REPUBLIC OF SLOVENIA
FISCAL COUNCIL

Report on the Fiscal Council's operations in 2017

May 2018

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FOREWORD

The Fiscal Council started its operations at the end of March 2017, after the National Assembly had appointed its members by more than a two-thirds majority on 21 March 2017. The present Report on the Fiscal Council's operations in the past year is thus the first report to be submitted to the National Assembly in accordance with the provisions of the Fiscal Rule Act (ZFisP). In the Fiscal Council's view all the obligations imposed by the aforementioned act were duly fulfilled in 2017.

The first year of the Fiscal Council's operations was marked by favourable economic conditions that followed the deepest and longest crisis since Slovenia gained its independence. The general government revenue was boosted by a 5% economic growth rate, thus providing for a slight nominal surplus in the general government balance. Such balance enabled Slovenia to converge to the structural balance and significantly reduced the public debt-to-GDP ratio to 73.6%. Due inter alia to political circumstances no measures have yet been adopted to ensure that the favourable fiscal trends would continue and/or would lead to long-term fiscal sustainability.

The setting of a fiscal framework is a politically challenging process. Two years passed after the adoption of the Fiscal Rule Act until the establishment of the Fiscal Council. However, the Constitution of the Republic of Slovenia and the Fiscal Rule Act itself prescribe a strong commitment to respecting fiscal rule and thus reducing the risk that Slovenia would fall into a debt trap, as happened to many countries in the past.

The fiscal rule, which lays down that the revenues and expenditures of state budgets must be balanced in the medium term without borrowing, or that revenues must exceed expenditures, has been integrated in Article 148 of the Constitution since 2013. Slovenia joined the EU response to the debt trap risks arising from the lack of fiscal responsibility relatively late, by a direct integration of the fiscal rule in the Constitution. Two years later this step was followed by the adoption of the Fiscal Rule Act, which defined the aforementioned constitutional provision in detail and set up the Fiscal Council as an independent and autonomous state authority that prepares and makes publicly available assessments regarding the compliance of fiscal policies with the fiscal rules.

Firm commitments to respecting the fiscal rules and thus ensuring long-term fiscal sustainability are very important in the EU, and particularly in the euro area. The euro area Member States constitute a single monetary union, while at the same time every one of them has retained its fiscal sovereignty. Fiscal rules are therefore commitments of sovereign states to pursue a long-term sustainable fiscal policy, which is undoubtedly in the interest of their populations. Moreover, as they are closely interconnected, only the sustainable and sound public finances of every Member State can prevent the spreading of financial deterioration to partner states in the Union.

Ensuring a fiscal balance hardly scores political points in the short term, as it usually implies an unpopular message of restrictions over expenditure (growth of expenditure). The Fiscal Council, as an expert and autonomous authority, accordingly participates in drafting the budgets by providing opinions on the compliance of key budget documents with the fiscal rules. Its participation increases the transparency of budget adoption and provides the general public with greater control over the process, which in turn imposes a greater fiscal and, consequently, political responsibility, on decision-makers.

Stable and sustainable public finances are in the interest of us all. Notwithstanding the progress of economic science, economic forecasts and assessments of the cyclical position of the economy remain unreliable. The decision for a medium-term fiscal balance therefore lacks credibility if it is not supported by the current budget activities. A regular assessment of the appropriateness of budget documents is based on the fiscal rules that result from the current level of knowledge about the policy facilitating fiscal sustainability. Debates on the further development of the fiscal rules are underway in the bodies of the European Union and the Organisation for Economic Co-operation and Development. However, their basic purpose must remain clear: to maintain a long-term sustainable fiscal policy and to prevent the triggering of a debt trap.

Despite good economic and fiscal results in the last year, Slovenia remains vulnerable to risks. Its public debt is excessive and the medium-term fiscal objective with a slight structural surplus has not yet been achieved. Slovenia is one of the EU Member States in which the general government expenditure on ageing populations is expected to increase most, also because the social protection systems are not sufficiently adapted to such situation. High levels of economic growth, facilitated by the current global economic expansion and simultaneously combined with record low interest rates, will not persist over a long period of time and thus continue to ensure favourable fiscal trends. The precautionary principle in the planning of the general government budgets (as laid down by Article 4 of the Fiscal Rule Act) must therefore be an important consideration in fiscal decision-making, given all the uncertainties. By providing independent and expert opinions, the Fiscal Council will also strive to contribute to long-term fiscal sustainability in the future, and thus to improving the conditions of long-term economic growth and welfare of Slovenia's people.

Dr. Davorin Kračun,

President of the Fiscal Council

1. The Fiscal Council's operations in 2017

The Fiscal Rule Act (hereinafter: the ZFisP)[1], adopted in July 2015 by the National Assembly of the Republic of Slovenia (hereinafter: the National Assembly), constitutes the basis for the establishment and operations of the Fiscal Council. The ZFisP defines inter alia the tasks, the composition and the method of the Fiscal Council's operations. Its members were appointed by the constitutional majority of the National Assembly on 21 March 2017, when the Fiscal Council also started its operations. This chapter presents the main aspects of the Fiscal Council's operations in the first calendar year of its existence.

1.1 The guiding principles of the Fiscal Council's operations

The Fiscal Council is an independent and autonomous state authority supervising the conduct of fiscal policy. It is accountable for its operations solely to the National Assembly, which appoints and can also replace its members. The autonomy of this authority is a basic condition for the provision of opinions that are not subject to political developments each time a new government takes office. This is facilitated by the two-thirds majority vote of all deputies required for the appointment of the Fiscal Council's members and the autonomous disposal of the funds allocated from the state budget.[2] In budget planning process the Fiscal Council itself proposes the funds needed for its operations in accordance with the ZFisP. The autonomy of and a strong analytical support to the Fiscal Council's opinions are essential for the credibility of the new institution's operations. The guiding principle in the formulation of the Fiscal Council's opinions on public finances is their long-term focus, as only the public finances that are stable and sustainable in the long term can provide the basis for economic development and, in consequence, for people's welfare.

The tasks of the Fiscal Council are defined by the ZFisP. They mainly include the assessment of the appropriateness of budget documents, which must ensure compliance with the fiscal rules and/or fiscal stability in the medium term. The Fiscal Council also assesses whether exceptional circumstances that justify deviation from the medium-term public finance balance have occurred and when they ceased to exist. The full range of the Fiscal Council's tasks is described in Article 7 of the ZFisP. In addition to the provisions of the ZFisP, the Act Amending the Public Finance Act from February 2018[3], which also defines the deadlines for the preparation of opinions and assessments pursuant to the ZFisP, also imposed on the Fiscal Council the task of assessing the bias of historical macroeconomic forecasts that constitute the basis for the preparation of budget documents, and the Decree on development planning documents and procedures for the preparation of the central government budget also the task of the quality assessment of historical fiscal projections (a transitional period until 2020 has been laid down for the implementation of both tasks).

The first year of Fiscal Council's existence was marked by establishing its regular functioning cycle. Early on it adopted the Rules of Procedure of the Fiscal Council, which were published in the Official Gazette of the Republic of Slovenia [Uradni list RS], No. 26/2017, and which define the organisation and the method of its work. The Fiscal Council usually meets once per week at closed sessions to discuss the current macroeconomic and fiscal developments and, among other things, adopts decisions on the

[1] http://www.pisrs.si/Pis.web/pregledPredpisa?id=ZAKO7056

[2] For more information on the operating costs and the selected components of the Fiscal Council's balance sheet for 2017 see Annex 1.

[3] https://www.uradni-list.si/glasilo-uradni-list-rs/vsebina/2018-01-0544?sop=2018-01-0544

Table 1.1: Fiscal Council annual schedule of releases

	Week 1	Week 2	Week 3	Week 4
January		**FC: Current Developments**		
February				*SORS: National Accounts*
March		*IMAD: macro projection*		*SORS: General Govt Accounts*
April	*MoF: SP&NRP;* **FC: assess SP**	*MoF: Framework;* **FC: assess Framework**		
May			*EC: assess SP/CSR*	*SORS: National Accounts;* **FC: Annual Report**
June				*SORS: Gen Govt Accounts* **FC: assess t-1 Budget**
July	**FC: Current Developments**			
August				*SORS: National Accounts*
September		*IMAD: macro projection*		*SORS: General Govt Accounts*
October		*MoF: State Budget, Framework, DBP*	*SORS: EDP;* **FC: assess SB/FR/DBP**	
November		*EC: assess DBP*		*SORS: National Accounts*
December				*SORS: General Govt Accounts*

Note: This scheme shows the time aspect of Fiscal Council regular publication releases (in red) during a calendar year. Fiscal Council may publish assessments which are not mandated by law outside this schedule. Abbreviations: CSR: Country Specific Recommendation, DBP: Draft Budgetary Plan, FR: Framework, NRP: National Reform Programme, SP: Stability Programme.
Source: Fiscal Council.

publication of opinions and/or documents. It adopted its annual work plan, taking into account the requirements laid down by the ZFisP. In terms of its schedule, the annual work plan is largely defined by the procedure of preparing budget documents and by the publication of important macroeconomic and fiscal data.

For the purpose of providing support to its operations, the Fiscal Council concluded two agreements on cooperation with the national institutions. In comparison with similar institutions operating in other Member States, the Slovenian Fiscal Council is one of the smallest bodies in terms of staffing. This was one of the reasons why paragraph 7 of Article 10 of the ZFisP also provides for the possibility of concluding cooperation agreements with institutional units of the general government sector, which are obliged to provide the Fiscal Council with all the information, analyses and data at their disposal. In August 2017 the Fiscal Council concluded an agreement with the Institute for Macroeconomic Analysis and Development of the Republic of Slovenia (hereinafter: IMAD), and in September 2017, it also concluded an agreement with the Ministry of Finance (hereinafter: MoF).[4] The two agreements define the data and/or documents that these institutions have to provide and the deadlines for their provision.

[4] Both agreements are available at: http://www.fs-rs.si/legislation/

The Fiscal Council also sent a proposal for a cooperation agreement to the Bank of Slovenia (hereinafter: BoS)[5], but the agreement has not yet been concluded. In 2017 the two cooperation agreements concluded with IMAD and the MoF were implemented as agreed.

On several occasions in 2017 the Fiscal Council met with both the representatives of the institutions with whom the cooperation agreements were signed, as well as with the representatives of certain other national institutions. The cooperation agreements concluded with the MoF and IMAD also include a provision on holding regular meetings at the technical level for the purpose of informing the Fiscal Council of the current macroeconomic and fiscal developments and forecasts. The representatives of the two institutions held meetings at the technical level with the Fiscal Council's Analysis Service on a regular basis, discussing in detail the aforementioned topics, and the Analysis Service also held one meeting with the Bank of Slovenia on those same topics. Moreover, the Fiscal Council's members met several times with the MoF's representatives with the purpose of obtaining information on legislative procedures and the challenges of the conduct of fiscal policy.

For the purpose of its operations the Fiscal Council also needs data and information that are not available to the public and are not official. With a view to being regularly provided with the necessary information, the Fiscal Council made a request to the Secretariat-General of the Government of the Republic of Slovenia (hereinafter: the Government) to be granted the same preliminary access to the materials prepared for the Government sessions as is being granted to the bodies functioning within the context of the Government. Its request was, however, denied, so the Fiscal Council only has access to such materials after the Government sessions are held, i.e. when they are published on the Government's website. For the purpose of analysis and forming opinions the Fiscal Council, in accordance with the ZFisP, also made requests to obtain data and information from the Ministry of Public Administration and the Statistical Office of the Republic of Slovenia, although the relevant cooperation agreements have not yet been concluded. In particular, the Fiscal Council wishes to further improve the flow of information with the Statistical Office. Consequently there is room for further improving the smooth functioning of the Fiscal Council in this area, as it is a very small institution whose effectiveness is easily and strongly affected by even minor administrative obstacles.

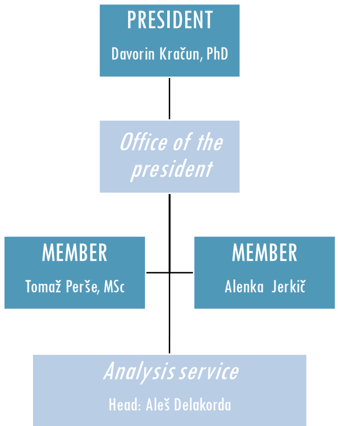
1.2 Composition of the Fiscal Council

The Fiscal Council has three members, i.e. the President and two members. Members of the Fiscal Council are appointed for a period of five years, but for not more than two consecutive periods. Article 8 of the ZFisP lays down that the function of a member of the Fiscal Council is incompatible with holding a public office including activities of managing, supervising or representing direct and indirect spending units of the budgets of the general government sector.

The President represents the Fiscal Council, and organises and manages its work. In accordance with the provisions of Article 10 of the ZFisP the President of the Fiscal Council must be employed with the Fiscal Council for at least half-time full employment, whereas the members of the Fiscal Council may be employed with the Fiscal Council for not more than half-time full employment. Currently, the President is employed full-time with the Fiscal Council, and the two members for 50 percent of full-time employment each.

[5] Some fiscal councils work closely with national central banks. In Austria and Slovakia, their central banks finance the operations of fiscal councils and the offices of fiscal councils are physically located within the central banks. Such arrangements increase, inter alia, the possibility of effectively using the capacities available to the central banks (e.g. human resources).

Figure 1.1: Organizational chart of the Fiscal Council



Source: Fiscal Council.

