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## **Improving Fiscal Management in the METAC Region: The Role of Macro-Fiscal Units**

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# Improving Fiscal Management in the METAC Region: The Role of Macro-Fiscal Units

*This Regional Note summarizes the results of a June 2020 webinar on the structure and role of macro-fiscal units (MFUs) in the METAC region. Based on a survey<sup>1</sup> and discussions at the webinar, it explores the institutional arrangements, organizational capacities, and tools and outputs of MFUs. It concludes that while all MFUs are producing fiscal forecasts, their role for guiding fiscal policy analysis remains limited. Although institutional settings vary across countries, common challenges to organizational capacity include: insufficient ICT (hardware and software) and data to undertake fiscal planning and analysis; lack of information sharing and coordination across departments within ministries of finance and with other government institutions; and the small size of MFUs, which constrain expanding their outputs to levels that would improve the quality of policymaking, fiscal transparency, and public debate on fiscal policy. The note concludes with some lessons and suggestions to improve the volume and quality of MFUs' outputs.*

## INTRODUCTION

**Fiscal policy remains challenging in the MENA region.**<sup>2</sup> It is the most procyclical among emerging market and developing countries (Bova, Carcenac, and Guerguil, 2014), especially in oil exporters, where government expenditure is closely linked to oil prices and revenues. Moreover, it is conducted against the backdrop of long-standing structural vulnerabilities.<sup>3</sup>

**Such vulnerabilities highlight the important role of effective macro-fiscal planning.** The macro fiscal function encompasses three elements: (i) macroeconomic and fiscal forecasting, which may include debt sustainability analysis (DSA); (ii) policy analysis (including macroeconomic, fiscal, and tax policy); and (iii) fiscal risk analysis (Fainboim and Lienert, 2018). Conducting effective macro-fiscal planning is especially crucial in the presence of crises, such as the COVID-19 pandemic. Combined with lower oil prices (which have recovered somewhat

since early 2021), the pandemic has had repercussions that will likely be felt over the medium term.

**METAC countries face organizational and capacity constraints in macro-fiscal management.** The region is characterized by wide cross-country differences in how the macro-fiscal function operates across its three components. Increasingly, and borrowing from the experience of others,<sup>4</sup> METAC countries are creating macro-fiscal units (MFUs) in ministries of finance to organize and build the necessary capacities for the macro-fiscal function.

**The next section analyzes three dimensions of the macro-fiscal function in METAC countries:** institutional settings; organizational capacities; and tools and outputs. The note concludes with some suggestions for strengthening the macro-fiscal function.

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<sup>1</sup> The survey was sent to all 14 ministries of finance of METAC members, and five responded (Afghanistan, Egypt, Lebanon, Libya and West Bank and Gaza). Although the results in this note should not be seen as representing practice in all countries, experience from providing capacity development in the region suggests that these results are lessons learned are relevant in general.

<sup>2</sup> METAC members are a sub-set of the Middle East and North Africa (MENA) region; the latter includes Gulf-Cooperation Council countries.

<sup>3</sup> Oil exporters are largely undiversified. Among oil importers, tourism and remittances account for a large share of GDP. The MENA region has had a structurally high unemployment rate of about 9 percent for the last 10 years (over 20 percent among the youth in half of the countries). The size of the informal sector is high across the region (IMF, 2020 and 2019).

<sup>4</sup> The lessons from building the macro fiscal function in Eastern and Southern Africa are summarized in Battersby and Lienert (2021).

## CHARACTERISTICS OF THE MACRO-FISCAL FUNCTION IN METAC

### Institutional Settings

**All countries that responded to the survey have established MFUs.** Their names vary: Macroeconomic and Fiscal Policy General Directorate (Afghanistan), Macroeconomic Unit (Egypt, West Bank and Gaza), Macroeconomic and Financial Analysis Unit (Libya), and Macroeconomic Analysis and Studies Department (Lebanon).

**Institutional arrangements are a key determinant of how MFUs influence fiscal policy.** They include three components: (1) where the MFU is placed within the hierarchy of the ministry of finance; (2) what specific functions are assigned to the MFU; and (3) how coordination with other units inside and outside the ministry is structured.

