PUBLIC FINANCE MANAGEMENT

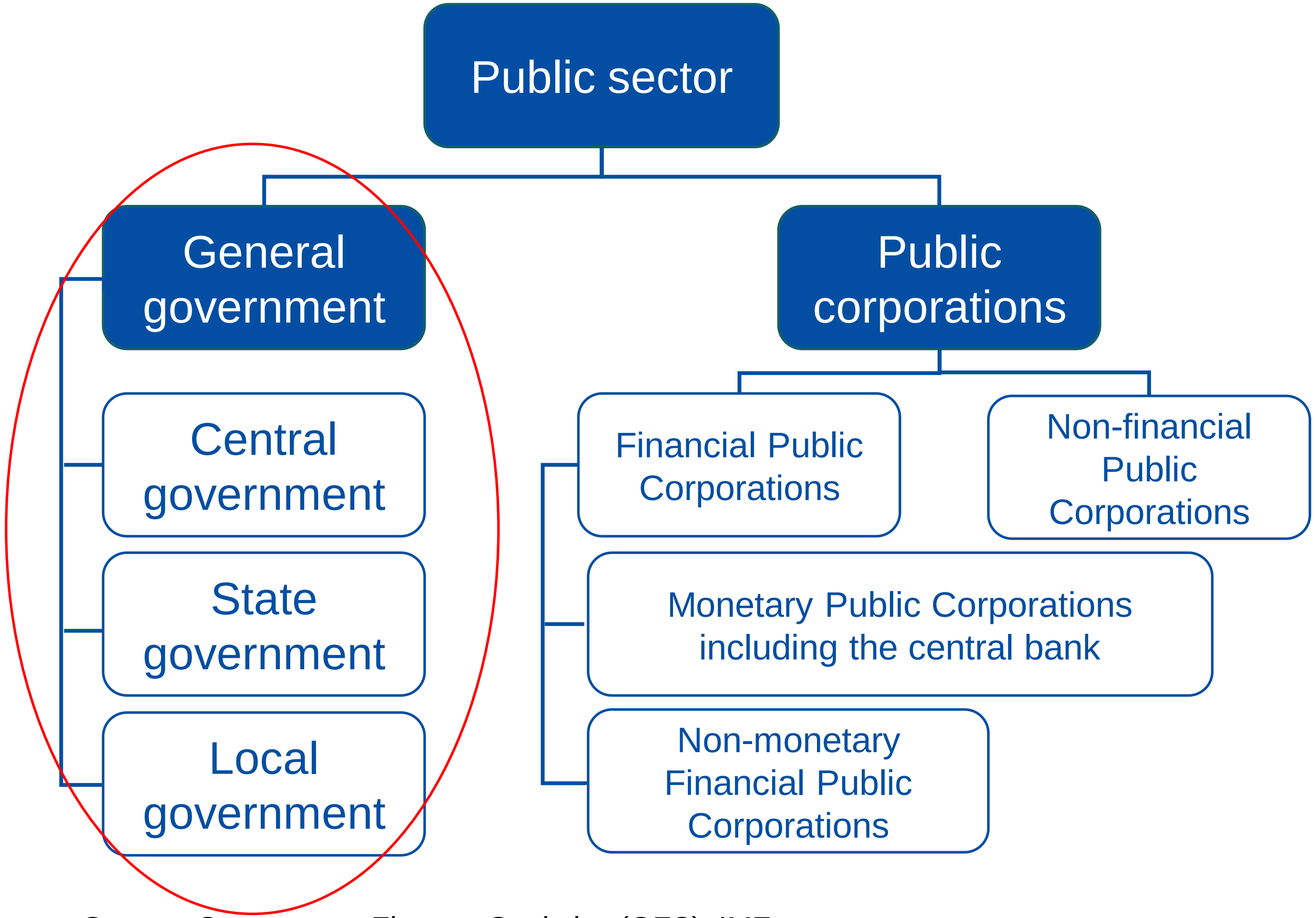
Virtual Module 2:

Fiscal & Budgetary analysis; the basics

Sectors

The Real Sector (National Accounts)	The Public Sector (The Statement of Government Operations/TOFE)
The External Sector (Balance of Payments)	The Money Sector (The Monetary Survey)

What is the Government?



Source: Government Finance Statistics (GFS). IMF

What is the Budget?

The most important instrument of the executive to carry out its policies.