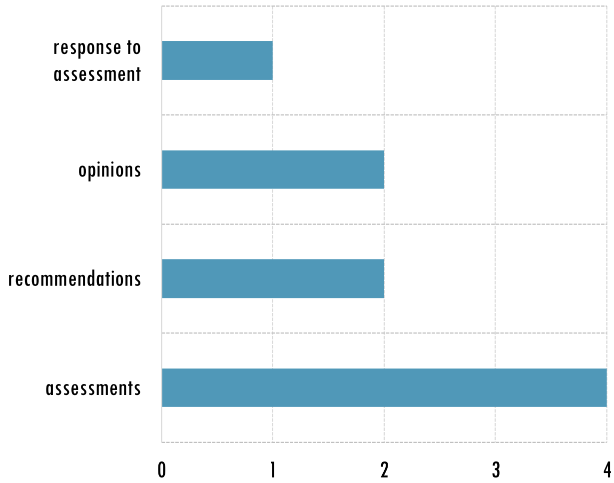
Four public employees are employed in the Fiscal Council. This is also the maximum number of employees of the Fiscal Council as laid down by paragraph 5 of Article 10 of the ZFisP. Public employees provide administrative and expert support to the Fiscal Council's members. The staffing of expert services was completed in October 2017. One public employee works in the President's office and performs administrative and organisational tasks, and three public employees work in the Analysis Service. In accordance with paragraph 6 of Article 10 of the ZFisP, administrative and technical tasks (human resources, information technology and accounting tasks, public relations tasks, etc.) for the Fiscal Council are performed by the services of the Court of Audit of the Republic of Slovenia (hereinafter: Court of Audit), where the Fiscal Council's premises are located. The Fiscal Council, in accordance with the agreement concluded between the two institutions, pays the cost of services and rental of premises to the Court of Audit (see the explanation for the item "Material expenditure" in Table 1 in Annex 1).

The Analysis Service provides expert assistance to the Fiscal Council's members. In this context it regularly monitors and analyses macroeconomic and fiscal developments in Slovenia and abroad and prepares working documents for the members and expert groundwork for their opinions. The priority areas of the first year's operations of the Analysis Service included the setting up of databases, the automation of processes for the monitoring of economic indicators, the setting up of basic analytical tools for the analysis of cyclical and fiscal trends, and the technical and content design of the Fiscal Council's regular publications.

1.3 The Fiscal Council's recommendations and assessments and the Government's responses

In 2017 the Fiscal Council worked actively on the tasks defined by the ZFisP. It should also be noted that paragraph 4 of Article 7 of the ZFisP lays down that the Government must respond to the opinions provided by the Fiscal Council. The Government must draw up a written reasoned opinion on the assessments of the Fiscal Council and submit it to the National Assembly (i.e. the "comply-or-explain principle", laid down by the Union legal framework in Directive 2011/85/EU). The drafting of a

Figure 1.2: Recommendations and assessments by the Fiscal Council in 2017



Source: FC.

written reasoned opinion by the Government increases the transparency of its operations and its eventual lack of response to the recommendations aggravates its political responsibility.

In accordance with the ZFisP, the Fiscal Council's assessments referred to the budget documents drawn-up by the Government. Thus the Fiscal Council:

– on 13 April 2017 submitted to the National Assembly and the Government an assessment of the sustainability and compliance of the fiscal policy with the fiscal rules on the basis of the draft amended Stability Programme and the proposed framework for drawing up budgets of the general government sector for the period 2018–2020 (as laid down in point 1 of paragraph 2 of Article 7 of the ZFisP),

– on 25 April 2017 submitted to the National Assembly and the Government an assessment of the sustainability and compliance of the fiscal policy with the fiscal rules on the basis of the proposal for the ordinance amending the ordinance on the framework for drawing up budgets of the general government sector for the period 2017-2019 (as laid down in paragraph 4 of Article 6 of the ZFisP),

– on 18 July 2017 submitted to the National Assembly and the Government an assessment of compliance of the implemented budgets of the general government sector with the fiscal rules in 2016 (as laid down in point 4 of paragraph 2 of Article 7 of the ZFisP), and

– on 19 October 2017 submitted to the National Assembly and the Government an assessment of compliance of the budget documents for the period 2018 – 2020 with the fiscal rules (as laid down in points 2 and 5 of paragraph 2 of Article 7 of the ZFisP).

In 2017 the Fiscal Council, for objective reasons, has not prepared a report on its operations in the previous year (it began to function at the end of March 2017), as laid down in point 8 of Article 10 of the ZFisP.

During its reviews of budget documents in 2017 the Fiscal Council found that, for the most part, compliance with the fiscal rules in the period when Slovenia has not yet achieved its medium-term fiscal objective was only partial. As the future-oriented budget documents were found to only partially comply with the fiscal rules, the Fiscal Council called on the Government to implement a consistent restrictive fiscal policy in order to gradually reduce the debt to the pre-crisis level and to create sufficient reserves to ensure long-term sustainability also in view of demographic changes. The Fiscal Council also called attention to the insufficiently defined measures aimed at ensuring the appropriate fiscal effort in structural terms. It also called for efficient expenditure, which should not have a discouraging effect on the quality of services or the efficiency of the public sector, and also called for an inclusive and growth-friendly economic environment. In reviewing the implementation of the fiscal policy in 2016 the Fiscal Council assessed that Slovenia, with the exception of achieving the medium-term fiscal objective, complied with the fiscal rules, although this was largely achieved on the basis of factors that do not ensure a lasting fiscal balance.

The Government responded to the Fiscal Council's assessments with public written explanations, in which it emphasised its commitment to a gradual fiscal consolidation and highlighted the achieving of its own medium-term budgetary objective by 2020, which, however, does not comply with the rules of the Stability and Growth Pact. The Government explained that, through gradual consolidation, it intends to limit expenditure growth on the one hand, and to promote faster growth and prosperity on the other hand. Great role in the assessment of the necessary dynamic pattern of fiscal consolidation was attributed by the Government to methodological differences in assessing the cyclical position of the economy. At the same time, the Government stressed that it would monitor the risks highlighted by the Fiscal Council in its assessments, and respond to them accordingly.

The Fiscal Council's recommendations in 2017 referred primarily to the challenges encountered in the conduct of fiscal policy in the period of high economic growth, also associated with the effects of an ageing population. The GDP data released for the first quarter of 2017 thus indicated that economic growth in 2017 could exceed the growth that served as the basis for drafting the budget documents in spring 2017. As a result, in June the Fiscal Council called on the Government to immediately define an additional fiscal effort in structural terms. The Fiscal Council also urged the Government and all stakeholders involved in proposing budget expenditures to be prudent in the planning of general government expenditure, and pointed to the necessity of setting up a budgetary reserve. It pointed out that the setting up of budgetary reserves in times of good economic conditions is particularly urgent due to the unfavourable consequences of demographic changes that are expected to arise already in the medium term. In August the Fiscal Council called on the Government to take action regarding the expenditure associated with the ageing population. According to the Fiscal Council, one of the consequences of the lack of action in this area would also be the requirement to create an even higher structural surplus in order to ensure the long-term sustainability of public finances.

The Fiscal Council also issued two opinions on the current economic and political issues. In autumn it called for the fast-track adoption of a new Public Finance Act, so that the provisions of the Directive on requirements for budgetary frameworks of the Member States (2011/85/EU) would be properly transposed into the national legislation and the provisions of the new act could be applied in budgetary procedures as of the beginning of 2018. The Fiscal Council also joined the debate on the fiscal implications of transport infrastructure construction. It also drew attention to the need for transparent planning and use of public funds, a possible excess domestic demand and the need to include large infrastructure projects in the medium-term budgetary framework.

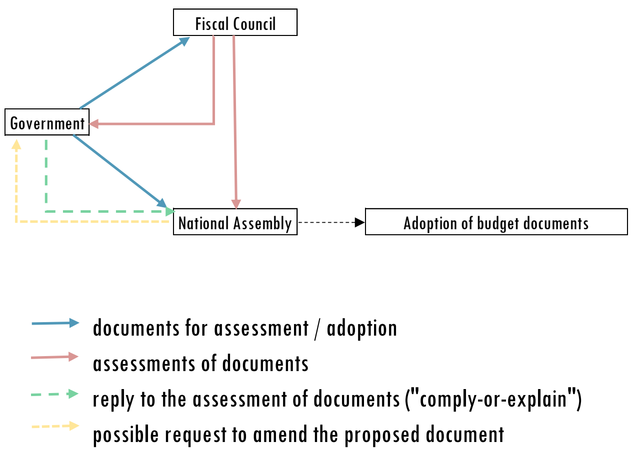
In November 2017 the Fiscal Council responded to the assessment of budget documents provided by the European Commission (hereinafter: the EC). The EC found that the Draft Budgetary Plan 2018 only partly complies with the fiscal rules applicable in the context of the Stability and Growth Pact. The Fiscal Council's findings were similar to the EC's and they were included in its Assessment of the Compliance of Budget Documents for the period 2018-2020 with the fiscal rules published in October. At the same time, the EC highlighted the risks posed by the pressures to further increase general government expenditure, in particular wages and pensions, and by the absence of measures to ensure a gradual equilibration of the structural balance in the medium term, which was also pointed out by the Fiscal Council in its assessments.

1.4 The Fiscal Council in the National Assembly

The Fiscal Council's cooperation with legislature is extremely important. As an independent institution dealing with nonpartisan analyses of economic and fiscal developments, the Fiscal Council can provide indirect support to the deputies' decisions on budget guidelines and on public finance topics.[6] In accordance with its mandate the Fiscal Council relies in its work strictly on a positive analysis and does not provide opinions on particular fiscal measures and/or laws. Such policy enables the Fiscal Council to maintain its nonpartisan status, while at the same time ensuring the apolitical nature of its operations.

The Fiscal Council also submits its assessments of budget documents and fiscal trends to the National Assembly for consideration. It accordingly also takes part in the sessions held by the Committee on Finance and Monetary Policy, where it presents and explains its opinions and weighs them against the Government's opinions. If opinions on budget documents are provided, the Government must respond to them at the same session by explaining how such opinions will be taken into account or why they will not be taken into account ("comply-or-explain"). As an autonomous authority, the Fiscal Council was also invited to some sessions held by the Commission for Public Finance Supervision, where it presented its opinions on topical issues relating to its area of work.

Figure 1.3: Relations between the Fiscal Council, the Government and the National Assembly during the process of adoption of budget documents



Source: Fiscal Council.

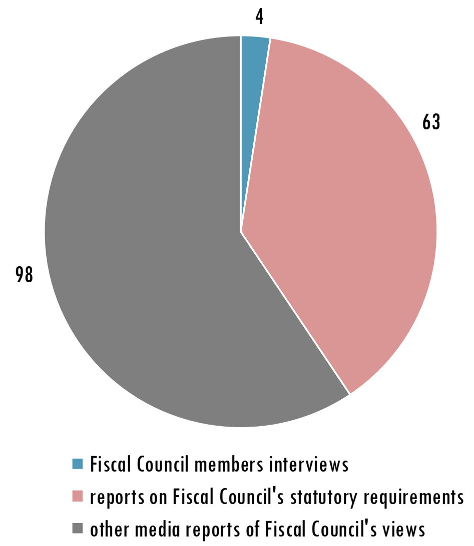
[6] In some countries (such as Australia, Croatia, Italy, South Korea, Canada, and the USA) fiscal councils are placed within the parliamentary framework by institutional regulation.

The Fiscal Council actively participated in the drafting of the Act amending the Public Finance Act as regards the medium-term budgetary framework.[7] During the transposition of Directive 2011/85/EU into Slovenian legislation, the Fiscal Council submitted proposals for adapting the requirements of said Directive to the national institutional framework, coordinating its work with the Ministry of Finance. As early as in September 2017 the Fiscal Council issued a call for the prompt adoption of the Public Finance Act. In its invitation[8] it voiced the opinion that an improved legal basis for the budgetary planning of the expenditure of indirect budget spending units is of great importance for ensuring more stable public finances. The Fiscal Council also proposed that every new government, upon taking office, adopt a medium-term strategy and define all the key elements for its implementation. At the same time due attention should also be paid to the long-term equilibrium of the general government balance and/or the structural balance, and to a detailed definition of measures that have an impact on the long-term equilibrium of the general government balance. Furthermore, the Fiscal Council was of the opinion that the new Public Finance Act should also provide for an effective response system to the recommendations and assessments submitted by the Fiscal Council, thus upgrading the provisions of the ZFisP.

1.5 The Fiscal Council's contacts with the media

Communication with the media and informing the general public of its findings are among the important tasks of independent fiscal institutions. Since the Fiscal Council merely provides opinions on budget documents that the Government is not obliged to take into account (as only the "comply-or-explain" rule applies), it can only have an indirect impact on the fiscal policy. As a result, its task is primarily to raise the awareness of the general public, public opinion makers and other stakeholders about the importance of ensuring a long-term sustainable fiscal policy. However, in order that its opinions be taken into account in public debates, its credibility should be established, i.e. public confidence in the Fiscal Council's analyses and opinions.

Figure 1.4: Number of media reports about the Fiscal Council in 2017



Source: Fiscal Council.

[7] http://www.pisrs.si/Pis.web/pregledPredpisa?id=ZAKO6975
[8] http://www.fs-rs.si/position-of-the-fiscal-council-on-the-legal-framework-for-medium-term-fiscal-planning/

In 2017 the Fiscal Council provided information about its work to the public through publishing recommendations and opinions, interviews with the President and/or the members, and organising press conferences. The President of the Fiscal Council held four interviews with various media, covering a wide range of macroeconomic and fiscal topics. The media also responded to individual publications of the Fiscal Council's opinions and views. The first press conference was organised upon the publication of the assessed compliance of budget documents for the period 2018-2020 with the fiscal rules as part of the autumn drafting of budgets.