**There are differences across countries in the position of the MFU within ministries of finance (Table 1).** MFUs in Egypt, Libya and West Bank and Gaza report directly to the minister of finance, ensuring access to the highest level of policymaking in the ministry. The MFU in Afghanistan reports to the deputy minister. Lebanon places the MFU in the Budget and Expenditure Control Directorate, three levels down from the minister. Despite these differences, survey respondents indicated that visibility and access to the minister were largely independent of the position of the MFU within the ministry of finance.

**Table 1. Reporting levels of MFUs**

Reporting level	AFG	EGY	LBN	LBY	WBG
Minister		X		X	X
Vice-Minister	X				
Lower levels			X		

Source: Based on survey's answers.

### Tasks and Responsibilities of MFUs

**There are important differences in responsibilities of MFUs across countries.** One is the allocation and sharing of macroeconomic modeling with central banks and ministries of economies. MFUs in Afghanistan, Egypt, Libya, and Lebanon prepare their own

macroeconomic forecasts and do not, as is practiced in some other countries, rely on central banks' forecasts.

**Another difference is fiscal policy analysis.** Some countries do not exercise this function and rely instead on specialized departments. This is the case of Egypt and Libya in assessing the impact of revenue and expenditure measures, and Egypt in projecting public investment. However, MFUs in Libya and Afghanistan conduct debt projections and debt sustainability analysis; fiscal risk analysis is done by MFUs in Afghanistan, Egypt, Lebanon, and Libya; Sudan created a stand-alone fiscal risk unit in the ministry of finance.

**In all surveyed countries MFUs prepare key forecasts for budget planning.** This underscores the centrality of this responsibility. In West Bank and Gaza, the MFU's task is limited to forecasting, with other tasks (e.g. fiscal policy analysis) delegated to other departments.

### Coordination with other ministry of finance units and government agencies

**Coordination requirements are critical for MFUs given that their responsibilities cut across several dimensions of macroeconomic management.** The most important link is with budget preparation (Box 1). International experience suggests that this link is very weak in many countries (not only METAC), because of the tension between the fast-paced budget preparation process and the often more forward-looking and analytical approach taken in MFUs.

**METAC countries take different approaches to this coordination.** Some assign this task to a specific department (e.g. the budget directorate in Lebanon coordinates with revenue and public debt directorates). Others reported that they have coordination mechanisms in place, with no single entity responsible for ensuring that coordination is effective—it is not clear in these countries if such mechanisms are well established and institutionalized.

## Organizational and Operational Capacities

### Staffing arrangements

**MFUs in METAC countries are staffed with well-educated personnel.** This includes undergraduates and master's degree levels, often with more than three years of experience, and some with PhDs.<sup>5</sup> Generally speaking, pay in MFUs is not competitive with similar private-sector jobs (and even some government sector jobs), leading to high turnover in some countries.

**MFUs tend to be small in size in the region, in relation to their responsibilities.** Most have between 6 to 10 staff (Table 2). This often leads to unsustainable capacity development—e.g. one staff out of seven is tasked with preparing macroeconomic projections in Libya, and two out of six in Afghanistan. Despite this seemingly important staffing constraints, survey respondents indicated that the size and skills of staff are not significant challenges (see Table 3). This is probably due to the fact that projections, one of the key outputs of MFUs, are prepared in a simplistic way—e.g. using trend techniques in Excel instead of stochastic forecasting models, where forecasts can deviate from an average trend value on the basis of probabilities; the fact that MFUs do not publish substantive reports is also another factor—organizing technical outputs in a publishable format is labor intensive.

**Table 2. Number of technical staff**

AFG	EGY	LBN	LBY	WBG
6	10	8	7	10

Source: Based on survey's answers.

Note: excludes support staff.

### Operational and capacity constraints

**Table 3 provides a summary of the different capacity constraints faced by MFUs.** These are organized in five categories and 11 sub-categories. Not

<sup>5</sup> Egypt and West Bank and Gaza have proportionately more master's degrees. Egypt, Lebanon and Libya also have PhDs.

surprisingly, insufficient ICT (hardware and software) and information from other sources are the biggest challenges facing MFUs, followed by understaffing and non-competitive remuneration.

