis

	Broad distribution	Tail risks
To baseline	<ul style="list-style-type: none"> • magnitude of uncertainty and “tilt” (e.g. “risks around the forecast remain large and tilted to the downside.”) • discuss main sources of risk (external demand, exchange rate, commodity prices,...) 	<ul style="list-style-type: none"> • generally done only if large downside risks are more likely than usual to materialize → discussion of a downside (but plausible) scenario (e.g. sharp slowdown in China, intensification of euro crisis, reversal of capital flows) • In complete fiscal reports: “early warning” or “vulnerability” analysis.
From baseline	<ul style="list-style-type: none"> • discussion of the debt sustainability analysis (DSA), including liquidity risk. • discuss uncertainty around key forecasting assumptions (e.g. continued tax admin. Progress, uncertain impact of specific reforms,...). 	<ul style="list-style-type: none"> • discuss stress tests from the DSA. • analyze DSA implications of a downside policy scenarios (e.g. failure to deliver on a planned consolidation). • If data availability allows: probabilistic analysis of highly adverse developments.

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Broad policy implications

- The medium-term trends call for **an assessment of unchanged policies** in terms of:
 - Fiscal **space** created for productive spending, or for buffering future shocks,
 - Fiscal **stance** in light of cycle or main drivers of growth,
 - Fiscal **sustainability**.
- Eventual **policy corrections** could also be discussed, but in **broad** terms. Elected officials will determine the specifics (i.e. who will pay or benefit from policy changes).

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Caveat

- Suggestions above are only one characterization of good practice based on experience.
- There can be alternative ways to proceed.

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