The Fiscal Council set up its own website at the beginning of its functioning,[9] thus providing access to the current publications of opinions, assessments, views and recommendations to a broad circle of the interested public. Furthermore, the legislation associated with the work of the Fiscal Council, cooperation agreements with other institutions and interviews with its members are currently available at its website. The majority of publications, as well as other basic information on its operations, are also available on its English website. In the future the website is planned to be redesigned with a view to increasing the transparency of the published documents and of the data and methods that provide the basis for the Fiscal Council's assessments. At the same time, the website's content will be expanded, with a particular focus on educating the general public.

1.6 Contacts with international institutions

Shortly after it started its operations, the Fiscal Council began to join international networks of similar institutions and participated in discussions with international institutions that analyse economic developments in Slovenia. The purpose of joining international networks of independent fiscal institutions is to follow the current trends in budgetary surveillance, the exchange of information and the transfer of good practices of similar institutions. The Fiscal Council cooperates not only with the national institutions that formulate and implement economic policy in Slovenia, but also has contacts with international institutions. In such contacts it presents and explains its views on the macroeconomic and fiscal developments in Slovenia.

1.6.1 The Fiscal Council and networks of EU independent fiscal institutions

The Fiscal Council joined the EU Network of Independent Fiscal Institutions (EUNIFI) and the network of the European Union's Independent Fiscal Institutions (EU IFI). The EUNIFI is a formal network of EU independent fiscal institutions, whose work is organised by the EC and whose purpose is to link the institutions predominantly in terms of public finance management and compliance with the fiscal rules laid down by EU law. At the first meeting of the EUNIFI network, attended also by the Slovenian Fiscal Council, the President outlined the establishment of the new institution and the challenges faced by it. The EU IFI[10], however, is a voluntary and informal network of independent fiscal institutions, which provides a platform to exchange views and information among its members, but without the participation of EU institutions. The EU IFI thus also provides opinions on the legislative proposals of the European Commission. Among other things, it delivered an opinion on a EU Council Directive implementing the Fiscal Compact into EU law.[11]

[9] www.fs-rs.si/news

[10] http://www.euifis.eu/

[11] http://www.euifis.eu/eng/fiscal/215/statement-on-com-proposal-for-a-directive

Box 1.1: Strengthening fiscal responsibility and the medium-term budgetary orientation in the EU

In December 2017 the EC presented a Roadmap and proposals for directives and/or plans for further steps for deepening Europe's Economic and Monetary Union.[1] The proposals refer to (i) establishing a European Monetary Fund (EMF) to assist euro area Member States in financial distress, (ii) setting up new budgetary instruments for a stable euro area, (iii) introducing the function of a European Minister of Economy and Finance within the Union for the purpose of strengthening the efficiency of the EU and the euro area, and (iv) strengthening fiscal responsibility and the medium-term budgetary orientation in the Member States.[2] The discussion, expected to result in the finalization of the majority of proposals for the Directive, will take place until mid-2019.

The strengthening of fiscal responsibility and the medium-term budgetary orientation in the Member States refers to the integration of the substance of the intergovernmental Treaty on Stability, Coordination and Governance in the Economic and Monetary Union from 2012 into the Union legal framework and/or in national legislation in the event of any new provisions. The proposal for a directive in this area refers in particular to Article 3 of the Treaty, the so-called the Fiscal Compact, which recognizes the need for a structural balance of the general government and sets up a correction mechanism in the event of a deviation from such rule. Member States have already transposed the content of Article 3 of the Fiscal Compact into their national legislations, including Slovenia – by adopting the Fiscal Rule Act in 2015. In the opinion of the European Commission, the adoption of the proposed Directive would simplify the legislative framework and facilitate a swift and improved surveillance within the framework of economic governance in the EU. This would complement the existing fiscal frameworks whose common purpose is to reduce a government debt to a long-term sustainable level.

According to the proposed Directive the imposition of additional responsibilities upon independent fiscal institutions that monitor the implementation of the fiscal rules is crucial for the strengthening of fiscal responsibility. Evidence shows that the independent monitoring of fiscal rules is associated with increased transparency, better fiscal outcomes and lower sovereign debt financing costs. The proposed Directive consequently also foresees involving independent fiscal institutions in assessing the adequacy of the medium-term budgetary objectives (and not only its implementation), as well as in monitoring how the correction mechanism is activated and applied. The monitoring also includes assessing the adequacy of the measures taken to eliminate deviations from the medium-term budgetary objectives, as well as assessing the progress made in eliminating deviations. The importance of the "comply-or-explain" rule, which is listed in the proposed Directive as the "comply-or-justify" rule, is to be increased as well. Under this rule the Government must explain the reasons for its lack of response in the event of failure to comply with the recommendations of an independent fiscal institution. According to the proposed Directive, Member States should improve the access of independent fiscal institutions to information and ensure that they have the capacity to effectively fulfil their given tasks.

The proposed Directive addresses the strengthening of medium-term orientation through a refreshed approach to the medium-term fiscal planning. In the future the expenditure rule is supposed to be given a more prominent role. The Directive foresees the setting of a medium-term growth path of government expenditure that will comply with the medium-term fiscal objective and/or the time schedule for achieving such objective. The medium-term growth path of government expenditure should be set as soon as a new government takes office for the whole term of its office. Such an expenditure growth path should be taken into account in budget documents for the entire period covered by such a plan.

The new proposals introduced by the proposed Directive apply only partially to Slovenia, as many of them are already integrated in the national legislation. Thus, in the Fiscal Rule Act, the functioning of the correction mechanism in the event of significant deviations from the budgetary objectives has been already introduced, but the provisions that would incorporate new features introduced by the proposed Directive (such as the setting of the expenditure rule for the whole term of a government's office), or the provisions associated with the proposals of the Directive that call for greater powers of independent fiscal institutions (such as the expansion of their tasks and the related adequate provision with information and human resources), are still lacking.

[1] http://europa.eu/rapid/press-release_IP-17-5005_en.htm

[2] Calls for reforms in the EU economic governance system are common and reflect dissatisfaction with the current complex and non-transparent system of rules and their functioning. One of the more comprehensive proposals, which also refers to the reform of the fiscal structure in addition to regulating the financial system, is the brainchild of French and German economists (available at: http://bruegel.org/2018/01/reconciling-risk-sharing-with-market-discipline-a-constructive-approach-to-euro-area-reform/). They propose changing the fiscal rules with a view to increasing the importance of the expenditure rule in terms of the general government debt restrictions. This is expected to reduce the current pro-cyclical orientation of the rules and increase the effectiveness of the agreed rules, thereby increasing the credibility of the Economic and Monetary Union's functioning.

The Fiscal Council prepared a contribution for the web presentation of fiscal developments in Slovenia within the EU IFI framework. Twice per year the EU IFI publishes brief information on economic developments in EU Member States, and the EU IFI's Secretariat also summarizes the contributions on the basis thereof.[12] For this purpose, IMAD[13] presented macroeconomic forecasts and the Fiscal Council its view on the short- and long-term fiscal trends and the related challenges, according to the type of tasks performed by both institutions.

1.6.2 Contacts with other independent fiscal institutions

In December 2017 two representatives of the Fiscal Council paid a visit to the Irish Fiscal Advisory Council for the purpose of exchanging good practice. The Irish Fiscal Advisory Council[14] is roughly comparable with the Slovenian Fiscal Council (five members and six public employees) in size, and the annual report of the European Fiscal Board[15] lists it as an example of a new and successful institution. After its founding in 2011, the Irish Fiscal Advisory Council quickly began its operations and managed to establish itself as a credible institution. Discussions with two members and employees in the Secretariat of the Irish Fiscal Advisory Council referred to the main difficulties encountered in establishing a new independent fiscal institution, co-operation with the Ministry of Finance, a strategy of action and relations with the media, and cooperation with the parliament.

1.6.3 Contacts with international institutions

Within the framework of the European Semester, the Fiscal Council has established cooperation with the European Commission. In 2017 representatives of the European Commission paid a visit to the Fiscal Council twice, in August and in November. Cooperation took place at a technical level and was

[12] http://www.euifis.eu/eng/fiscal/174/european-fiscal-monitor

[13] Due to its independent drawing-up of macroeconomic forecasts, which constitute the basis for the preparation of budgets, IMAD is recognised as an independent fiscal institution and participates in the EU IFI and EUNIFI

[14] http://www.fiscalcouncil.ie/

[15] https://ec.europa.eu/info/sites/info/files/2017_efb_annual_report_en_0.pdf (Chapter 3).

intended to exchange the views on the current and future budgetary developments, in particular in terms of compliance with the fiscal rules.

The Fiscal Council was visited by the International Monetary Fund (IMF) twice in 2017. During the IMF's first visit immediately after the establishment of the Fiscal Council, the interlocutors exchanged the opinions and views on the Fiscal Council's role in Slovenia and compared its position with the position of fiscal councils in other countries. The second visit was intended for exchanging views on the current and the expected fiscal position of Slovenia and on the medium-term challenges of the fiscal policy, and the discussion focused primarily on the assessments of budget documents and long-term fiscal sustainability. Members of the Fiscal Council also presented to the IMF representatives their experiences regarding the position and role of the Fiscal Council in the budgeting process.

The Fiscal Council has also established cooperation with the OECD,[16] within which there is a network of independent fiscal institutions that provides a platform for exchanging information and good practices. On the basis of multi-annual cooperation and monitoring the OECD also drew up good practice guidelines for the effective operation of fiscal councils. Within the framework of the aforementioned network of independent fiscal institutions, the OECD also keeps a database[17] which, since summer 2017, has also included Slovenia, and which is intended to be a survey of the main features of independent fiscal institutions.[18]

In the framework of international cooperation, the employees of the Analysis Service took part in the following events:

- Workshop "Update of the Vade Mecum on the Stability and Growth Pact", organised by the EC in July 2017 in Brussels. At the technical level, the workshop highlighted the analysis of compliance with the fiscal rules at EU level through practical and detailed examples.
- Workshop "Fiscal Governance and the EU", organised jointly by the EC and the European Central Bank in Frankfurt in October 2017. The main purpose of the workshop was to point to the problems in monitoring the implementation of the current fiscal rules and in presenting proposals for their mitigation. At the technical level, representatives of some countries presented the methods of monitoring discretionary measures. The possibilities for improving the assessments of the cyclical position of the economy were also mentioned in the discussion.
- Workshop "Strengthening Fiscal Risk Management and Oversight of Public Corporations", organised by the Centre of Excellence in Finance and executed by the IMF in December 2017. The main guideline of the workshop was the implementation of the IMF guidelines on the identification, assessment, monitoring and management of fiscal risks. The areas of risk identification and assessment are the areas that must be examined also by the Fiscal Council.

[16] http://www.oecd.org/gov/budgeting/oecdnetworkofparliamentarybudgetofficialspbo.htm

[17] http://www.oecd.org/gov/budgeting/OECD-Independent-Fiscal-Institutions-Database.xlsx

[18] The survey of key features includes several areas, among them the legal basis, institutional model, leadership, relationship with legislature, mandate and functions, financial resources and the number of staff, independence, publications, access to information, transparency and external evaluation of the work of independent fiscal institutions.

2. Selected topics

Selected topics in the Report on the Fiscal Council's operations in 2017 describe certain aspects of the analyses performed by the Fiscal Council. The Fiscal Council has been facing important challenges in its work, as it has been largely engaged in preparing assessments of the current situation, which are uncertain and difficult to measure, and in assessing various expectations and scenarios regarding the future. The range of selected topics in the Report on the Fiscal Council's operations in 2017 attempts to highlight certain key challenges encountered within the framework of the Fiscal Council's operations, as well as the content-related and methodological bases for its opinions. The selected topics also shed light on additional tasks that the Fiscal Council will perform in the future, pursuant to the amendments to the Public Finance Act.

In order to assess the compliance of budget documents with the fiscal rules and/or the relevance of fiscal policy orientations in terms of achieving fiscal sustainability the Fiscal Council must formulate an opinion on the reliability of macroeconomic and fiscal forecasts. In accordance with Article 9g of the Public Finance Act the Fiscal Council will start regularly assessing the past macroeconomic forecasts produced in Slovenia independently by IMAD for the purposes of public finance projections in 2020. In the light of a full transposition of the requirements contained in EU Directive 2011/85 into national legislation the forecasts of fiscal aggregates will also be assessed in a similar manner. The survey of macroeconomic forecasts of all institutions that systematically and regularly make forecasts for Slovenia shows that, over a longer period of time, most forecasts underestimate actual GDP growth; however, the deviations in overestimated forecasts have been on average considerably higher. In principle, the accuracy of forecasts increases by reducing the forecast horizon. Any deviation of the general government revenue realisation from the forecast is largely associated with the deviations of the actual GDP from the projected one. The survey of government expenditure forecasts shows that the realisation was for the most part higher than the forecasts. It is also noted that in the years when revenue forecasts rose due to better macroeconomic conditions, expenditures also consistently followed this upward trend, which prevented any significant improvement in the fiscal balance. In this light it is assessed that the general government expenditure forecasts should become more realistic. Even more importantly, if higher revenues than planned are realised, they should not be used for unplanned increases in expenditure that unnecessarily hamper the achievement of the long-term fiscal sustainability. More consistent compliance with the fiscal rule should also contribute to achieving this objective in the future.