"… the plan of the future financial activities of the government […] prepared annually, comprising a statement of the government's proposed expenditures, revenues, borrowing and other financial transactions […] It is submitted to parliament, which authorises expenditure…"

Allen & Tommasi (2001)

The Budget; legal framework

The key elements of legislation:

- ✓ Enables the legislature (parliament) to provide ‘authority to spend’ to the executive (government) – the *budget appropriation*
- ✓ Provides the framework for spending and collect, and for control thereafter
- ✓ Establishes responsibility and accountability for the stewardship of public monies
- ✓ Empowers the Minister of Finance – the *central fiscal authority*
- ✓ Sets out the *principles for fiscal management*
- ✓ Sets out the reporting obligations

The ‘Government Budget/Fiscal Constraint’

$$G^K + G^R + r(D) = T + GRANTS + \Delta(D)$$

G^K - Capital Expenditure

G^R - Recurrent Expenditure

r(D) - Interest payments on Debt

T - Domestic Resources (Tax and Non-Tax)

Δ(D) - Borrowing (change in the stock of Debt)

Statement of Government Operations

Tableau des opérations financières de l'Etat (TOFE)	
Revenues	
Revenues and grants	T
Total Revenues	T1
Grants	T2
Expenditure	
Total expenditure	G
Recurrent expenditure	G1
Wages and salaries	G11
Purchases of goods and services	G12
Transfers	G13
Interest payments	G14
Capital expenditure	G2
Balance of government operations	
Overall balance	S=T-G
"The Line"	
Financing	F = F1+F2
Domestic financing	F1
External financing	F2

Basic fiscal indicators

FISCAL INDICATOR	DEFINITION
Overall (fiscal) balance	Expenditure – Income (Revenue)
Primary balance	Fiscal balance – interest payments
Current (Revenue) balance	Current revenues (excl. grants) – current expenditures
Overall balance w/t grants	Fiscal balance – grants

‘Above’ or ‘below the line’?

Mentimeter

‘Above the line’: revenue/expenditure

‘Below the line’: net financing (because it *creates* or *takes away* a liability)

What about...?

- ✓ Interest payment
- ✓ Principal repayment (amortisation)
- ✓ New loans
- ✓ Budget support (Grant)

