2.3 The preparation of the fiscal forecasts

The methodologies used by the MFIN to prepare the fiscal forecasts also remained largely unchanged compared to the previous forecast rounds (Box 1 provides a detailed description of the process as documented by the National Audit Office (NAO) in one of its recent audits). The framework continued to be based on the expert input provided by the line ministries, working along the line items of the Consolidated Fund. In turn, the expert input is supported by the analysis of trends by the various departments, as well as knowledge about specific fiscal legislation and ad-hoc factors. This bottom-up approach ensures the tapping of expert knowledge and micro information which is available at ministry level.

Top-down ESA-based forecasts are also produced, based on the estimated relationships between the fiscal variables and their respective proxy bases. The top-down projections act as an envelope, to ensure prudence and the overall consistency between the fiscal forecasts and the official macroeconomic outlook. The bottom-up and top-down fiscal projections are discussed among senior ministry officials and fine-tuned. The objective is to ensure that the official projections contained in the DBP, are compatible with the budgetary targets, and respect the fiscal rules. The attainment, and in some cases, the overachievement of the headline targets for the fiscal balance and public debt, observed in recent years, suggest that the current forecasting framework used by the MFIN tends to be somewhat conservative, whereas financial controls appear to be adequate.

Box 1: The preparation of the revenue projections by the Inland Revenue Department (IRD), The Value Added Tax (VAT) Department and the Department of Customs (DOC)

Reproduced from pages 9-10 of An Analysis of Revenue Collection, carried out by the NAO, published in December 2017. This report is available on http://nao.gov.mt//loadfile/08d6f413-ae2d-4e94-82c8-a2bf51fec90a.

Communication by the NAO with the Budget Office (BO) showed that revenue projections required as part of the 2016 budget preparatory process were initially prepared by the respective Departments as per MFIN Circular No. 1/2015 - '2016 – 2018 Business and Financial Plans'. Each Department provided its three-year revenue projections, in response to said Circular. However, during the meeting held with Senior Management, information collected by the NAO suggested that a top-down approach was being adopted with regard to revenue projections and that ultimately, the revenue targets for the year 2016 were those set by MFIN.

It was also confirmed that while departmental projections were submitted to MFIN in the first quarter of 2015, the official budgetary estimates for 2016 were finalised late in the year, whereby the BO had a better picture of the relevant revenue trends, including any planned budget measures and their impact on projected revenue.

Upon request by the NAO, the BO provided the revenue projections submitted by each of the three Departments. Subsequently, these figures were compared to the amounts included in the Financial Estimates for the year 2016. It was noted that the published estimated revenue figures provided by MFIN exceeded the ones submitted by each of the Departments.

Whilst each Department submits its projections in the first quarter of the year, the final 2016 Financial Estimates were presented in Parliament in October 2015.

It was confirmed that throughout the year ongoing discussions were held between the BO and the respective Departments, through which the relative projections were updated to reflect any monthly performance fluctuations. Since current year performance serves as a baseline for the forthcoming year's estimate, estimated amounts reflect improvement, or otherwise. In addition, the Financial Estimates may be revised further due to various initiatives deemed necessary at any given point in time, including increased enforcement measures.

Subsequently, the Economic Planning Division within MFIN performs independent forecasts through econometric modelling, where the macroeconomic performance and outlook are assessed for each revenue item. Ongoing revisions are made during the analysis, with material variances analysed to establish the underlying assumptions, as well as to compare results. Towards the end of the process, the final estimates are the ones most compatible with the macroeconomic scenario for the year to which they refer.

Such estimates are provided net of any new initiatives, since such measures only become known as the annual National Budget approaches. Consequently, targeted revenue to be derived from such initiatives would have to be reflected at a later stage accordingly. In addition, the Financial Estimates may be further revised due to various initiatives deemed necessary at any given point in time, including increased enforcement measures and higher collection of revenue arrears.