In assessing the compliance of fiscal objectives with the fiscal rules the Fiscal Council, among other things, also assesses the output gap and the one-off or temporary measures. The assessment of the output gap is one of the key indicators of the cyclical position of the economy, and at the same time forms the basis for the calculation of the structural balance and for the definition of the fiscal effort in structural terms required within the Stability and Growth Pact. The output gap is difficult to measure and, as a result, its assessment is uncertain and variable. In the case of Slovenia these assessments vary significantly over time, which is particularly true for periods of major economic fluctuations. A relatively wide range of assessments at a given point of time is even more important than their variability and is mainly caused by the use of different methodologies. We accordingly decided to use a wide range of methodologies and sources for the calculation of the output gap estimate in assessing compliance with the fiscal rules. Consequently, we do not only focus on the structural balance point calculation, but, due to the aforementioned uncertainty, we use a range of estimates in assessing the cyclical position of the economy; we also take into account a wide range of the relevant indicators. In calculating the structural balance it is also important to determine the one-off or temporary measures that are excluded from it. Because of their one-off nature, such measures are relatively difficult to foresee and are often subject to subsequent changes. It is also noted that one-off or temporary measures in previous years had often been projected in a way that at least partial compliance with the fiscal rules was achieved, but were not implemented at all or were implemented to a lesser extent. Their impact on the calculation of the structural balance will be even more important in times when the structural balance will fluctuate around the equilibrium. For this reason we decided to approach such measures with caution in our fiscal rule compliance assessments.

One of the key purposes in establishing the fiscal rules is to reduce the country's debt to a long-term sustainable level. The Fiscal Council's simulations also show that Slovenia faces in particular the long-term risk of debt sustainability. Simulations of changes in various macroeconomic and fiscal variables indicate that the medium-term risk of a significant increase in the general government gross debt associated with macroeconomic conditions is at present relatively limited. In the long term, however, the risks increase significantly, particularly in connection with the negative fiscal consequences of demographic changes. The simulations of the assumptions of the 2018 Ageing Report show that the debt should persist at the current levels until around 2025, when it would begin to rise rapidly. This indicates a time perspective in which the changes in social protection systems should start to take effect. The setting of a medium-term budgetary objective (MTO), which forms the basis of the Stability and Growth Pact, can also significantly contribute to the achievement of sustainable debt levels. The MTO that is currently appropriate for Slovenia should not be less than 0.25% of the GDP structural surplus, and current estimates suggest that, mostly due to the reduction of the debt-to-GDP ratio in the recent years, it could be decreased to a requirement of a structural balance in the future. The pursuit of different fiscal targets can have a significant impact on the general government debt level just in a few years, as indicated by the simulations of different MTO levels.

2.1 Accuracy of macroeconomic forecasts

One of the important risks in forecasting fiscal aggregates arises from the forecast of macroeconomic aggregates. Assessing the accuracy of the past macroeconomic forecasts, used as the basis for the preparation of budget documents and independently prepared by IMAD, will be one of the statutory tasks of the Fiscal Council from 2020 on.[19] Such analyses are currently made by IMAD and the Bank of Slovenia on a regular basis in the course of preparing their own forecasts. Our analysis represents the first step towards the legally required assessment of forecast quality, in which the relevant statistical indicators will be used as well. The focus is not on the accuracy of the forecasts from individual institutions, but rather on analysing the general characteristics of the trends of forecasts from different institutions. In addition to IMAD's forecasts the forecasts prepared by the Bank of Slovenia, the EC, the IMF, and the OECD were also used in the analysis.[20] Moreover, publicly available macroeconomic forecasts were also prepared by some other institutions (SKEP GZS, EIPF, Consensus Forecasts,

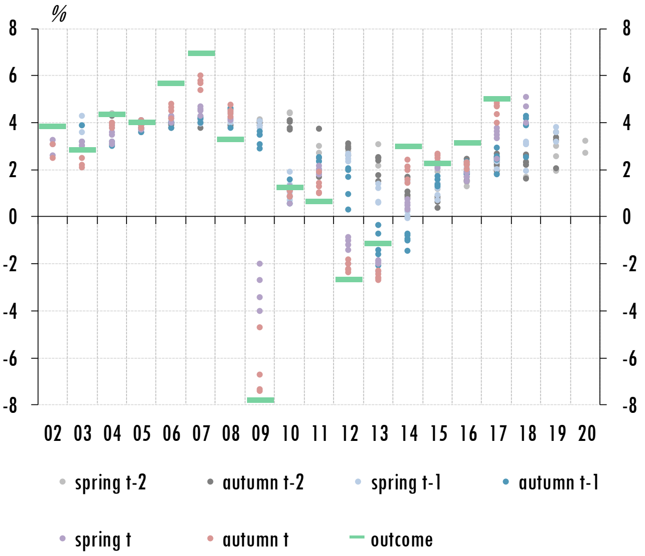
[19] Article 9g of the Public Finance Act (ZJF-H). The Act lays down a transitional period until the assessment of past macroeconomic forecasts is undertaken. From 2020 on, the Fiscal Council will have to perform biennially the analysis of IMAD's forecasts of macroeconomic aggregates for the past four years and present it in its report. If any deviations are detected, the Fiscal Council must submit to the Government the relevant findings and the Government has to prepare the relevant corrective measures. The Fiscal Council has to make the report available to the public on its websites.

[20] The available regular semi-annual forecasts prepared by these institutions are taken into account; however, it should be noted that the OECD only started to publish forecasts for Slovenia in 2011.

WIIW, EBRD), at least during part of the studied period, but they have been omitted from the analysis as these institutions no longer make such forecasts and/or updated data are not available. The latest available officially published statistical data were used as benchmark.[21] The forecasts published in the first half of the calendar year are marked as the spring ones and the rest of them as the autumn ones.

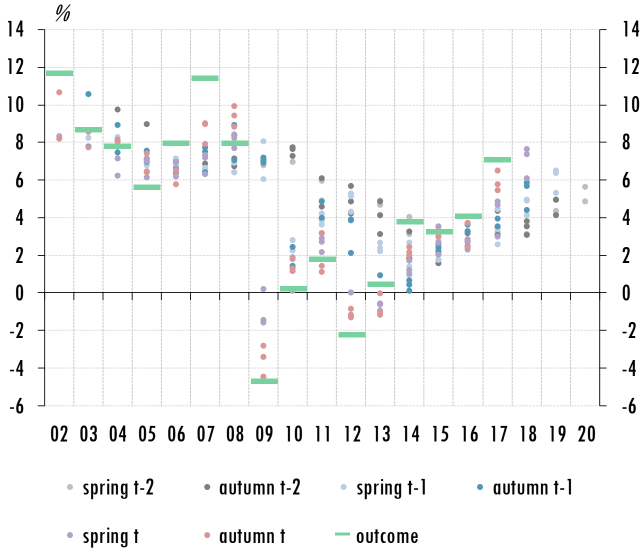
The availability of information at the time of the forecast (e.g. the publication of data on national accounts) and the use of differing assumptions have an important impact on the accuracy of fore-

Figure 2.1: Comparison of past forecasts of real GDP growth



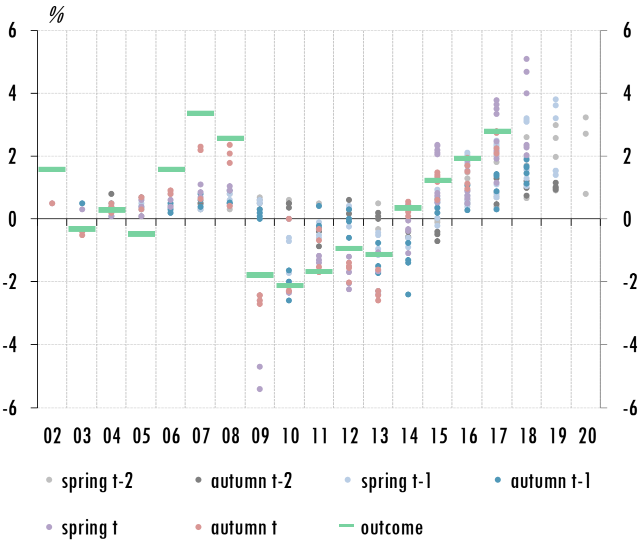
Sources: forecasts: IMAD, BoS, OECD, EC, IMF, outcome: SORS.

Figure 2.2: Comparison of past forecasts of nominal GDP growth



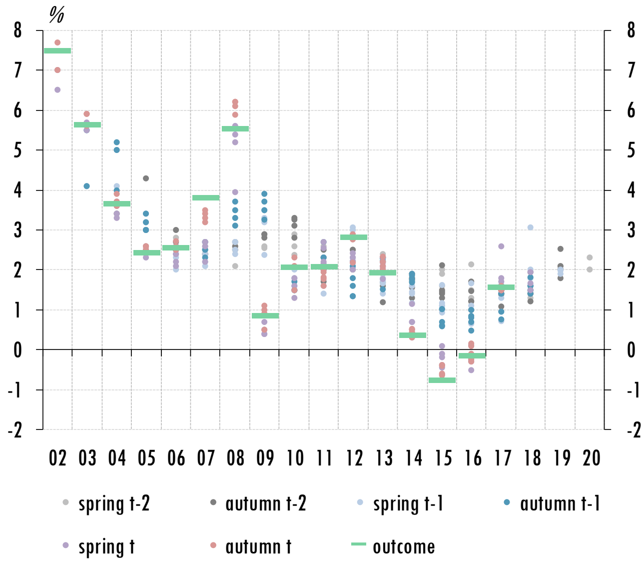
Sources: forecasts: IMAD, BoS, OECD, EC, IMF, outcome: SORS.

Figure 2.3: Comparison of past forecasts of employment growth



Sources: forecasts: IMAD, BoS, OECD, EC, IMF, outcome: SORS.

Figure 2.4: Comparison of past inflation forecasts



Sources: forecasts: IMAD, BoS, OECD, EC, IMF, outcome: SORS.

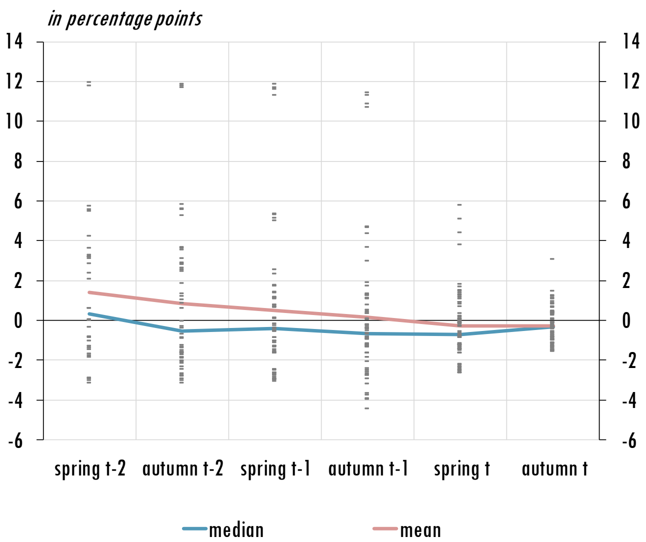
The charts show all available forecasts of the institutions which regularly make forecasts for Slovenia (IMAD, BoS, OECD, EC, IMF) for a particular year according to the time aspect of forecast preparation (from spring two years prior to outcome to autumn of the year for which the forecast is made). More than one marker of the same colour in the same year (e.g. 2007) means that more than one institution prepared forecasts at the same time (e.g. spring t-2: spring 2005).

[21] A detailed analysis should also take into account the revisions of statistical data performed by the SORS, as they were particularly significant in certain years. For example, according to the latest available data, the annual GDP growth in 2011 was 0.6%, while the first publication by the SORS at the end of February 2012 announced a 0.2% reduction of GDP.

casts prepared by various institutions.[22] Even the same institution may have made its forecasts during various periods of the year. For example, during the major part of the studied period 2002–2017, the Bank of Slovenia published its forecasts in April and October, but in the last two years, it switched the publication to June and December. Different institutions may use different time series as the criterion for the same variable. For example, IMAD measures inflation using the national CPI, while the remaining institutions mostly use the HICP, which has also been used as benchmark for the purpose of the present analysis.

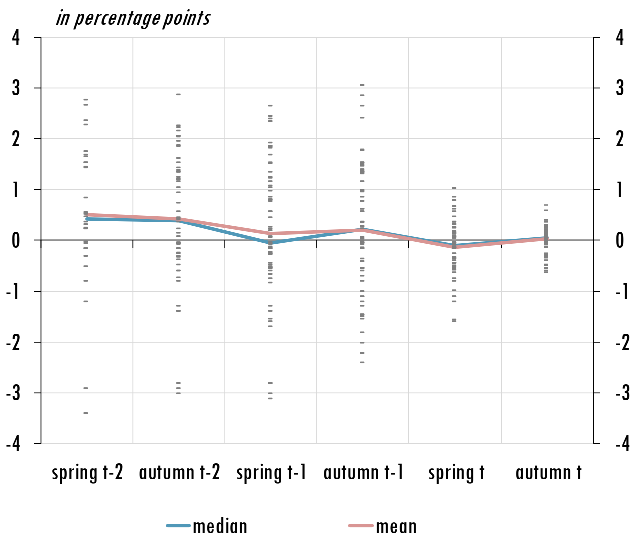
In principle, the accuracy of forecasts is increased by reducing the forecast horizon, which is most evident when comparing the forecasts for the year ahead and those for the current year. The forecasts usually underestimate the GDP growth during a cyclical expansion period and overestimate it in the period when the GDP growth is slowing down or falling. In the studied period 2002–2017 the actual real GDP growth was not within the range of various forecasts covering ten years; of these, the most accurate forecast deviated from the actual GDP growth five times by more than 0.5 percentage points. Similarly as in most other countries, the 2009 forecasts are an extreme example, as all the forecasts made before the beginning of 2009 and included in the analysis overestimated the actual GDP growth by more than 10 percentage points. In inflation forecasts the forecast range did not include actual values only in 2007 and 2015. In employment forecasts this has not happened since the onset of the crisis, whereas in the nominal GDP growth it has occurred eight times. The forecasts of the real GDP for most forecast horizons were more often underestimated than overestimated, as indicated by the movement of the mean deviation; however, the deviation in overestimated forecasts was on average much higher. This is largely associated with a huge unexpected drop in GDP in 2009 at the onset of the crisis. The deviations in inflation forecasts deviate less systematically, with the exception of the forecasts for the forecast horizon of two years before the realisation. Such results also indicate the need for careful planning of budget revenues.

