



Comments on “Long-term dimension to fiscal uncertainty” - Jim Ebdon, Office for Budget Responsibility

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European Commission

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Fiscal policy in an uncertain environment
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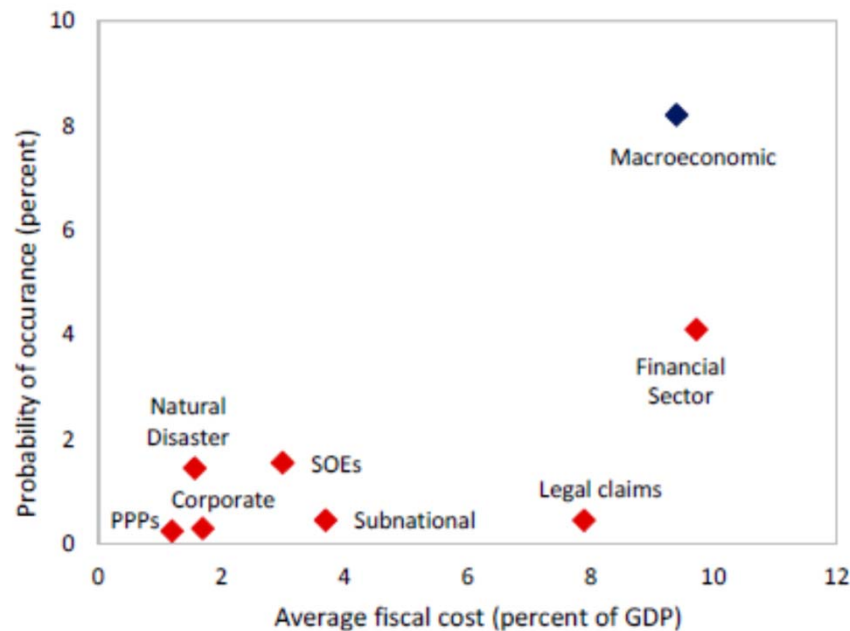
1. Background

Background

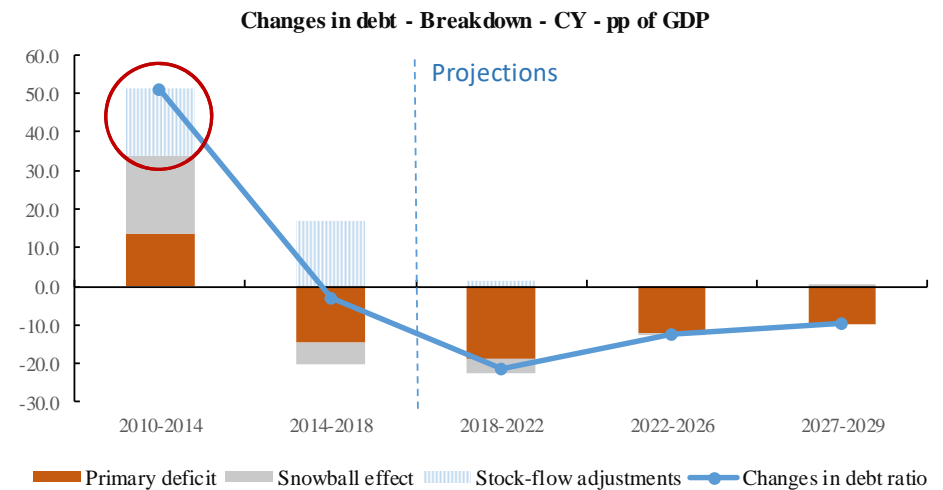
- Growing recognition of large uncertainties surrounding medium-/long-term projections e.g.
 - **Balassone et al. (2008), Crafts and Mills (2017)**
 - **IMF contributions on analysing and managing fiscal risks (2016) and review of DSA framework for market-access economies (on-going)**
- Increases in government debt often driven by ‘unexpected’ & large shocks 
- Revision of long-term projections when change in underlying assumptions can be large

Increases in government debt often driven by 'unexpected' & large shocks

Figure 1. Costs and Frequency of Fiscal Risk Realizations



Sources: Bova and others (2016) and staff estimates.



Source: COM FSR 2018



1. The OBR approach

Key features and strengths (cont'.)