**The lack of timely and quality information to produce fiscal forecasts is particularly a concern where macroeconomic and fiscal forecasts are carried out directly by MFUs.** These MFUs collect information from several sources, including national statistics offices, central banks, international organizations (such as the IMF and the World Bank), other units in ministries of finance, and analyses by private independent agencies.<sup>6</sup> Data on public investment spending and its financing are usually prepared by ministries of planning—reflecting the prevalent use of dual budgeting in the region. Given the richness of information the Egyptian central bank produces and collects, the MFU in Egypt relies heavily on these sources to feed into its own analyses and projections; however, key indicators (e.g. GDP growth, exchange rate, inflation) are discussed among the key central agencies before they are used as a basis for macro-fiscal planning (Khattab, 2020).

**Technological constraints hinder effective daily operations of MFUs.** Lebanon, Afghanistan, and Libya have highlighted insufficient computers and outdated software. Some MFUs do not have access to a shared network drive and do not use cloud-based servers such as Dropbox and Google Docs, which can be particularly useful to ensure business continuity during prolonged periods of work-from-home (such as during the COVID-19 pandemic).

**Finally, incomplete legal frameworks do not appear to hinder the operation of MFUs.** Even in a case like Afghanistan, where neither an internal legal instrument of the ministry of finance,

<sup>6</sup> For example, in preparing the macro-fiscal forecasts, Lebanon's MFU complements its data with consumer and industrial survey results from private entities.

nor a law define the responsibilities of the Macro-Fiscal General Directorate, the

directorate discharges its functions without major difficulties.

**Box 1. Coordination requirements inside ministries of finance: a delicate balance between conducting analytical tasks in-house and relying on inputs from other units**

Coordination requirements are particularly important in three areas: (i) the tax policy function, which requires coordination with tax units; (ii) the budget directorate, to ensure that inputs needed by MFU, such as ceilings, are produced on time and in line with the budget calendar; and (iii) DSA, which requires coordination with debt management units.

Placing insufficient attention on complementarity and using different data sets can lead to duplication. In cases where capacities are stretched due to insufficient human resources, MFUs should rely on other sources for critical inputs, while challenging the quality of such sources. It is positive to note that survey respondents, except Afghanistan, indicated that coordination challenges inside the ministries are moderate and not insurmountable. However, challenges of coordination with other agencies can be substantive, and can significantly hinder fiscal analysis—e.g. financial data are rarely available on time for MFUs to analyze the macro-fiscal implications of fiscal risks from state-owned enterprises.

Source: Authors.

**Table 3. Operational challenges of MFUs: average survey responses**

Categories		Average
Governance	Insufficient legal framework	2.2
	Ad-hoc interference	2.5
Organizational arrangements	Low visibility of the MFU	1.8
	Lack of communication/coordination with other areas of the Ministry	3.2
HR and skills	Understaffed	3.6
	Staff does not have the required skills	2.6
	Noncompetitive remuneration	3.5
Tools and information	Lack of adequate models/methods/tools for projection exercises	2.8
	Lack of information to carry-out projections	3.6
ICT	Insufficient technological equipment (computers)	4.0
	Outdated software	3.0

Source: Based on survey's answers.

Note: The average is the simple average response across countries for each category. Responses are ranked 1 to 5, with 1 representing the lowest challenge and 5 the highest.

## Tools and Outputs

### Tools

**All MFUs apply simple Excel-based projection tools.** These ensure, at least in principle, that staff use them systematically to prepare projections. Most MFUs are limited in staffing to conduct macro-fiscal forecasting tasks that rely on more complex analytical tools and models. During the METAC webinar, countries noted that it was prudent to “keep it simple”.

**Some countries apply in parallel to Excel-based trend analysis, more complex methods and tools.** In Lebanon, the MFU combines simple Excel-based tools with statistical and econometric models, such as vector autoregressive and ordinary least

squares methods. Libya has a general equilibrium model, but it is not clear to what extent the model is used in fiscal management. These models generally use specific software platforms (e.g. EViews, Stata), and are difficult to keep up to date. Moreover, only few staff are generally equipped to use them, and they seem not to be trusted by policymakers—there are complex and not well understood interactions between the technical elements of macro-fiscal analysis and political economy considerations of bringing more complex and realistic forecasts to the public.