Figure 2.5: Deviations of real GDP growth forecasts



Sources: forecasts: IMAD, BoS, OECD, EC, IMF, outcome: SORS; FC calculations.

Figure 2.6: Deviations of inflation forecasts



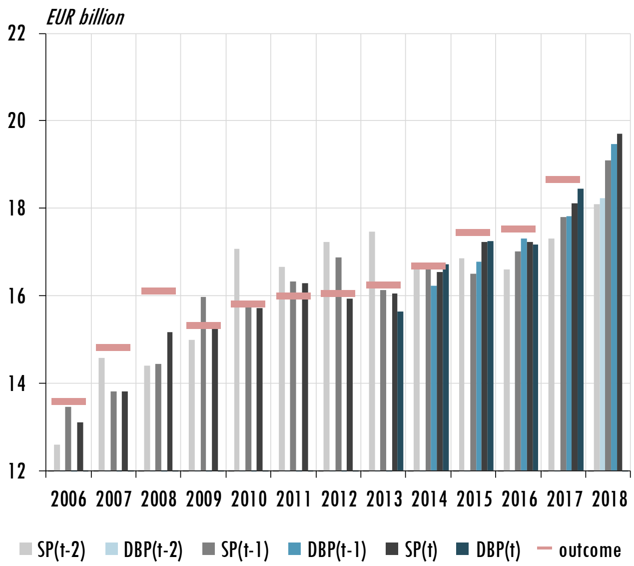
Sources: forecasts: IMAD, BoS, OECD, EC, IMF, outcome: SORS; FC calculations.

[22] Among other reasons that have an impact on the quality of forecasts, Cimperman and Savšek (2014) include the specifications of the models used and the expert knowledge of the forecasters, as well as the frequency of forecasts, the selection of data on realisations, the nature of the predicted variables and the degree of openness and the size of the economy (Cimperman and Savšek: Natančnost napovedi makroekonomskih agregatov Slovenije, Prikazi in analize, 1/2014, Banka Slovenije, https://bankaslovenije.blob.core.windows.net/publication-files/PA_1_2014_Natan%C4%8Dnost_napovedi_makroekonomskih_spremenljivk.pdf).

2.2 Accuracy of forecasting fiscal aggregates

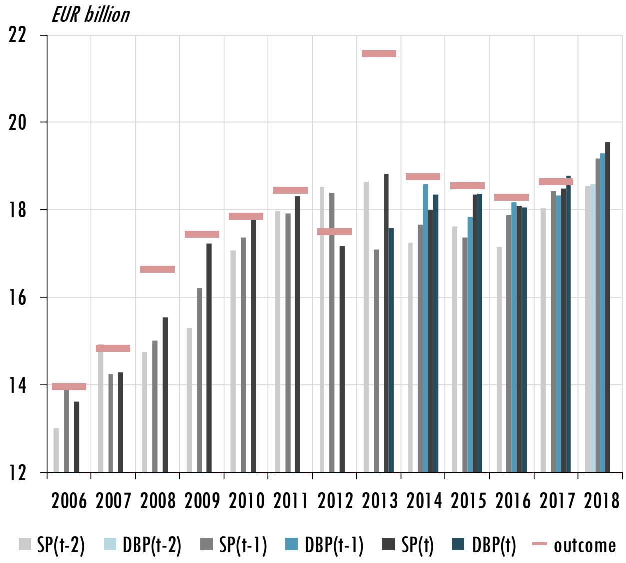
As part of preparing the compliance assessment of budget documents with the fiscal rules and for the purpose of assessing the risks associated with their fulfilment the Fiscal Council must also take a position on the realistic nature of forecasts of fiscal aggregates and/or their components. Regular, unbiased and comprehensive analyses of the quality of fiscal forecasts and an appropriate response to their findings are also part of the requirements of EU Directive 2011/85. In accordance with the Decree on development planning documents of the central government budget, amended at the end of May 2018, the Fiscal Council will also undertake this task in the future. This survey represents an initial insight into the accuracy of fiscal forecasts in Slovenia.

Figure 2.7: Past general government revenue forecasts



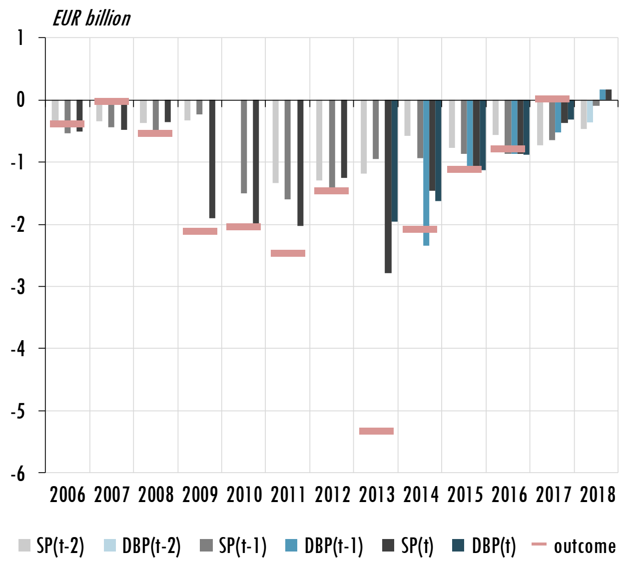
Source: SORS, MoF, IMAD, FC calculations.

Figure 2.8: Past general government expenditure forecasts



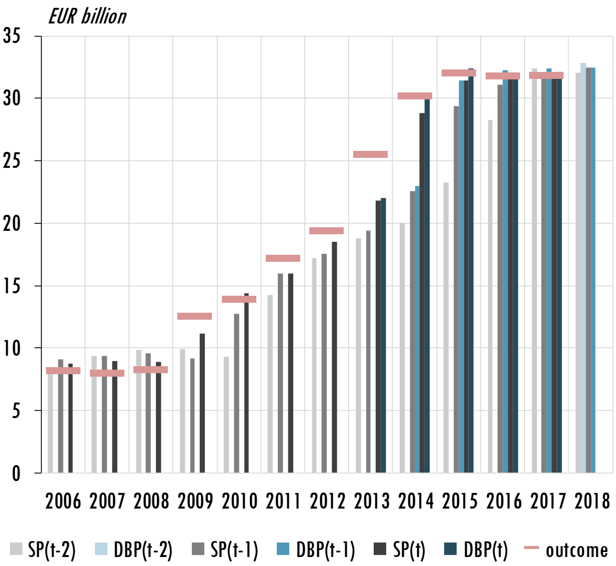
Source: SORS, MoF, IMAD, FC calculations.

Figure 2.9: Past general government balance forecasts



Source: SORS, MoF, IMAD, FC calculations.

Figure 2.10: Past general government debt forecasts



Source: SORS, MoF, IMAD, FC calculations.

The charts show public finance aggergates forecasts for a particular year in budget documents prepared at various times (t-2, t-1, t).

In the analysis the forecasts of revenues, expenditures, balances and gross debt of the general government from Stability Programmes (PS)[23] and Draft Budgetary Plans (DBP) are compared with their realisations. The analysis includes the forecasts that were published not more than two years before the year to which they refer (t-2). Thus a maximum of six fiscal forecasts are available for a particular year (3 years (t-2, t-1, t) x 2 publications (PS, DBP). Nominal data are calculated as the product of the data on the share of the fiscal aggregate in the nominal GDP from the PS or the DBP[24] and the nominal GDP level predicted in IMAD's forecast, which was taken into account in their preparation.

For most of the years in the period 2006–2017 expenditure forecasts were increasing with reduced forecast horizons, while the final values in most years exceeded all the forecasts. The only exceptions were the year 2012, when certain austerity measures were introduced, and the year 2017, when the final value was slightly lower than the last available forecast. The major upward deviation in 2013 is associated with expenditure for the recapitalisation of banks. An almost consistent underestimation of expenditure forecasts could indicate bias in budget planning, although a review of the components does not indicate a systematic contribution of any of them to such bias. The revenue forecasts in the pre-crisis and post-crisis period also increased with the reduction of forecast horizons, while in the crisis years, their trend was reversed. Considering that revenue forecasts depend on the forecasts of macroeconomic aggregates, deviations of their forecasts from the actual values are largely associated with the corresponding deviations of projected GDP. As a result, the forecasts of the general government deficit were most underestimated precisely in the crisis years, when the expenditure forecasts were underestimated and the revenue forecasts were overestimated. In the conditions where structural deficit continues to persist, a relatively consistent adjustment of expenditure to any higher revenue estimates is the main concern, as in most years it prevented the achievement of an improved balance of the general government sector. Due to deviations in the forecasts of the general government balance the general government gross debt was also underestimated.

In the future a detailed analysis is planned to examine the trend of individual forecast revenue and expenditure components. The purpose of such analysis will be the identification of components demonstrating major deviations of forecasts from the actual values and contributing most to the observed deviations in the forecasts of fiscal aggregates. As in the analysis of macroeconomic forecasts, the relevant statistical indicators will be used in the quality assessments of forecasts of fiscal aggregates as well.

2.3 Variability of output gap estimates

An output gap estimate is one of the key indicators of the cyclical position of the economy, and at the same time the basis for the calculation of the structural balance and for the definition of the fiscal effort in structural terms required within the Stability and Growth Pact (hereinafter: SGP). The output gap estimate is the difference between the actual GDP and the potential GDP estimate, expressed in percentage points of the potential GDP.[25] Because the potential output and the output gap are not directly observable or measurable, their estimates are rather uncertain and variable. The purpose of this overview is (i) to present the variability of output gap estimates for Slovenia, including its consequences for the calculation of the structural balance, and (ii) to show the variability of output gap

[23] Convergence programme in the years 2004 and 2005.

[24] Said documents do not contain nominal forecast values.

[25] Potential output is the total gross domestic product (GDP) that could be produced by an economy if all its resources were fully employed and the price growth stable.

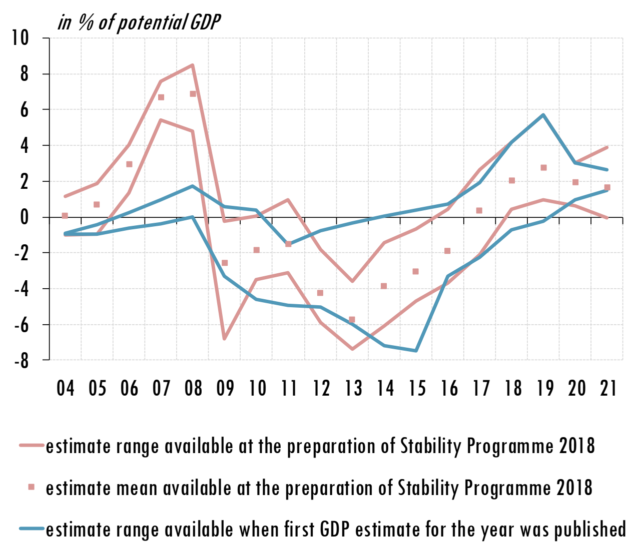
estimates for EU Member States, especially in the context of the required fiscal effort in structural terms under the SGP. The fiscal effort is determined also according to the cyclical position of the economy, which is defined by the output gap estimates.

The potential output and output gap estimates depend on a number of factors. Differences in estimates are caused mainly by the use of different methodologies, different time periods for which they are produced, and also differences in the input data themselves. At the same time, the production function methodology, which is officially used by the EC to calculate the potential GDP estimates, raises the question as to the quality of data for the calculation of the capital and labour inputs; among the latter, this is especially questionable in terms of calculation of the structural unemployment rate.

The potential output estimates and the output gap estimates are subject to considerable revisions. The revisions of the potential GDP estimates are particularly extensive in the periods of major fluctuations in economic activities. Among other things, revisions of the data on the national accounts and changes in economic growth forecasts often cause changes in potential output estimates. The comparison of the currently available output gap estimates prepared by various institutions for the 2006–2008 period and the estimates available in those years indicate that the potential output estimate was considerably overestimated, whereas the output gap estimate was considerably underestimated.[26] In 2007 for which the estimates have changed the most, the then available output gap estimates ranged from -0.4% to 0.9%, while according to the currently available data, the output gap in 2007 is estimated at between 5.4% and 7.6 % of the potential GDP. Such variability has significant consequences for the calculation of the structural balance and encumbers the conduct of fiscal policy. In addition to time variability of the estimates, the unreliability of estimates for individual years, reflected in a wide range of output gap estimates according to the currently available data, should also be pointed out.

