

Streamlining the macroeconomic forecast in the annual budget cycle

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Structure

1. Introduction
2. The macroeconomic forecast in the annual budget process
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Introduction

Background:

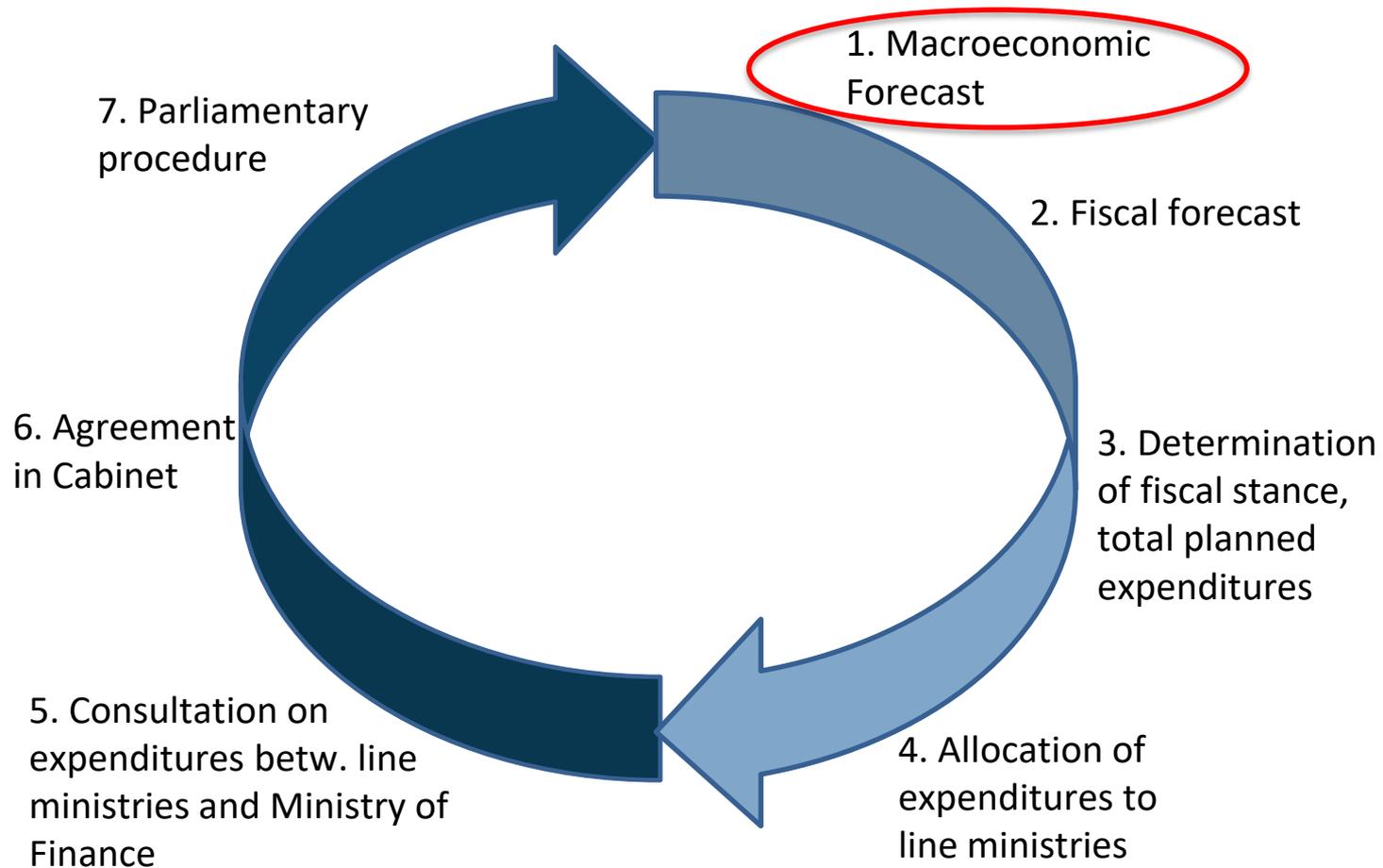
- Macroeconomic forecast is the first element of the annual budget preparation cycle in Ukraine and other countries
- Based on the macro forecast, revenue expectations and other main ingredients of the budget are developed
- In Ukraine, the process of the macro forecast is said to be too complex, involving many steps and institutions

Content of this Policy Briefing:

- Clarify criteria and goals for a good macro forecast in the budget cycle
- Analyse the *process* governing the macro forecast in Ukraine
- Draw on international experience from Germany
- Generate recommendations on how to improve the process in Ukraine

2. The macroeconomic forecast in the annual budget process

Annual budget process cycle, schematic



Source: Schematic illustration based on Potter and Diamond, 1999

Requirements on the macro forecast

Role of macro forecast in budget cycle

- Macroeconomic forecast is the beginning of the entire cycle
- Basis for fiscal forecast and hence expenditure ceiling (after steps 2/3)
- Macroeconomic and fiscal forecasts *can* be done jointly as “macro-fiscal forecast” by one institution or separately by multiple institutions

Procedural objectives for the macro forecast:

- **Process** objectives:
 - Efficiency: Process should consume least possible resources, involve minimal number of steps and institutions
 - Consistency: Projections should be the outcome of one modelling framework with internally consistent assumptions and inputs
- **Outcome** objectives:
 - Accuracy: The forecast should be as precise as possible, with minimum deviation of realisations of variables from forecasted values
 - Timeliness: Forecast should be as up-to-date as possible when budget is debated/passed in parliament

3. The procedure for the macroeconomic forecast in Ukraine

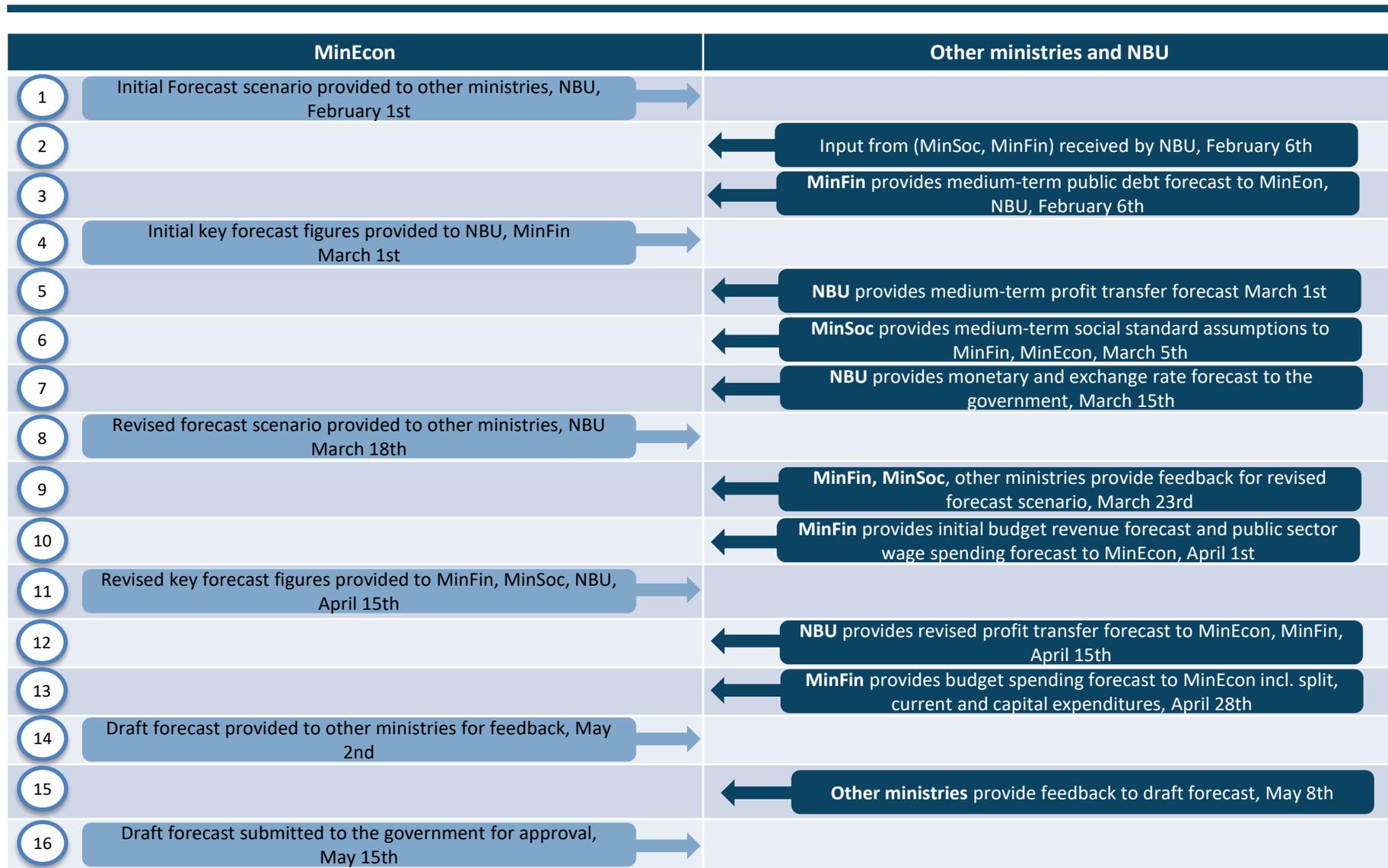
General budget cycle

- Ukraine currently operates an annual budget cycle without a medium-term fiscal framework (as used in many other places, currently under development)
- Government has to approve forecast and budget declaration by 1st of June
- Budget process in Verkhovna Rada starts 15th of September
- Macro forecast is handled by Ministry of Economy
- Fiscal forecast handled by Ministry of Finance

Macroeconomic forecast by Ministry of Economy

- Three year forecast for current, following (budget) and year after
- Contains core economic data (e.g. output, inflation, corporate profits, wages, employment, international trade, productivity)
- Governed by a complex process, set by govt. Resolution 621

Steps in the forecast procedure in Ukraine



Macroeconomic forecast: Summary

- 16 steps between Feb 1st May 15th (submission of forecast to government)
- Complex interplay of different institutions:
 - Ministry for Development of Economy, Trade and Agriculture
 - Ministry of Finance
 - Ministry of Social Policy
 - NBU
- Three main stages:
 1. Initial forecast scenario/key figures stage: until March 1st