- Few national institutions perform long-term analysis and even less so risk analysis (IMF, 2016)
- OBR approach goes beyond standard stress test analysis by:
 - Identifying a *large* set of risks *most relevant* for the UK (e.g. macroeconomic, financial, policy-related)
 - Associated *range of probability* of realization (based on judgement / experience)
 - *Broad* measured fiscal impacts: over medium-/long-term, and for flow and stock variables

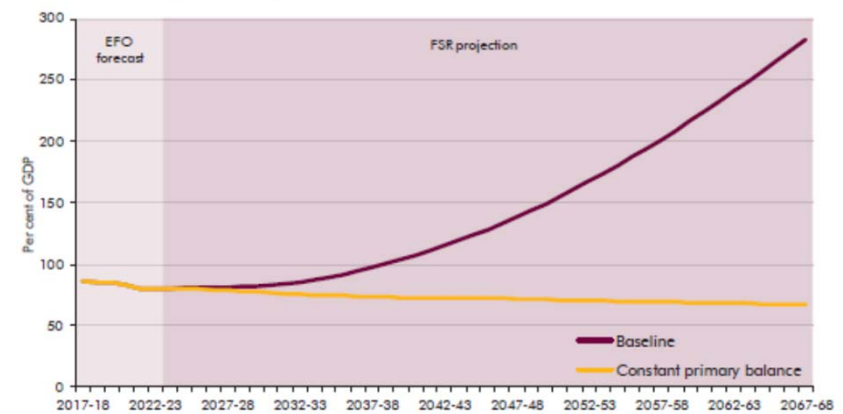
Key features and strengths

- **Transparent framework** in terms of inputs, analysis, results and limitations
- Large variety of *individual* risks considered, with some feedback effects taken into account
- Specific to some items (expenditure / receipts, specific balance sheet risks)
- *A combined* fiscal stress test (based on BoE stress test)
- **Main metric to assess results: public sector net debt**

Main results

- **OBR: matrix with 5 ranges of probability** (very low/low/medium/high/very high) and **3 ranges of impact** (low/medium/high)
- **Medium-term:**
 - Shocks with a **high impact** have a (very) low probability (except. 'typical recession')
 - Shocks with a **(very) high probability** have a low impact
- **Long-term:**
 - Over 60% of shocks with **medium / high impact** and **medium to very high probability**

Chart 3.18: Projections of public sector net debt



Source: OBR



1. The COM approach: similarities and differences

OBR: FSR, FRR

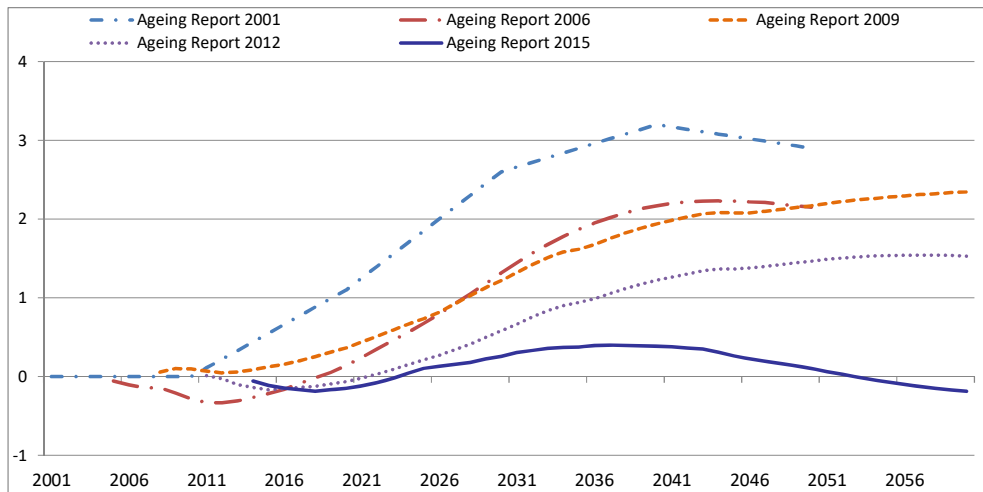


COM: FSR / DSM, AR

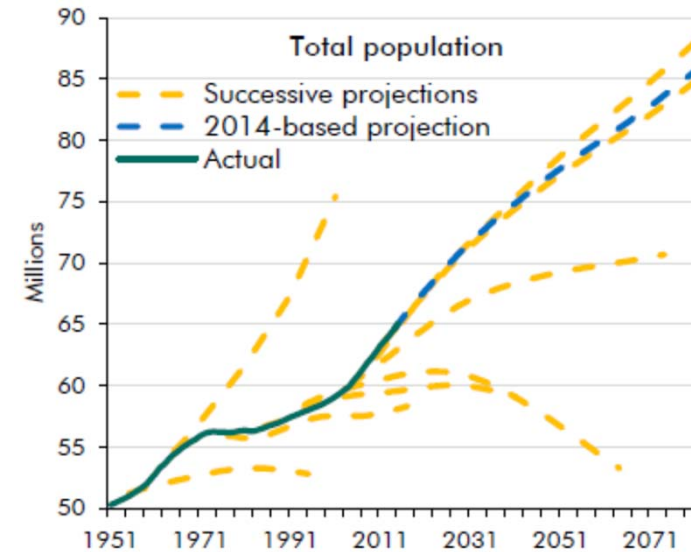


Confronted to similar challenges

Changes in public pension expenditure as a share of GDP in the 2001, 2009, 2012 and 2015 vintages, EU