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Case study - exercise

Analysis

Statement of government operations of Moldova

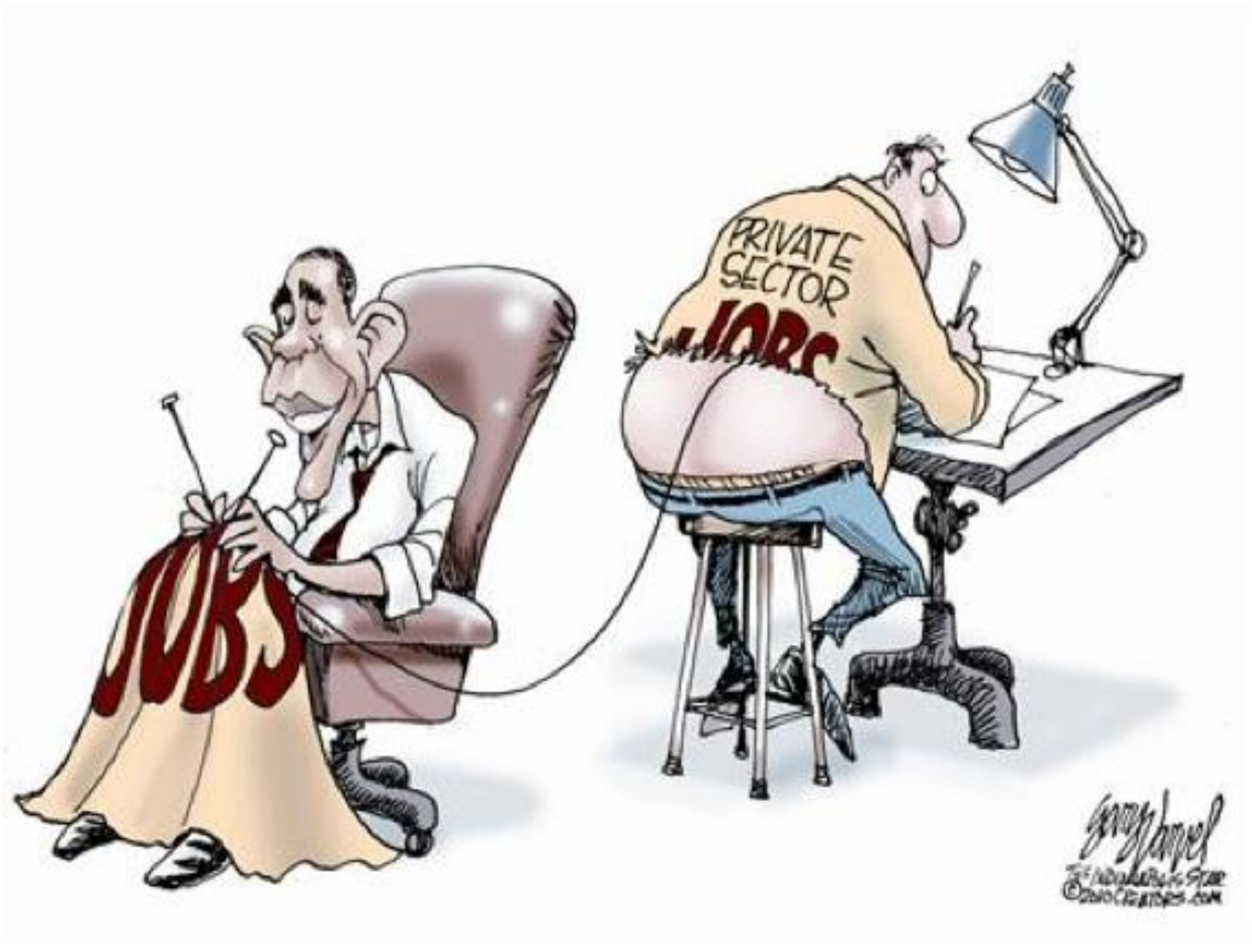
75 minutes

Financing the Budget Deficit

What Financing options?

1. **Borrowing**
   - ***Domestically***
     - Banks
     - Individuals
     - Others
   - ***Externally***
     - Banks
     - Financial institutions
     - Governments
2. **Not paying and building up Expenditure Arrears**
3. **Selling Assets**
4. **“Printing Money”**

The ‘Crowding Out’ Effect



Crowding out is the reduction of private sector consumption or investment resulting from ‘additional’ government financing [deficit]…

- an additional tax; reduces disposable income for private sector;
- domestic borrowing; i.e. the effect of increasing the interest rate and the cost of borrowing for private sector (or directly limits availability of finance in countries with weak financial markets).

The negative effect of absorbing scarce resources at the expense of the private sector.

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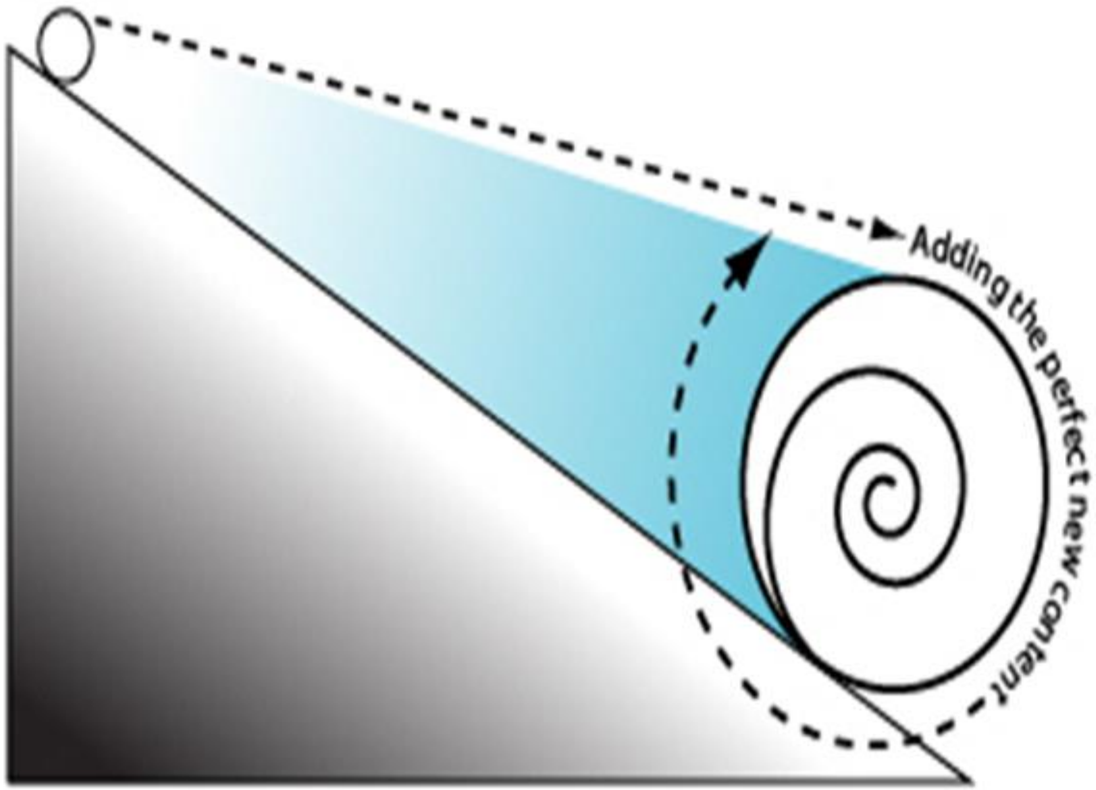
Challenges with Financing