 2. Revised forecast scenario/key figures stage: until April 15th
 3. Full forecast : until May 15th
- Full forecast already incorporates fiscal policy information from MinFin, based on prior economic projections
- Revision of figures: Can be done and has been done, leading to revisions of revenue projections before 2nd Rada reading

Potential problems with the current structure

Potential issue	Affected objective
<ul style="list-style-type: none">No clear separation of macro forecast and fiscal forecast: Multiple back and forth steps between MinEcon and MinFin➤ Due to lack of medium term fiscal framework?	Efficiency
<ul style="list-style-type: none">Input from different institutions (esp. exchange rate forecast by NBU)	Efficiency Consistency
<ul style="list-style-type: none">Formalised feedback and approval process risks a politicisation of the forecast	Accuracy
<ul style="list-style-type: none">Unclear, whether current feedback process is useful to ensure accuracy of forecast. There is limited structured exchange with scientific community	Accuracy
<ul style="list-style-type: none">No formal revision process closer to budget approval in Rada	Timeliness

4. The macro forecast in the German budget cycle

Annual timeline of forecasts and key decision points

- Jan: Macro report and forecast of the government (current year only)
- Feb/Mar: Setting of fiscal stance and expenditure ceilings
- Apr: Line ministries submit expenditure proposals
- Apr: Medium term macro forecast
- May: Fiscal forecast
- May/Jun: Coordination of budget positions
- Jun: Cabinet decision on draft budget (and medium-term fiscal framework)
- Aug: Draft budget submitted to Parliament
- Sep: 1st parliamentary reading
- Nov: Macro and fiscal forecasts (medium term, t , $t+1$, $t+2$)
- 2nd and 3rd parliamentary reading

Procedural characteristics

- Budget cycle integrated with 5-year medium-term fiscal framework
- Allows determination of macro framework / fiscal stance and commencement of expenditure allocation process before April/May forecasts
- Regular macro and fiscal forecasts

Characteristics of the process for the macro forecast in DE

Institutional arrangement

- Full separation between macro and fiscal forecast:
 - Ministry of Economic Affairs handles macro forecast
 - Ministry of Finance responsible for fiscal forecast
 - No formal interchanges between the ministries
- Ministry of Economy handles macro forecast entirely on its own: No external input except for statistical data ensures lean & consistent modelling
- No formal approval process for the forecast outside the responsible ministry