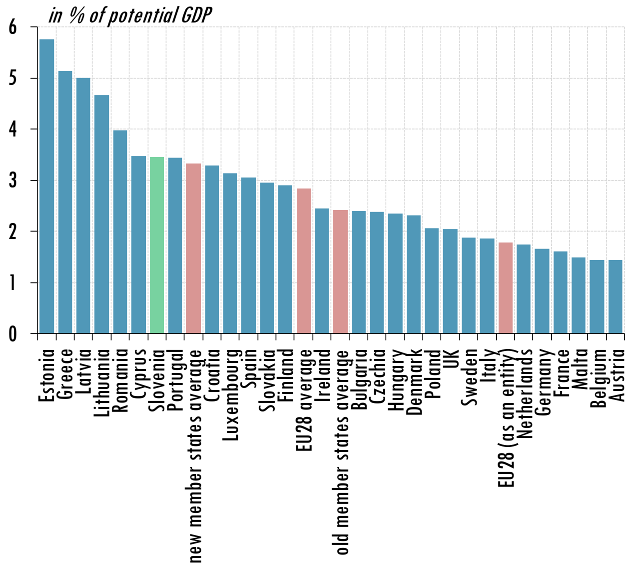
One way to cope with the uncertainties of output gap estimates is to expand the set of methodologies used for determining the structural balance of the general government. Thus not only the estimates of other institutions that are mostly based on the production function method are taken into con-

Figure 2.11: Output gap estimate range



Sources: IMF, OECD, EC, MoF, IMAD, FC calculations and estimates.

Figure 2.12: Standard deviation of EC output gap estimates



Source: European Commission (Spring 2018 Economic Forecast), FC calculations.

[26] We compared the output gap estimates prepared by the MoF, IMAD, the EC, the OECD and the IMF. It should be noted that not all institutions prepared estimates for all years of the period covered.

Box 2.1: The methods used to estimate the output gap in the Fiscal Council's assessments

Due to the uncertainties associated with the output gap estimation, the Fiscal Council has adopted an approach that uses a wide range of methodologies commonly used in practice[1]. In addition to output gap estimates of different institutions (IMAD, MoF, IMF, EC and OECD) the Fiscal Council uses additional methods presented in this box.[2]

Moving averages

The method is based on the assumption of different business cycle lengths and trend resulting thereof . Apart from the linear trend, this is the simplest technique to calculate the output gap.[3] The smoothed trend series represents the potential output. The centred 3-, 5- and 7- year GDP averages were used in the process. For the period not covered by IMAD's forecasts the levels of activity in the economy derived from the real GDP growth rates in the last year of available forecasts were taken into account in the calculations of multi-annual averages.

HP filter

The Hodrick-Prescott filter (HP filter) is one of the most widely used statistical trending methods, which estimates the output gap depending on the GDP deviation. It is based on the minimisation of the weighted sum of GDP deviations from its trend and the trend variability, and/or changes in the potential output growth. The value of the weight (lambda), which determines the intensity of the smoothing of the series, plays an important role, and its values are standardised according to the frequency of the series used (the weights are therefore different depending on whether the quarterly or annual time series are smoothed). Different weight values were used in our calculations in order to avoid biased decisions. In order to avoid the problems of inappropriate trend estimation at the end of the observed period (which is a frequent critique of the use of the HP filter), we extended the original GDP series so that, for five years after the end of the period covered by IMAD's forecasts, we assumed the levels of activity in the economy derived from the real GDP growth rates in the last year of available forecasts.

Factor models

Factor models rest on the analysis of a large number of time series. The various methods of factor analysis based on common attributes identify a series and/or a factor that best illustrates (statistically: deviates least from) the common characteristics of all time series used. Our analysis used two groups of time series in the determination of factors using different methods of factor analysis (ML, GLS, several variants of the principal component method). The first group included survey indicators on economic restrictions, and the second group included a large number of actual data and forecasts of macroeconomic variables prepared by the EC and IMAD. In the first group, after determining the factors that mimicked the potential output, we predicted them on the basis of a simple VAR model, in which we also used GDP growth and core inflation in addition to the identified factor. In the second group only stationary time series were used to determine the factors and two factors were determined separately on the basis of the forecasts of the European Commission and IMAD. The obtained cyclical indicator was transformed so that the standard deviation and the mean correspond to the output gap estimate prepared by IMAD.[4]

Blanchard-Quah

When estimating a potential output based on the contribution of Blanchard and Quah[5], we used the assumption that long-term effects on GDP reflect only aggregate supply shocks, while demand shocks only have short-term effects on the level of activity in the economy. On the basis of these assumptions we set the constraints in the structural vector autoregressive model (SVAR) so that these long-term and short-term effects were taken into account. These constraints show that potential output is a permanent component of the economy's activity and that the output gap reflects temporary deviations of activity in the economy from the potential output, which are caused by demand shocks. Various combinations of stationary macroeconomic variables (GDP growth, inflation, change in unemployment rate) and different lag lengths (4 and 8 quarters) were used in SVAR.

[1] Reviews of different methods for potential output estimation are rather common. One of them is available at: http://www.oecd.org/economy/growth/23527966.pdf
[2] See also the explanation under Table 4.3 in the Assessment of the fiscal policy compliance with the fiscal rules on the basis of the Draft Stability Programme – Amendments 2018.
[3] The above-mentioned source calls it a "split-trend", where trend output is calculated during each cycle separately.
[4] Office for Budget Responsibility adapts the cycle indicator, obtained by the principal components analysis, to the mean and standard deviations of the OECD output gap. (Office for Budget Responsibility: Estimating the output gap, Briefing paper No. 2, April 2011, http://obr.uk/download/briefing-paper-no-2-estimating-the-output-gap/)
[5] Blanchard in Quah (1989): The Dynamic Effects of Demand and Supply Disturbances. American Economic Review 79(4): 655-673.

sideration, but the set of methodologies used for estimating the output gap has been expanded to include certain statistical methods (see Box 2.1). In assessing the appropriateness of the fiscal policy's conduct, a range of calculations of structural balance and/or fiscal effort is used, defined on the basis of various methodologies and sources of output gap estimation and not just on a single point estimation. Combined with a wider survey of macroeconomic indicators, such an approach aims to mitigate the uncertainty and/or variability of the assessed cyclical position of the economy on the basis of an output gap estimate determined only by the production function method.

The differences in the deviations of output gap estimates among EU Member States also call into question the uniform thresholds that define an economy's cyclical position in the EC documents. Calculations of output gap estimates for individual EU Member States carried out by the EC on the basis of the production function method pursuant to the EC's macroeconomic forecasts show significant differences in the output gap fluctuations between individual countries. The standard deviation of output gap estimates based on the latest available EC evaluations varies between 1.4 for Austria and 5.8 for Estonia, while it is 3.5 for Slovenia.[27] There are also clear differences in the fluctuations of output gap estimates between old and new EU Member States, as the difference in standard deviations between the two groups of countries is almost 1 percentage point. This raises doubt about whether the use of uniform thresholds[28] to determine the cyclical position of individual national economies and, in consequence, the required fiscal effort in structural terms, is reasonable, as this has serious implications for the conduct of fiscal policy. In particular it means that, according to the EC matrix, the countries with a higher standard deviation of their output gap will more often fall into extreme cyclical conditions that may require more substantial structural adjustments to the balance of the general government.

2.4 One-off and/or temporary measures

One-off measures are one of the elements in the calculation of the structural fiscal balance, and their proper identification and quantification are therefore important in assessing the achievement of the mid-term fiscal sustainability. The main purpose of excluding one-off measures from the calculation of the structural balance is to reduce the propensity of the authorities to improve the public finances in the short term by means of easy-to-implement measures that do not necessarily lead to a sustained improvement of the general government balance. Due to their one-off and discretionary nature, the manoeuvring room for defining individual measures as "one-offs" is relatively ample.

[27] EC, Spring Economic Forecast 2018 (May 2018).
[28] The output gap thresholds for determining the required fiscal effort are presented in the EC Vade Mecum on the Stability and Growth Pact 2018 Edition, p. 38 (March 2018).

With a view to facilitating their identification, the EC[29] adopted the guiding principles for the definition of one-off measures. The main guiding principle is that these measures have a transitory budgetary effect that does not lead to a sustained change in the budgetary position. The guiding principles are: (i) one-off measures are not repeated. This means that their impact on public finances is temporary and/or lasts for a maximum of two years, in accordance with the EC definition. Within this guiding principle the most common measures are those taken in response to exceptional events with a very short-term impact; (ii) one-off measures may not be announced by law or by a government decision. This is particularly important because the measures are often announced as temporary and then they become permanent; (iii) one-off measures do not include revenue and expenditure components with volatility, as one-off measures are intended to smooth the time series of revenues and expenditures; (iv) deliberate policy actions that increase the deficit do not qualify as one-off measures. Deliberate policy actions that increase the deficit are considered to be of a structural nature so that the governments would fully recognise the permanent budgetary impact of their actions. In consequence, the EC is very restrictive in classifying deficit-increasing measures as one-offs; (v) only measures having a significant impact on the general government balance can be considered one-offs. As a rule, this includes measures of at least 0.1 % of GDP. Nonetheless, this guiding principle does allow for certain exceptions. First, in cases where a number of various measures can be logically grouped together and that have a combined impact of at least 0.1% of GDP, the aggregated impact could be classified as a one-off. Second, measures of less than 0.1% of GDP may be classified as one-offs for reasons of consistency across Member States when an exceptional event affects several Member States at the same time. Third, the measure is classified as a one-off if its value is over 0.1 % of GDP at least in one of the two successive years.

In Slovenia the volume of one-off measures in the 2010–2016 period was quite large and was among the highest in the EU. In the average of that period, the one-off measures accounted for 1.8% of GDP annually and were higher only in Ireland. The major one-off measures were associated with the measures enabling the recovery of the banking system, particularly in 2013, when their total volume reached peak values. The second group of one-off measures from that period was related to different court decisions that resulted in one-off expenditure. All these measures are considered one-offs in line with the guiding principle that one-off measures are not repeated and that they are introduced in response to exceptional events and have a very short-term impact.[30] The next set of one-off measures from the aforementioned period is associated with acceptable exceptions to the guiding principles, which in the case of Slovenia were in particular financial transfers to or from non-financial

Table 2.1: Comparison of estimates of one-off measures

in % of GDP	2010	2011	2012	2013	2014	2015	2016	2017
Ministry of Finance	-0.2	-1.2	-0.2	-11.0	-1.6	-0.1	-0.2	-0.1
European Commission	0.0	-1.0	0.0	-10.4	-1.1	0.0	0.0	-0.1
Fiscal Council	-0.1	-1.1	0.0	-10.0	-1.2	-0.1	0.1	-0.1
-recovery/resolution of banking system		*-0.7*	*-0.2*	*-10.0*	*-0.9*			
-court decisions				*-0.2*	*-0.7*	*-0.1*	*-0.1*	*-0.1*
-other	*-0.1*	*-0.5*	*0.1*	*0.2*	*0.4*	*0.0*	*0.1*	

Note: MoF - last available data based of Stability Programme or Draft Budgetary Plan is listed for each year.
Source : MoF, EC, SORS, FC.

[29] Report on Public Finance in the EMU 2006, Report on Public Finance in the EMU 2015.
[30] Report on Public Finance in the EMU 2015, pg. 54.

companies. They constituted certain financial support to public companies (recapitalisation, assumptions of receivables), which was exceptionally defined as a one-off measure if such a transaction was directly associated with privatisation or liquidation, meaning that any options for additional general government expenditure for that purpose were permanently removed. The profits and/or dividends, however, are exceptionally defined as a one-off measure where they result from exceptional events.

In assessing the planned fiscal effort in structural terms in the coming years, the Fiscal Council will use a conservative approach for the assessment of one-off measures. When examining the role of one-off factors in budget documents (Stability Programmes, Draft Budgetary Plans), two main conclusions were arrived at. First, assessments of the size of one-off measures often change due to uncertainty in their planning. Second, the planned achievement of the appropriate fiscal effort in individual past years was often the result of the planned volume of one-off measures, which could be changed later (the actual value was below the planned volume of one-off factors), therefore the fiscal effort in the ex-post assessment was not sufficient. For this reason, and due to the fact that according to the current projections, in coming years Slovenia will face a balanced fiscal position, where a relatively small volume of one-off measures could contribute to a more favourable assessment of compliance with the fiscal rules, the Fiscal Council will advocate a conservative approach in taking account of one-off factors.

2.5 Analysis of the general government gross debt in the medium and long term

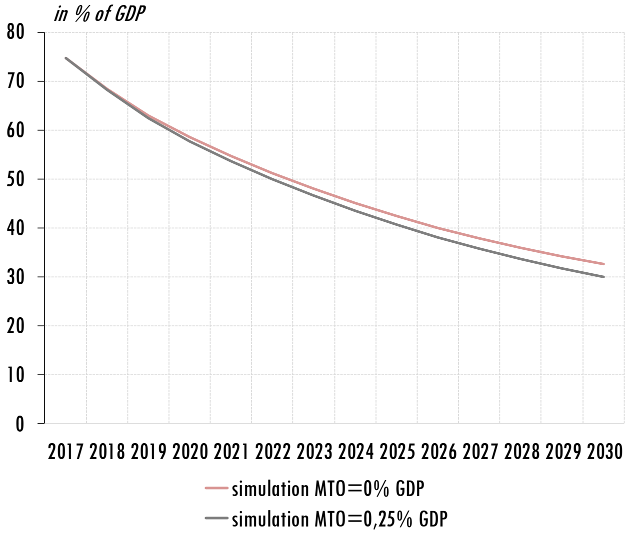
The mid- and long-term analysis of the movement of the general government gross debt, including simulations of the response to changes in various macroeconomic and fiscal variables, is an important tool in identifying fiscal risks. The general government gross debt is one of the most important macroeconomic and fiscal indicators. Its level reflects the gross liabilities of the general government and roughly represents the cumulative amount of the general government deficit. Assessments of the fiscal situation provided by the Fiscal Council are always focused on the medium and long term, as we are primarily interested in the sustainability of fiscal policy. This chapter therefore presents the current general government debt and some of the possibilities and results of a mid- or long-term analysis for Slovenia. The main findings of the general government debt simulations are:

- The pursuit of even slightly different medium-term fiscal objectives can have a significant impact on the debt level and the cost of its financing even in the medium term,
- The debt sustainability analysis through simulations of macroeconomic shocks does not indicate excessive risks for the general government debt over the next few years,
- The risks rise dramatically in the long term, i.e. soon after 2025, and are mainly associated with the currently estimated costs of the population's ageing.