### Outputs

**Annual macro-fiscal projections and forecasts are MFU's main output (Table 4).** They are used for preparing the annual budget and the Medium-Term

Budget Frameworks, DSAs, and (more rarely) fiscal policy advice. They are also used for different reports, presentations, and speeches by the minister of finance and ministry's officials. In time, and as experience has shown in the METAC region and elsewhere, communication of the outputs of MFUs to the wider public ensures their sustainability and regular use in macroeconomic management.

**MFUs also produce medium-term outputs.** These include fiscal strategies and scenarios, and Medium-Term Fiscal

Frameworks. They are updated annually and on occasion more frequently, but they are used primarily for internal policy discussions and do not figure prominently in budget documents.

**All survey respondents indicated that MFUs monitor monthly or quarterly fiscal developments.** However, there is no public reporting on such monitoring, suggesting that the exercise remains largely an internal one. This is one area where countries can quickly and easily improve fiscal transparency.

**Table 4. Outputs and Production Frequency**

	EGY	LBN	LBY	AFG
<b>Fiscal strategy</b>	Yearly	Yearly	Yearly	Yearly
<b>Medium-term fiscal framework or medium-term fiscal scenarios</b>	Yearly	Yearly	Yearly	Yearly
<b>Fiscal risk statement</b>	Yearly	Yearly	Quarterly	Quarterly 1/
<b>In-year reporting</b>	Yearly (mid-year review)	Yearly	Monthly	Quarterly
<b>Other</b>	Fiscal policy analyses	Financial and economic reports	N.A.	Fiscal and Policy Analysis

Source: based on Survey's results and ministries' web pages. West Bank and Gaza did not respond to this question. 1/ The MFU's quarterly fiscal risks reports were discontinued recently. The annual Fiscal Strategy Paper contains an analysis of fiscal risk.

**Four countries (Egypt, Lebanon, Libya, and Afghanistan) responded that they produce a quarterly or annual fiscal risk statement.** This is a positive and relatively recent development, which highlights the importance of forward-looking analysis of risk factors and their fiscal implications. Only Egypt in the surveyed countries report publicly on fiscal risk analysis, with a self-standing output.

**In Afghanistan and Lebanon, it is mandated by law that some of these outputs be made public, while in Egypt and Libya, there is no obligation to publish.** Afghanistan publishes on an annual basis the Fiscal Strategy Paper.<sup>7</sup> The document includes the outlook of

macroeconomic performance, the medium-term fiscal framework, the forward estimates, the risks to the framework, and the growth options for enhancing economic performance. In Egypt, even if it is not mandated by Law or Decree, the MFU prepares and publishes periodic and occasional reports such as the budget statement, a fiscal risk report and a mid-year budget review.

**MFUs also prepare analyses on fiscal policy issues.** For instance, in Egypt, the MFU studies and advises on fiscal and structural reform measures. Afghanistan's MFU analyzes the impact of the implementation of new policies using a computable general equilibrium

<sup>7</sup> See, for example, *Fiscal Strategy Paper*, 2021. <https://mof.gov.af/sites/default/files/2020-09/FSP%202021%20Final.pdf>

model and econometric methods, and provides analyses on tax and expenditure policy, financial stability, and pensions, among other topics. Overall, however, this important area of macro-fiscal analysis remains embryonic.

## LESSONS LEARNED

**This note and the accompanying webinar and survey results suggest that MFUs are seen as increasingly relevant in the region.** But significant challenges remain for improving the effectiveness of the macro-fiscal function and its organization. In concluding, we offer some suggestions to strengthen this function, recognizing that this is a long-term endeavor:

- The influence of MFU's work can be enhanced by having them reporting directly to ministers or deputy ministers.
- Coordination between MFUs, other ministry of finance units, and other government agencies (and even external players) can reduce the information gap that MFUs suffer from and bring together the work of disparate functions of macro-fiscal management.
- Addressing staff shortages and expertise and clarifying tasks can enhance the volume and quality of outputs produced by MFUs.
- MFUs should invest in analytical tools for preparing budget projections and forecasts. While simple Excel-based projections based on historical averages are useful, complementary models should be considered when institutions have the capacity and resources.
- The core outputs of MFUs should be published, to enhance transparency and public debate on fiscal policy.

## REFERENCES

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## Regional Notes

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