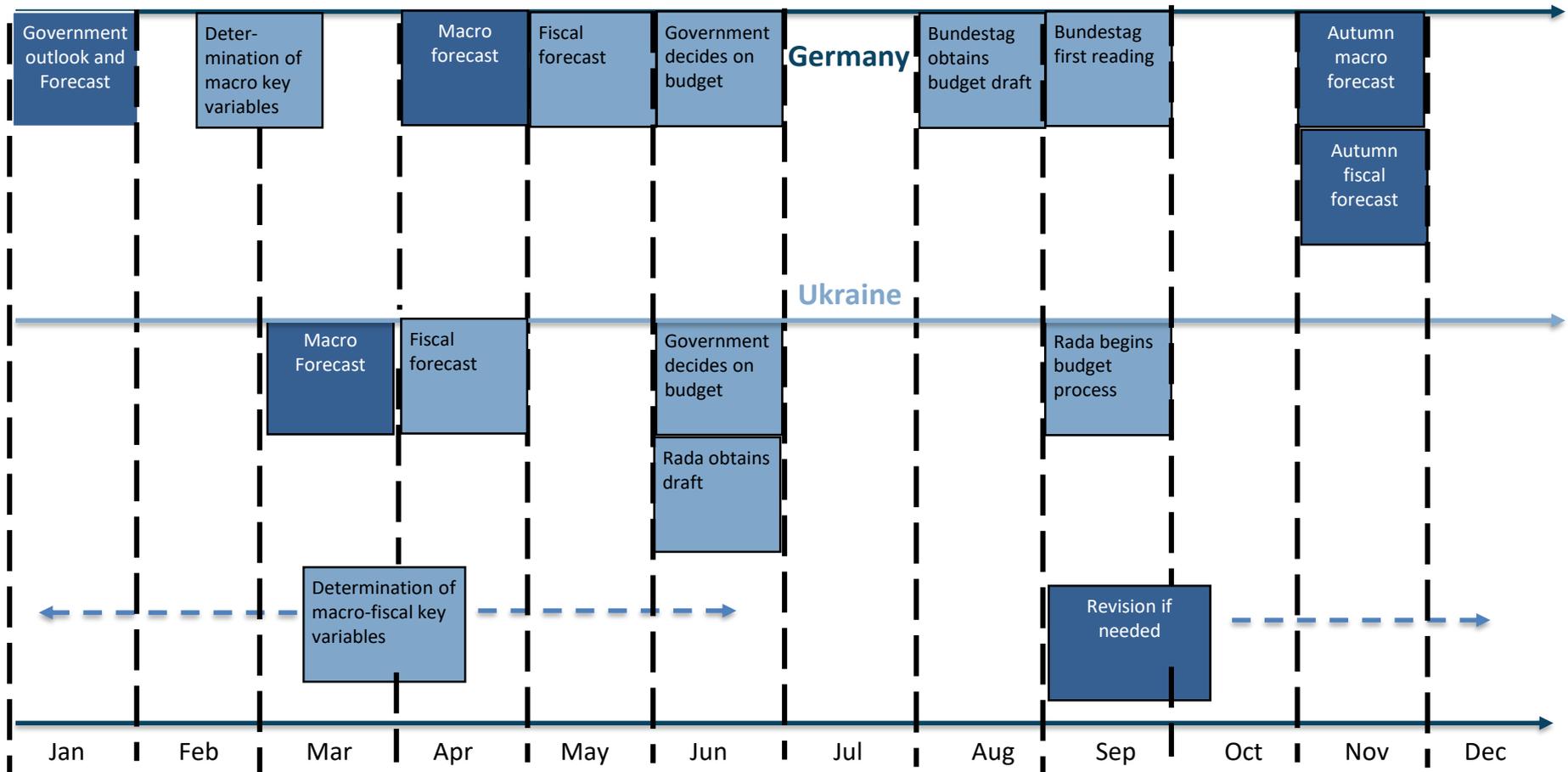
Quality control

- Ongoing informal exchanges consultations between Ministry of Economic Affairs and top economic research institutes with in-house forecasts
- Similar format for fiscal forecasts
- Regular, biannual forecasting cycle ensures up-to-date figures in final budget

Content

- Macro forecast contains a full set of all key macroeconomic variables, more comprehensive than forecast in UA (but less tailored to fiscal forecast)