2.5.1 Debt and the medium-term fiscal objective

The pursuit of different medium-term fiscal objectives can have a significant impact on the general government debt level. The Stability and Growth Pact defines the medium-term fiscal objective as the target value of the structural balance. This is determined for each Member State according to its current economic situation and the future risks to which it is exposed. In the budget documents the

Figure 2.13: Debt simulation of pursuing different medium-term objectives



Source: SORS, FC simulation.

Government points out that its medium-term fiscal objective is balanced structural position, although given the high risk associated with the population ageing, Slovenia's mid-term fiscal target is currently set at 0.25% of GDP. A difference of 0.25 percentage points of GDP does not appear to be significant, but simulations show that even with a small annual difference major deviations in the debt level can occur in just a few years.

The pursuit of two different medium-term fiscal objectives in the period from 2018 to 2030 was simulated. The starting point was the Fiscal Council's assessment of the structural deficit being at the level of 0.1% of GDP in 2017. In the first scenario it was assumed that in order to achieve the medium -term fiscal objective as defined by the Government of the Republic of Slovenia, a fiscal effort of 0.1% of GDP is made in 2018, while in the second scenario a fiscal effort of 0.35% is made in order to achieve a structural surplus of 0.25% of GDP in 2018. In both simulations it was assumed that the structural balance would be maintained at an unchanged level throughout the period and that the positive outcome gap would be gradually closed by 2030.

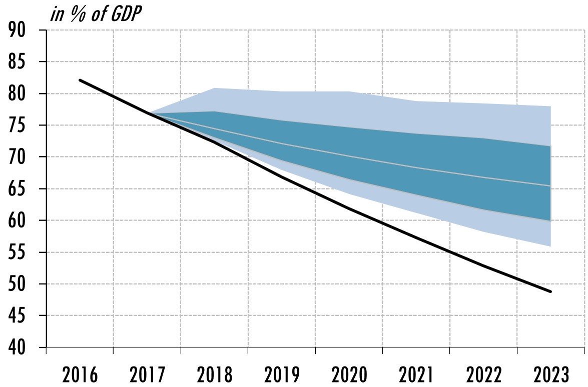
The results show that in 2030, if insisting on the balanced structural position of the general government, the debt would increase by approx. EUR 2 billion or by approx. 2.5% of GDP, compared with the debt in the scenario where the structural surplus at the level of 0.25% of GDP is pursued. This is the difference of the sums of the budgetary balances in approximately ten years. Due to smaller budgetary surpluses, interest costs would increase by around EUR 500 million in the studied period if the structural balance were pursued, compared with the scenario where the fiscal policy would focus on a more demanding medium-term objective.

2.5.2 Debt sustainability analysis

Debt sustainability analysis shows the country's capacity to finance its obligations in the event of various macroeconomic shocks. In analysing the debt sustainability we used the procedure developed by the IMF.[31] In doing so a baseline scenario based on macroeconomic projections is developed,

[31] https://www.imf.org/external/pubs/ft/dsa/mac.htm.

Figure 2.14: General government debt - simulations of simultaneous realisation of GDP and interest rate shocks



Note: The line represents projection of debt share under the baseline scenario of Stability Programme 2018 and Fiscal Council simulation after 2021. The coloured areas represent probability distribution of 10th-25th, 25th-50th, 50th-75th and 75th-90th percentiles of the simulations of debt share in case of a combined macroeconomic shock. Lighter shades represent less central and darker shades more central areas of the probability distribution.
Source: SORS, Stability Programme, amendments 2018; FC calculations.

followed by several alternative scenarios, which show the responsiveness of debt to various macroeconomic shocks. Changes in the dynamics and levels of the general government debt indicate the country's sensitivity in the event of shocks, which, however, may deviate in practice from the ones used in the analysis both in terms of their direction and size.

The analysis of medium-term debt sustainability takes into account the baseline scenario of the PS 2018, which is based on IMAD's 2018 spring forecast. The debt sustainability analysis covers the period 2018–2023, whereby the projections of fiscal aggregates from the end of the PS 2018 projection period after the end of the analysed period (for the years 2022–2023) were supplemented using uniform revenue and expenditure elasticities. The analysis takes into account shocks to fundamental macroeconomic variables. Shocks in the alternative scenario of a lower real GDP growth are set at one-half standard deviation of real GDP growth in the period 2006–2017. This scenario would see real GDP growth in 2019 and 2020 slightly above 1% (in the baseline scenario, growth rates are around 3.5 %). Interest rate shock is implemented by increasing the interest rates from the baseline scenario by a standardised 200 basis points. The period of shocks is limited to the first two years of the simulation (i.e. to 2018 and 2019).

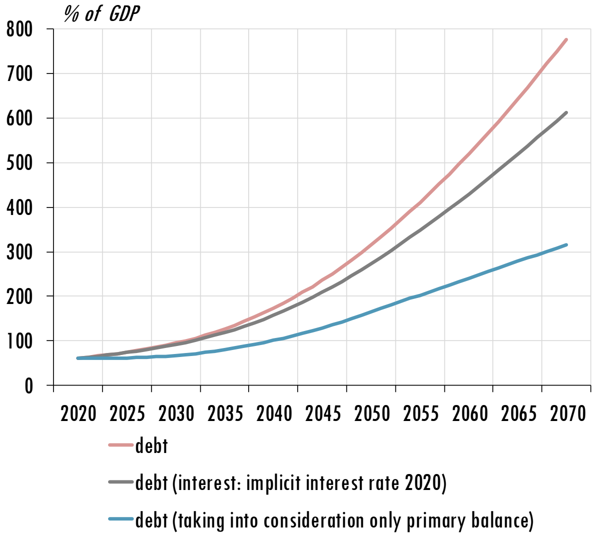
The analysis does not indicate excessive risks to the debt sustainability over the next few years. This is true even if we only take into account the simulation that analyses the asymmetric possible shocks. In such a simulation no shocks that could have a favourable impact on the debt level are allowed. Slower economic growth has the largest impact on debt sustainability in the medium term; a deteriorated primary balance would also have an impact on a higher risk assessment of debt sustainability, although to a lesser extent. In the event of both of the aforementioned shocks, the debt would not fall below 60% of GDP, and in the case of a combined macroeconomic and fiscal shock, it would persist at about 70% of GDP. It should be noted that the assessments of debt sustainability are made without taking into account the potential response of the fiscal policy to the presumed shocks; consequently debt estimates within the described scenarios may even be overestimated.

2.5.3 Analysis based on the projections of population ageing costs

The general government expenditure on the ageing population, associated with the adverse consequences of demographic trends, is one of the most important economic policy challenges in Slovenia. Projections of population ageing costs are also the basis for determining long-term fiscal sustainability. The results of the projections of population ageing costs are shown in Table 16 of the Stability Programme, Amendments 2018.[32] Based on these projections, the movement of the general government debt may be predicted, unless measures to limit the negative fiscal consequences of the ageing population are promptly taken. The assumptions show that the total age-related expenditure (mainly expenditure on pensions, health care and long-term care) should increase by 6.4 percentage points of GDP by 2070, compared to that in 2016. Due to indirect costs, mainly related to the financing of such an increase in age-related expenditure, the share of the total government expenditure could increase by almost a quarter of GDP.

Simple simulations of the impact of population ageing costs on the general government debt point to the risk of an exceptional increase in debt, unless measures are taken to mitigate such costs. The aforementioned simulations do not constitute projections, but serve only as a tool for identifying and assessing the fiscal risks. The simulations do not take into account the potential fiscal policy response to the increasing population-ageing costs. They are made using a simple linear interpolation of data contained in the Stability Programme, Amendments 2018 (Table 16), where such data are defined only for every decade until 2070 (i.e. for 2020, 2030, 2040, etc.). Given the assumed trend in the total general government revenues whose growth is similar to that of GDP, and the general government expenditure whose dynamics depends primarily on the population-ageing costs and interest costs, the general government deficit is constantly increasing as well. Based on the assumptions contained in the said table, the general government deficit would thus amount to approximately 28% of GDP in 2070. A cumulative increase in the deficit could trigger a rapid and substantial increase in debt in the period 2016–2070, covered by the projections in the Stability Programme.

Figure 2.15: Simulations of general government debt taking into consideration the Stability Programme 2018 projections of age-related public expenditures



Source: Stability Programme, amendments 2018; FC calculations.

[32] The data are taken from the 2018 Ageing Report.

The simulations show that under the given assumptions, the debt would persist at the current levels of around 75% of GDP only until approx. 2025, when it would begin to rise rapidly under all presented scenarios. Simulations thus indicate the year by which changes to the parameters of social protection systems aimed at ensuring the sustainability of the general government debt should already take effect. In accordance with the Stability Programme data the projection also assumes an increase in the implicit interest rate, which is expected to increase to approximately the level of the required rates of return from 2013 (slightly below 7%) by 2070. If the implicit interest rate were maintained at the level of that from 2020 (the assumption is around 3.8%), the increase in debt would be slightly less significant. If the increase in the costs of financing is ignored and the increase in debt is attributed only to the direct costs of the population ageing and/or the accumulation of the primary balance deficit (which would amount to around 7% of GDP in 2070), the general government debt would amount to around 300% of GDP at the end of the observed period.[33]

It is important to note that the developments in recent years deviate significantly from certain assumptions used in the projections, which may be an indication that the risks associated with the general government expenditure on the ageing population are overestimated. Thus, the average GDP growth in the period 2016–2020 is expected to be only slightly below 2%, while the realisation and IMAD's spring forecast for the same period show an average growth of around 4%. It should also be noted that, even in the short term, the projections from the previous 2015 Ageing Report have turned out to be slightly too pessimistic. They indicated the costs of population ageing at around 24.6% in 2016, whereas according to the 2018 Stability Programme, they amounted to only 21.9%. In the case of the repeated overestimation of the costs of population ageing the debt at the end of the observed period would increase by much less than in the presented simulation and would persist at the level of around 75% of GDP until around 2030; in the simulation where only the primary balance is taken into account in debt accumulation it would persist at that level until around 2035.[34]

2.6 Assessment of a new fiscal policy medium-term objective

The Medium-Term Objective (MTO) is the cornerstone of the preventive arm of the Stability and Growth Pact and guides the fiscal policy operation. The MTOs are defined in structural terms, i.e. the general government balance, adjusted for business cycle and excluding the effects of one-off and other temporary measures. The MTO must be set so as to ensure:[35] (i) a safety margin with respect to the 3% GDP deficit limit, where the reserve is provided by taking into account the minimum benchmark as defined by the EC once a year; (ii) sustainability or rapid progress towards the long-term sustainability of public finances, in particular by taking into account the debt level and the costs of ageing populations; and (iii) taking into account (i) and (ii), allowing room for budgetary manoeuvre, in particular taking into account the needs for public investment.[36]

The state must determine the value of the fiscal policy medium-term objective in the annual Stability Programme. The MTO is therefore country-specific and the EC verifies its compliance based on the

[33] Similar increases in debt are also assessed for other countries faced with rapid ageing of populations. See, for example, the recent IMF assessments for South Korea at: http://www.imf.org/en/Publications/WP/Issues/2018/04/24/A-New-Strategy-for-Koreas-Fiscal-Policy-in-a-Low-Growth-Environment-45770?cid=em-COM-123-36963

[34] Certain analyses (e.g. by the IMF, 2013: Staff Guidance Note for Public Debt Sustainability) show that in developed countries, the debt level, indicating possible problems with its financing, is around 85% of GDP. Our simulations show that this level would be exceeded within a few years after 2030 and 2035, respectively.

[35] Council Regulation (EC) No 1466/97.

[36] Council Regulation (EC) No 1466/97 also lays down that that the euro area and the ERM2 Member States are obliged to set the MTO at a level of at least -1% of GDP. Contracting Parties to the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG) additionally committed to achieve the MTO at least at the level of -0.5% of GDP, except for Member States with a debt level significantly below 60% of GDP and with low risks for the long-term sustainability of public finances.

MTO, calculated by the EC at least every three years.[37] The three-year interval of the MTO calculation is linked to the publication of the Ageing Report. The lowest MTO selected by a country is defined as the most favourable value of the three components:

$MTO^{min} = max(MTO^{ILD}, MTO^{MB,\ Eur/ERM\ 2}, MTO^{ILD})$,[38] where

$MTO^{ILD} = Balance_{debt\text{-}stabilizing} + \alpha * AgeingCosts + Effort_{debt\text{-}reduction}$

$Balance_{debt\text{-}stabilizing}$ in the formula for MTO^{ILD} (ILD: Implicit Liabilities and Debt) is the budget balance that would stabilise the debt ratio at 60% of GDP, and is determined in the calculation by the product of the coefficient 0.6 and the average nominal GDP growth by 2070 defined in the Ageing Report. The contribution of budgetary costs of ageing where $\alpha = 0.33$ and the ageing cost corresponds to the discounted value of the increase in the cost of ageing, calculated up to an infinite horizon. $Effort_{debt\text{-}reduction}$ = 0.024*debt - 1.24. MTO^{MB} (minimum benchmark) is assessed by taking into account past output volatility and the budgetary sensitivity to output fluctuations.[39] $MTO^{MB,\ Eur/ERM\ 2}$ has values of -1 % or -0.5% of GDP.