UK



Source: OBR FRR 2017 (ONS)

Overall classification of main assumptions by comparing budgetary projection exercises

	Ageing report 2001*	Ageing report 2006**	Ageing report 2009***	Ageing report 2012***	Ageing report 2015
Demographic assumptions					
Labour force assumptions					
Macroeconomic assumptions					

Source: Commission Discussion Paper on pensions (2016)



Some similarities with the OBR approach

- Distinction between **medium-/long-term risks**, entailing different indicators and risk scenarios considered
 - Some differences in terms of time-span
- For the long-term: also strong focus on **ageing-related costs** and non-demographic drivers of **health-care spending**
- Similar attention to **downside risks** in both cases

Some differences

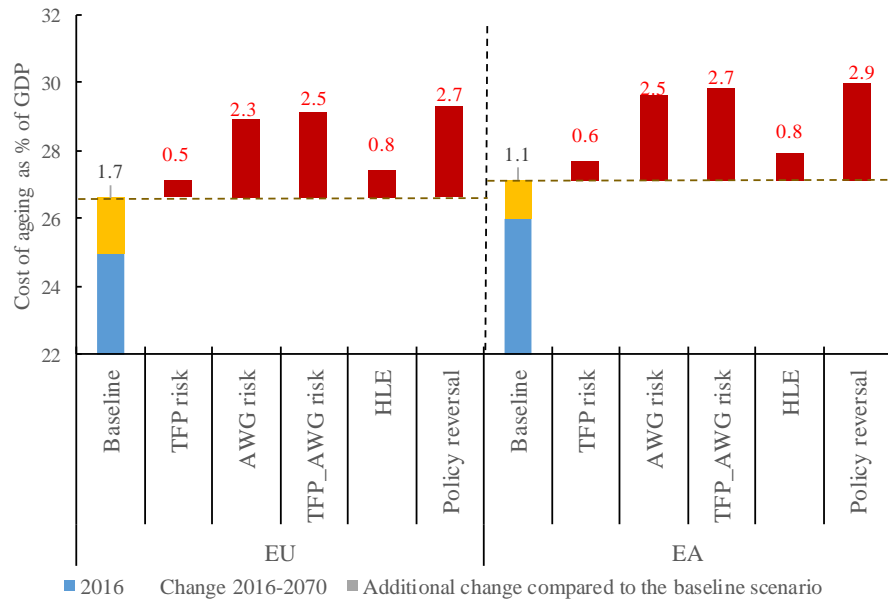
- **Horizontal approach**, less tailored-made stress tests and less granular projections
- Some differences in the interpretation of the no-fiscal policy change assumption
- **Use of stochastic projections**
- **Overall risk assessment provided by time-dimension**
- Increasing use of **additional indicators** to debt in the medium-term such as **GFN** (important in case of liquidity tensions)

Different ways to capture uncertainties in COM framework

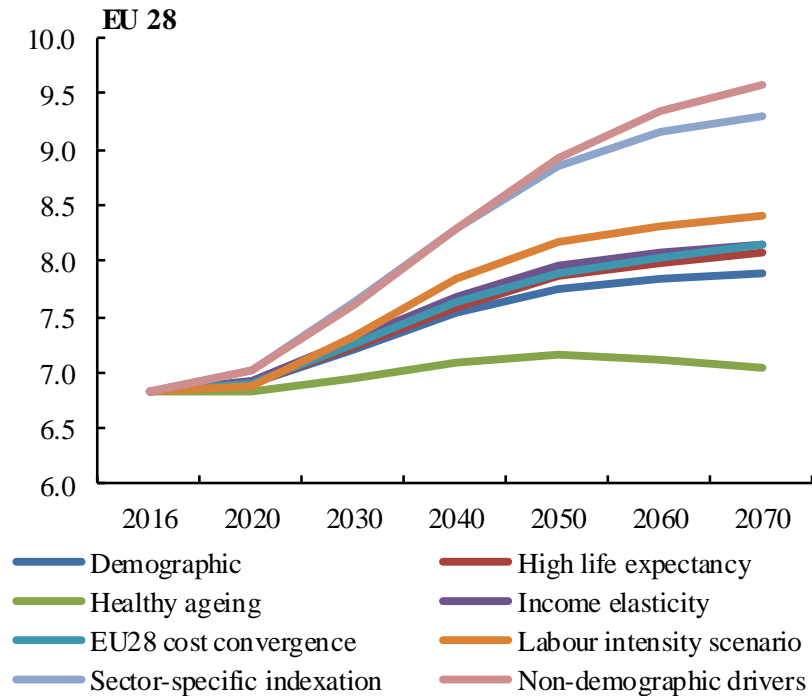
- Medium- and long-term assessment is based on a **large set of tools, indicators and scenarios**
- **Extensive sensitivity analysis** (S1 and S2 indicators, debt projections) 
- **Stochastic projections** used to inform the risk classification 
- Additional tools to capture **tail events** and **broad government liabilities** (based on Eurostat reporting, Symbol)

