

Box D: Fiscal revenue model developed by MFAC

The MFAC has recently developed a new fiscal model, based on the standardised ESA 2010 framework, to enable a more granular analysis of the primary revenue components, i.e., taxes on production and imports, current taxes on income and wealth, and social security contributions. These three revenue components account for more than four-fifths of total government revenue. The analysis was carried out at the sub-component level, thus, the individual elements contributing to the total revenue were examined. Through its model, the MFAC can perform a deeper analysis and obtain a better understanding of the tax base, the responsiveness of the revenue component to changes in the tax base and, accordingly, improve its risk assessment.

The development of the new fiscal model involved studying the various sources of revenue, such as taxes, fees, and other income streams, and examining their historical patterns and relationships. This data-driven approach allowed the MFAC to identify key factors influencing each revenue sub-component and establish econometric models to capture their dynamics.

The amount of revenue collected is driven by two main factors, the tax base and taxation policy. The tax revenue elasticity focuses on the impact of the macroeconomic environment alone on receipts, with tax policy held constant. Through this model, the MFAC was able to derive the relationship between the revenue collected and its respective tax base (see Table 5.12).

Using the above elasticity estimates, the Council considered two scenarios. The first scenario maintains the macroeconomic projections provided by the MFE. In this case, the MFAC employs its model-driven elasticities and produces a forecast. In this scenario, the MFAC assesses an element of upside risk in the budgetary projections as presented by the MFE, save for 2026. Overall, the magnitude of this upside risk decreases over time. Interestingly, the MFAC assesses a downside risk in taxes on production and imports and net social contributions, but upside risks in current taxes on income and wealth (see Table 5.13). In 2023, the MFAC foresees an upside risk of around €40.0 million in total revenue. For 2024 and 2025, the Council also projects an upside risk albeit not as significant as that in 2023.

Conversely, in 2026, a marginal downside risk of approximately €14.0 million is estimated.

Table 5.12: MFAC's estimate of elasticities for the main revenue components

	2023	2024	2025	2026
Taxes on production and imports	1.1	1.1	1.0	1.1
of which Value Added Taxes	0.9	1.0	1.2	1.2
Current taxes on income and wealth	1.0	1.0	1.1	1.2
of which taxes on individual or household income including holding gains	1.3	1.3	1.3	1.3
of which Taxes on the Income or profits of Corporations including Holding Gains	0.3	0.3	0.4	0.8
Net Social Security Contributions	1.0	1.0	1.0	1.0

Source: MFAC Estimates

The second scenario incorporates changes in the macroeconomic projections based on the expert judgment of MFAC, reflecting the macroeconomic risks highlighted in Section 3.11 of this Report. The MFAC considers various factors, such as changes in global economic conditions, domestic policies, emerging trends, and other relevant factors that may impact the baseline macroeconomic outlook of the MFE. By introducing changes to the macroeconomic projections in the second scenario, the MFAC aims to provide a more encompassing risk assessment of the Government's revenue outcomes, assuming the same discretionary measures as outlined by the MFE in the USP. This approach allows the Council to incorporate their expert judgment and insights into the forecasting process, which can be particularly valuable in situations where the Council identifies significant deviations or risks compared to the initial projections.

The projections derived from this scenario convey positively for the government's total revenue for 2023 by around €70.0 million, as an upside risk in all the primary revenue components, save for net social security contributions is estimated (see Table 5.14). Similarly, when incorporating the possible macroeconomic risks for 2024 and 2025, the MFAC assesses larger upside risks of close to €20.0 million, relative to the scenario when incorporating the same macroeconomic projections. In 2026, a downside risk is once again foreseen, yet to a lesser extent than that estimated in the first scenario.

Table 5.13: MFAC Projections Assuming the same Macroeconomic Projections from the MFE (EUR millions)⁶⁷

	2023			2024			2025			2026		
	MFE	MFAC	MFE-MFAC	MFE	MFAC	MFE-MFAC	MFE	MFAC	MFE-MFAC	MFE	MFAC	MFE-MFAC
Taxes on production and imports of which Value Added Taxes	1,924.7	1,923.3	1.4	2,035.7	2,022.6	13.1	2,166.6	2,149.1	17.5	2,299.6	2,280.9	18.7
Current taxes on income and wealth of which taxes on individual or household income incl. holding gains of which Taxes on the Income or profits of Corporations incl. Holding Gains	2,463.1	2,508.7	-45.6	2,617.2	2,649.0	-31.8	2,792.6	2,837.5	-44.9	2,998.2	3,034.5	-36.3
Net Social Security Contributions	N/A	1,596.2	-	N/A	1,760.3	-	N/A	1,916.7	-	N/A	2,081.9	-
Downside / (Upside) on Government Revenue			-38.9			-3.0			-4.7			13.7

Source: MFE, MFAC Estimates

Table 5.14: MFAC Projections incorporating changes in Macroeconomic Projections based on MFAC Expert Judgment (EUR millions)

	2023			2024			2025			2026		
	MFE	MFAC	MFE-MFAC	MFE	MFAC	MFE-MFAC	MFE	MFAC	MFE-MFAC	MFE	MFAC	MFE-MFAC
Taxes on production and imports of which Value Added Taxes	1,924.7	1,943.7	-19.0	2,035.7	2,054.4	-18.7	2,166.6	2,180.5	-13.9	2,299.6	2,309.9	-10.3
Current taxes on income and wealth of which taxes on individual or household income incl. holding gains of which Taxes on the Income or profits of Corporations incl. Holding Gains	2,463.1	2,521.3	-58.2	2,617.2	2,646.7	-29.5	2,792.6	2,829.7	-37.1	2,998.2	3,025.2	-27.0
Net Social Security Contributions	N/A	1,596.9	-	N/A	1,735.7	-	N/A	1,896.0	-	N/A	2,047.6	-
Total Effect on Gov. Revenue			-71.8			-22.5			-20.2			6.8

Source: MFE, MFAC Estimates

⁶⁷ A negative balance in Tables D.2 and D.3 reflects an upside risk to the projections by the MFE, whilst a positive balance indicates a downside risk.