The "Snow Ball Effect"

⇒ Primary deficit is kept stable, but debt increases nonetheless...

⇒ Example:

- 2% GDP growth
- 7% inflation
- 10% interest rate
- Fixed % primary revenue and expenditure of GDP

Challenges with Financing

Fiscal Year	0	1	2	3	4
Nominal GDP	**1000**	**1091**	**1191**	**1300**	**1419**
Government revenue		196	214	234	255
Primary expenditures		240	262	286	312
Primary deficit		-44	-48	-52	-57
Interest		40	48	58	69
Total deficit		**-84**	**-96**	**-110**	**-126**
Public debt	400	484	580	690	816
Primary deficit/GDP		-4%	-4%	-4%	-4%
Debt/GDP	40%	44%	49%	53%	58%
Stabilising primary surplus		4.0	4.8	5.7	5.7
Interest		40	44	47	52
Total deficit		**-36**	**-39**	**-42**	**-46**
Public debt	400	436	475	517	563
Stabilising primary surplus/GDP		**0.4%**	**0.4%**	**0.4%**	**0.4%**
Debt/GDP		**40%**	**40%**	**40%**	**40%**

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Debt Sustainability

Debt sustainability is the ability of a country to meet current and future debt service obligations in full, without:

- Debt rescheduling; accumulation of arrears; default;
- Compromising economic growth.

Debt sustainability is essential for:

- Economic stability, growth, development and poverty reduction;
- Fiscal management;
- Access to capital markets.

Debt Sustainability

Debt Sustainability Analysis (DSA) – a standard annex in IMF Article IV Consultation and/or Country Review reports...