Comparing processes in Ukraine and Germany

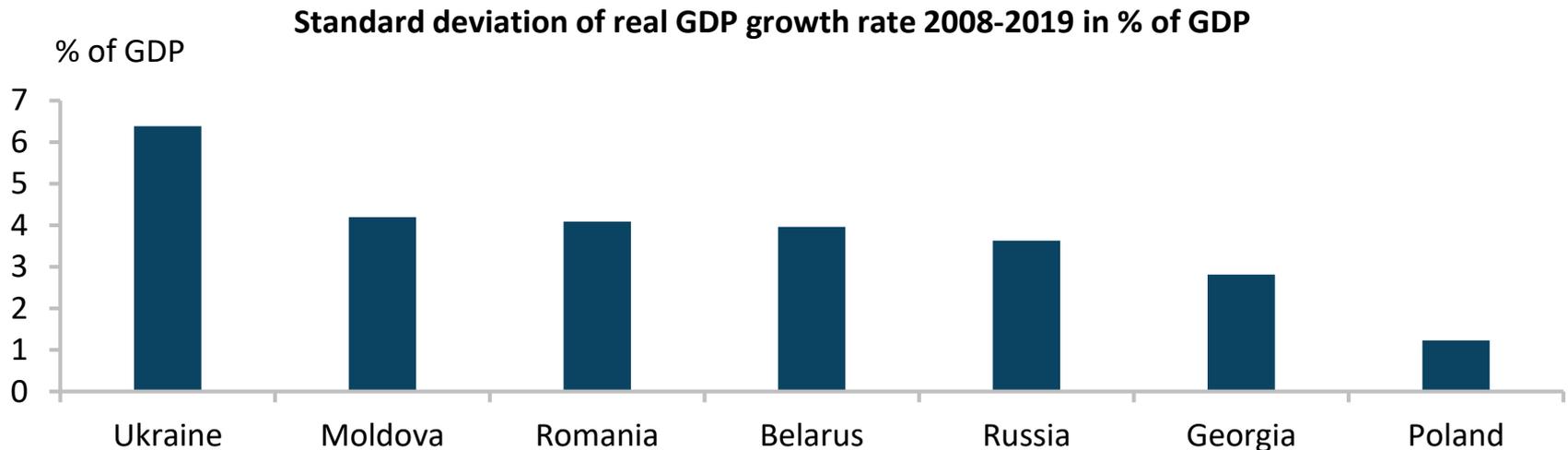


Comparing processes in Ukraine and Germany

- Overall, approaches and timelines relatively similar
- Four key differences:
 1. Formal cycle of “2+1” annual macro forecasts:
 - Forecast for current year in January (limited relevance for budget)
 - Two medium term forecasts in spring and autumn
 - The latter two allow continuous updating of budget figures
 2. In Germany, the macro and fiscal processes are more clearly separated
 3. No need for government approval of forecast in Germany, entirely technical process independently handled by civil servants
 4. Regular process of exchange of forecasting team with scientific community

5. Recommendations (I): Multiple, regular forecasts

- Regular cycle of 2+1 forecasts in Germany appears helpful
 - January forecast: Base for determination of macro budget framework
 - Spring/autumn medium term forecasts allow updating of budget figures



Source: IMF, German Economic Team

- **Institute a regular process of at least 2 medium term forecasts**
 - Due to high volatility of growth rate, autumn update before 2nd reading should possibly be institutionalised (**timeliness objective**)
 - Also, autumn forecast could serve as starting point for determining macro framework at beginning of next budget cycle (**efficiency objective**)

Recommendations (II): Independent macro forecast process

- **Make the Ministry of Economy responsible alone for the macro forecast**
 - Full conceptual separation of macro and fiscal forecasts allows easier process both for MinEcon and MinFin (**efficiency objective**)
 - Full development of model variables in-house (e.g. exchange forecast) will improve **efficiency** and **consistency** of forecast
 - May require additional resources/capacities in MinEcon in short term, should be compensated by efficiency gains
- **Cancel the need for government approval of the forecast**
 - Forecast should be a technical exercise and not politicised (**accuracy objective**)
 - Capacity and integrity of forecasting team is prerequisite
- **Institutionalise a regular exchange of the forecasting teams with the relevant scientific community**
 - Strengthens technical capacities of forecasting team and improves **accuracy** of the forecast over time

References

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About the German Economic Team



The German Economic Team (GET) advises the governments of Ukraine, Belarus, Moldova, Georgia and Uzbekistan regarding the design of economic policy reform processes and a sustainable development of the economic framework. As part of the project we also work in other countries on selected topics.

In a continuous dialogue with high-level decision makers of the project countries, we identify current problems in economic policy and then provide concrete policy recommendations based on independent analysis.

In addition, GET supports German institutions in the political, administrative and business sectors with its know-how and detailed knowledge of the region's economies.

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