Extensive sensitivity analysis

Projected change in cost of ageing, baseline and risk scenarios, 2016-2070, FSR 2018



Health-care expenditure, % of GDP, EU, AR 2018

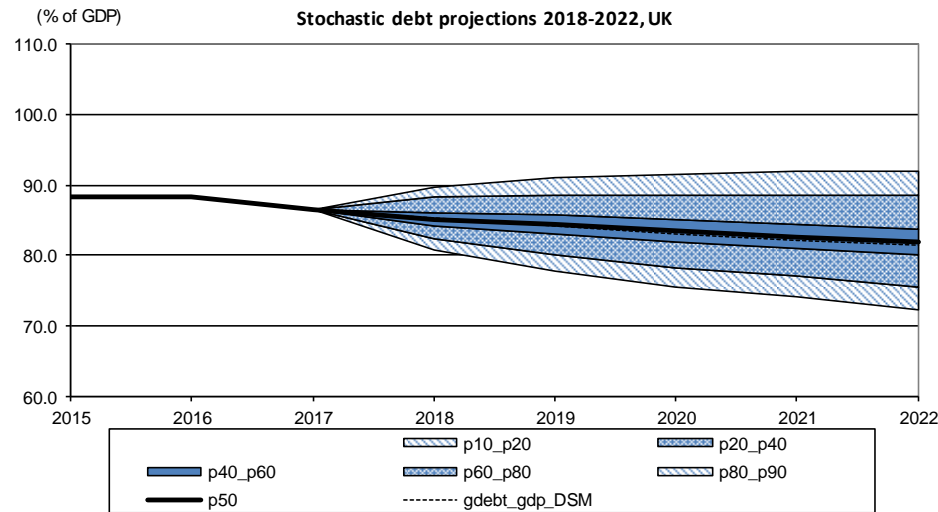


Source: COM FSR 2018, Ageing Report 2018



Comparing different risk scenarios

General government debt (% of GDP), COM DSM 2017



Source: COM DSM 2017

Public sector net debt (% of GDP), OBR FRR 2017



Source: OBR FRR 2017



COM: main results for the UK

- No short-term risk
- High-risk in the medium (10-15 years) and long-term
- Some qualifying aggravating / mitigating factors

2.1. Risk classification summary table

Short term	Medium term	S1	Debt sustainability analysis (detail)						DSA	S2	Long term	
			Baseline	Historical SPB	Lower GDP growth	Higher interest rate	Negative shock on SPB	Stochastic projections				
LOW (S0 = 0.4)	HIGH	MEDIUM (S1 = 1.3)	Risk category	MEDIUM	HIGH	MEDIUM	MEDIUM	MEDIUM	LOW	HIGH	MEDIUM (S2 = 3)	HIGH
			Debt level (2029)	73.9	96.9	78.3	77.6	76.5				
			Debt peak year	2018	2029	2018	2018	2018				
			Percentile rank	36.0%	75.0%							
			Probability debt higher						17.0%			
			Dif. between percentiles						19.3			

Source: COM FSR 2018

Open issues and questions

- **What about short-term risks?**
 - Near-term fiscal risks expressed as a concern of UK government
- **Deterministic projections:**
 - How to best choose and calibrate risk scenarios?
 - How to best 'estimate' their probabilities?
- **Use of stochastic projections:**
 - Useful metrics: probability of debt not to stabilise / to cross a certain risk threshold
 - Remaining questions: best calibration of shocks, scope of variables considered (typically not SFA)
- **Importance of tail events**
- **How to best communicate about the results?**
 - Trade-off between complexity and clarity of results

Thank you for your attention