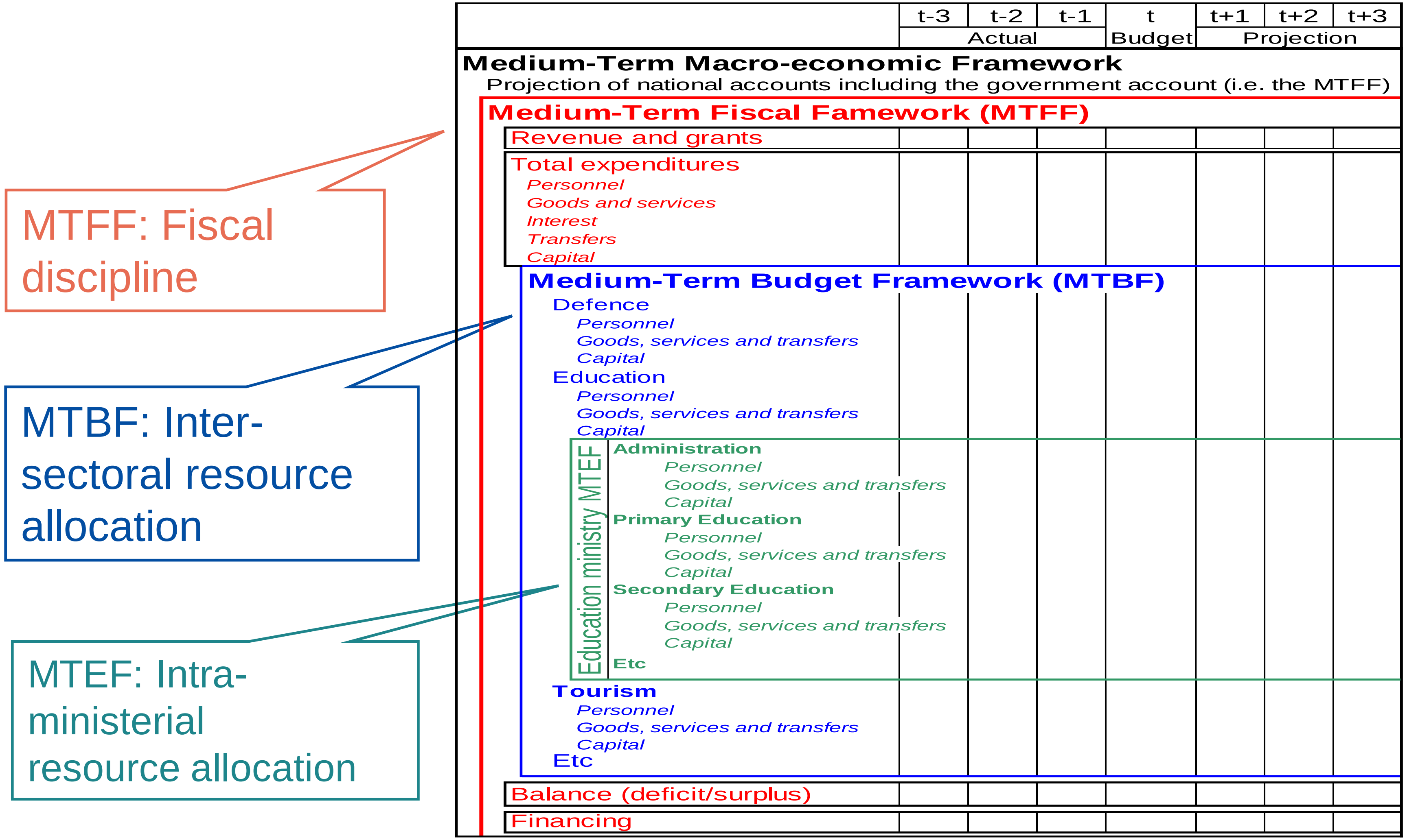
- ✓ Highly dependent on “accuracy” of macroeconomic projections
- ✓ Important exogenous factors to be analysed:
  - Exchange rates;
  - Export and import prices on world market (e.g. oil and food);
  - Weather (e.g. good or bad harvest);
  - Changing international interest rates.

Key points for fiscal sustainability

While preparing the Budget…

- ✓ Are the macroeconomic and fiscal constraints taken into account properly?
- ✓ Are the economic assumptions and revenue projections underlying the Budget accurate and consistent?
- ✓ Is there adequate consideration of implicit fiscal risks?
- ✓ Is there a Medium Term Fiscal Framework (MTFF) reflecting the above in a consistent and systematic manner?
- ✓ Is spending planned over a Medium Term Expenditure Framework (MTEF) reflecting the fiscal constraints?

Key points for fiscal sustainability



Key points for fiscal sustainability

Aggregate fiscal discipline is paramount...

- ✓ Adequate systems; macro-fiscal policy, medium term budget planning et.al. must be robust to prevent uncontrolled ‘additional’ financing over and above what is planned in the Budget;
- ✓ Fiscal rules; ‘bind’ a government (central and/or sub-national) into a specific fiscal behaviour and prevent discretionary intervention – examples:
  - Capping deficit/GDP and Debt/GDP ratios in legislation;
  - Precluding local government from incurring debt;
  - ‘Golden rule’ debt financing only for capital spending.

Key points for fiscal sustainability

Types of Fiscal Rules? [IMF 2012]

- ✓ **Debt rules** set an explicit limit or target for public debt in percent of GDP;
- ✓ **Budget balance rules** constrain the variable that primarily influences the debt ratio and are largely under the control of policy makers;
- ✓ **Expenditure rules** set limits on total, primary, or current spending;
- ✓ **Revenue rules** set ceilings or floors on revenues and are aimed at boosting revenue collection and/or preventing an excessive tax burden.

NB: *Some countries combine two or more fiscal rules.*

Key points for fiscal sustainability

Fiscal Governance in the European Union

The **Stability and Growth Pact (SGP)** requires that:

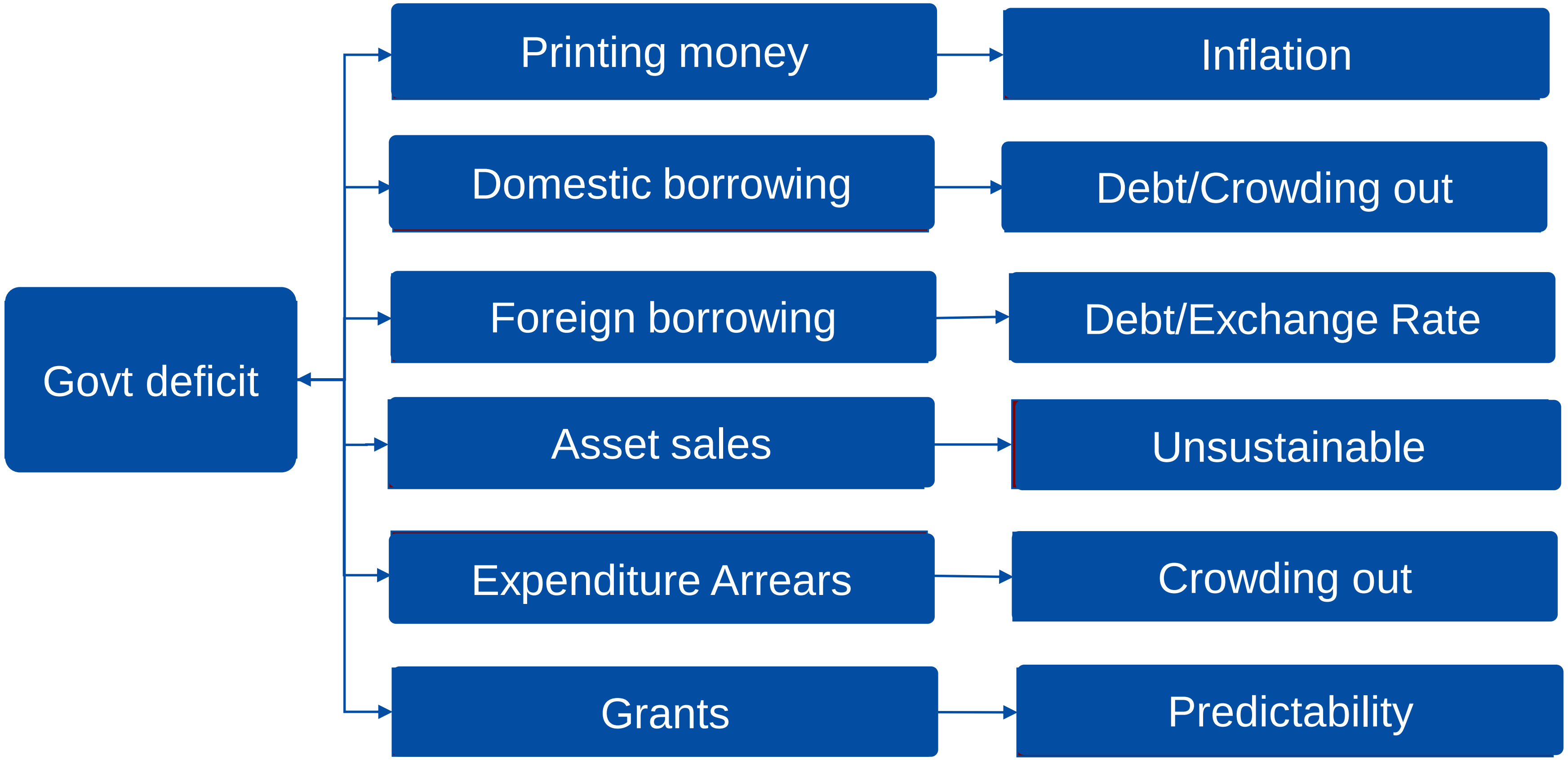
- ✓ General government deficit must not exceed 3% of GDP; and
- ✓ Public debt must not exceed 60% of GDP (or at least diminish sufficiently towards the 60% threshold).

For the EU, **fiscal governance** refers to the rules, regulations and procedures that influence fiscal and budgetary policy. This Includes:

- National numerical fiscal rules;
- Independent fiscal institutions; and
- Medium term budgetary frameworks.

Key message...

...how the Budget is financed, matters!



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Thank you