Assessments based on the currently known parameter values of the 2018 Stability Programme and the 2018 Ageing Report indicate that the MTO value could be reduced from 0.25% to 0.0%. The available data on parameter values in the Ageing Report are given only for every decade; consequently the intermediate data were determined on the basis of linear interpolation. The assessments may accordingly slightly, but probably not significantly, differ from the actual values of demographic parameters and parameters of activity in the economy. According to the calculations of the Fiscal Council and the EC, the value of the MTO for Slovenia is currently 0.25% of GDP. We have prepared an assessment of the MTO value that Slovenia will have to present for the first time in the 2019 Stability Programme. It suggests that the MTO value could fall to 0.0% of GDP. This conclusion, however, calls for a certain degree of caution, since the resulting non-rounded value (which is then rounded to the most favourable 1/4 of a percentage point) amounts to around 0.2% of GDP pursuant to the calculations made on the basis of the currently available data. The Fiscal Council's past analyses on the MTO's sensitivity to the components that define it[40] showed that the fiscal policy medium-term objective

Table 2.2: Comparison of the current value of MTO and new MTO estimates

		current value	updated value
Minimum benchmark	MTO^{MB}	-1.44	-1.00
MTO euro area	$MTO^{EA,\ ERM2}$	-1.00	-1.00
MTO implicit liabilities	MTO^{ILD}	0.35	0.19
Debt-stabilising budget		-2.07	-2.08
Ageing costs		5.20	5.30
Debt-reduction effort		0.70	0.53
MTO	max (MTO^{MB}, $MTO^{EA,\ ERM2}$, MTO^{ILD})	**0.25**	**0.00**

Source: Stability Programme 2018, The 2018 Ageing Report, Fiscal Council.

[37] Member States that implemented structural reforms with a considerable impact on the long-term sustainability of public finances are an exception. In such cases a new MTO is determined before the expiry of the three-year period.

[38] The resulting value of the MTO is then rounded to the most favourable ¼ of a percentage point

[39] The value of this component is published annually by the EC in the publication Vade mecum on the Stability and Growth Pact.

[40] See http://www.fs-rs.si/fiscal-council-recommendation-fiscal-policy-must-include-swift-actions-to-limit-the-fiscal-implications-of-population-aging/

Box 2.2: Assumptions of the 2018 Ageing Report

The Ageing Report is a European Commission document prepared by the Ageing Working Group (AWG)[1] within the Economic Policy Committee every three years. Based on the current legislation and long-term demographic projections the Report defines the anticipated changes in the population ageing costs in a particular country. The current Report contains long-term projections of the budgetary impacts of an ageing population by 2070. The Report's findings are important for determining the risks faced by EU Member States due to demographic change in the context of the existing social protection systems. At the same time, medium-term fiscal objectives that ensure the sustainability of public finances are set on the basis of the projections of ageing-related expenditure. The 2018 Ageing Report was published in May this year.

Demographic assumptions of the 2018 Ageing Report for Slovenia are in general less favourable than the assumptions of the previous report from 2015, whereas more favourable macroeconomic assumptions contribute to increasing the long-term sustainability of public finances. Assumptions of the Ageing Report contain demographic projections calculated by Eurostat and the projections of exogenous macroeconomic indicators based on a common methodology and determined by the AWG. The demographic assumptions in the current Report are less favourable mainly due to an additional assumption on the ageing of the population and the lower assumption on migrations to Slovenia. The combination of these assumptions leads to a decrease in the total population number (also compared to the EU where the population numbers are slightly increased), and an increase in the old-age dependency in Slovenia. The increase in old-age dependency in Slovenia is approximately one half higher than the EU average; however, the increase in old-age dependency is even higher than in Slovenia in 15 EU Member States. The projections also use the assumption that the long-term GDP growth and GDP per capita will be higher than in the previous Ageing Report, which should have a favourable fiscal impact.

Table: Assumptions of the 2018 Ageing Report compared to the 2015 Ageing report (changes)

	Slovenia	EU
Total population: difference in 2060 as a share of total population in 2060	-2.0	0.3
Old-age dependency ratio: change 2016-2060	2.4	1.6
Net migration: % of total population in 2016	-0.2	0.1
Net migration: % of total population in 2060	-0.1	0.0
Employment rate: change in 2060 (20-64 years)	-0.9	-0.3
Employment rate: change in 2060 (55-64 years)	-2.1	-1.0
Participation rate: change in 2060 (20-64 years)	0.1	0.5
Participation rate: change in 2060 (55-64 years)	-1.6	0.6
Unemployment rate: change in 2060 (15-64 years)	1.3	1.1
GDP growth rate: average 2016-2060	0.1	-0.1
GDP per capita growth: average 2016-2060	0.2	-0.1

Vir: The 2018 Ageing Report: Underlying Assumptions & Projection Methodologies.

[1] Experts from EU Member States and international institutions, and from Slovenia experts from IMAD and the Ministry of Finance, participate in this working group.

in Slovenia depends mostly on the long-term activity in the economy, as well as on the changes in debt level and the ageing population costs. Current assessments suggest that the shrinking of the debt-to-GDP ratio in recent years could have the largest impact on a reduced MTO value. The 2014 general government debt that was taken into consideration in the currently valid MTO estimate accounted for 80.8% of GDP, whereas the 2017 general government debt, which will be used for the calculation of the new MTO value, accounted for only 73.6% of GDP.

Annex 1: The Fiscal Council's business operations in 2017

Summary of the document "Obrazložitve zaključnega računa proračuna za leto 2017" ("Explanation to the Annual Financial Statement of the Budget of the Republic of Slovenia for 2017").

The budget of the Republic of Slovenia adopted for 2017 (Official Gazette of the Republic of Slovenia [Uradni list RS], No. 80/16) allocated funds totalling EUR 500,000 to the Fiscal Council for its activities. The appointment of the Fiscal Council's members by the National Assembly on 21 March 2017 established the conditions for the commencement of activities and the employment of public employees. The staff plan referring to the number of public employees to be employed in accordance with the law (four employments) was duly implemented by the end of 2017. As it was established that the funds allocated in the adopted financial plan will not be fully used, funds totalling EUR 234,000 were reallocated to the budgetary reserve upon the Fiscal Council's initiative (Decisions of the Government of the Republic of Slovenia No. 41012-60/2017/3 in the amount of EUR 180,000 and No. 41012-81/2017/3 in the amount of EUR 54,000). Thus the financial plan applicable for 2017 amounted to EUR 266,000. EUR 241,986 was used, accounting for 91% of the planned funds.

Table1: Fiscal Council expenditure in 2017

	EUR	share in total expenditure (%)
Expenditure on salaries and duties in 2017		
Salaries, supplements and other	120,259	49.7
Annual allowance	1,654	0.7
Restitutions, work-related bonuses	10,742	4.4
Social security contributions	20,249	8.4
Collective supplementary pension insurance according to ZKDPZJU	557	0.2
Total	153,461	63.4
Material expenditure in 2017		
Stationery and general goods and services	5,855	2.4
Special goods and services	1,243	0.5
Energy, water, communal services and communications	1,460	0.6
Transport costs and services	83	0.0
Expenses on business travel	3,193	1.3
Regular maintenance	2,522	1.0
Business rents	627	0.3
Other operative expenditure	44,298	18.3
Total	59,281	24.5
Expenditure on investment and investment maint. in 2017		
Hardware computer equipment	21,005	8.7
Intangibles (computer software)	7,389	3.1
Telecommunication equipment	850	0.4
Total	29,244	12.1
TOTAL EXPENDITURE IN 2017	**241,986**	100.0

Source: Explanation to the Annual Financial Statement of the Budget of the Republic of Slovenia for 2017.

Explanation of certain major headings:

1. Salaries are calculated and paid in accordance with the provisions of the Public Sector Salary System Act (ZSPJS), the Fiscal Balance Act (ZUJF), the Implementation of the Republic of Slovenia's Budget for 2017 and 2018 Act (ZIPRS1718), the provisions of the Collective Agreement for public sector and the Collective Agreement for non-commercial activities in the Republic of Slovenia, and other regulations and general acts. According to their classification in salary grades, the pay for annual leave was also paid to public employees and officials pursuant to the provisions of the Act Regulating Measures Relating to Salaries and Other Labour Costs in the Public Sector for 2017. The collective supplementary pension insurance for public employees is implemented in the form of a closed mutual pension fund managed by Modra zavarovalnica, d. d., Ljubljana pursuant to the Act Governing Conversion of the Pension Fund Management and Investment Policy of Pension Fund Management (KAD) and the Slovenian Compensation Company (SOD) (Official Gazette of the Republic of Slovenia [Uradni list RS], Nos. 79/10 and 26/11). The collective supplementary pension insurance premiums were paid in 2017 in accordance with the provisions of the Annex to the Collective Agreement for non-commercial activities in the Republic of Slovenia (Official Gazette of the Republic of Slovenia [(Uradni list RS], Nos. 91/15 and 88/16).
2. Article 10 of the Fiscal Rule Act (Official Gazette of the Republic of Slovenia [Uradni list RS], No. 55/15) lays down that administrative and technical tasks for the Fiscal Council are to be performed by the services of the Court of Audit of the Republic of Slovenia. In accordance with the Agreement on providing administrative and technical support and premises for the needs of the Fiscal Council No. 010-2/2017/1 of 27 March 2017, concluded with the Court of Audit, the services of the Court of Audit perform certain tasks within their competence also for the Fiscal Council. In addition to the above, the Court of Audit provides furnished offices with a surface area of 96.20 m2 and the sharing of the common areas, which accounts for 4.62% of the premises owned by the Court of Audit (i.e. the State). The Fiscal Council contributes to the payment of the corresponding part of the costs. In 2017, EUR 48,091 was used for this purpose (EUR 44,075 for administrative and technical assistance and EUR 4,016 for the use of premises and certain equipment). In 2017 there were virtually no education-related costs. Only the training required by the law was carried out (training in safety and health at work and fire protection; the employees attended clearance training for access to classified information and training for appointment to a title).
3. Computer hardware and software required for normal operation was purchased in 2017 (server equipment, computers, LCD screens). Mobile phones were purchased as well. The software includes the design and launch of the Fiscal Council's website, the corresponding software for server equipment and the EViews software. The MS EA software is rented.

As at 31 December 2017 the Fiscal Council did not have any funds recorded in the account of the Public Payments Administration of the Republic of Slovenia, Ljubljana Office. The Fiscal Council operates through the account of the budget of the Republic of Slovenia. The Fiscal Council has no recorded claims from long-term investments and loans.

In recording intangible assets, property, equipment and other tangible fixed assets the Rules on the method and rates of depreciation of intangible fixed assets and tangible fixed assets (Official

Gazette of the Republic of Slovenia [Uradni list RS], No. 45/05, as amended) and the Accounting Act (Official Gazette of the Republic of Slovenia [Uradni list RS], No. 23/99) were taken into account.

Equipment in the value of EUR 31,926 was purchased in 2017, of which small tools cost EUR 1,129. Computer hardware in the amount of EUR 21,415 (server equipment, computers, LCD screens) was purchased as well. The required computer software totalling EUR 9,382 (software for server hardware, EViews software, the Fiscal Council's website set up) was purchased. Stationery in the value of EUR 1,129 was purchased in 2017. As at 31 December 2017, the present value of intangible assets and tangible fixed assets was EUR 27,355.

Table 2: Value of tanglible and intangible fixed assets in 2017

	Intangible assets	Immovable assets	Equipment and other tangible assets	Total
PURCHASE VALUE				
As at 1 January 2017	0	0	0	0
Direct acquisition	9,382	0	22,544	31,926
Removal – transfer	0	0	0	0
As at 31 December 2017	9,382	0	22,544	31,926
VALUE ADJUSTMENT				
As at 1 January 2017		0	0	0
Reduction of value due to exclusions or transfers		0	0	0
Value adjustment	567	0	2,875	3,442
Value adjustment stationery		0	1,129	1,129
As at 31 December 2017	567	0	4,004	4,571
RESIDUAL VALUE				
As at 31 December 2017	**8,815**	**0**	**18,540**	**27,355**

Source: Explanation to the Annual Financial Statement of the Budget of the Republic of Slovenia for 2017.

As at 31 December 2017 the Fiscal Council also reported in its annual financial statement outstanding expenses in the amount of EUR 36,873, which were transferred to 2018. These outstanding expenses that fall due in 2018 refer to:

– calculated and yet unpaid salaries, duties and reimbursement of work-related expenses for December 2017 in the amount of EUR 27,063 (of this, EUR 22,221 for salaries and allowances, EUR 1,157 for other benefits, EUR 90 for collective supplementary pension insurance premiums and EUR 3,595 for duties),

– services rendered and supplies delivered in the amount of EUR 7,128, and

– supplied low-value equipment in the amount of EUR 2,682.

As at 31 December 2017, the Fiscal Council reported in its annual financial statement short-term liabilities in the amount of EUR 36,873, which were transferred to 2018. These liabilities that fall due in 2018 refer to:

– short-term liabilities towards employees in the amount of EUR 23,378, arising from the calculation of salaries for December 2017,

– short-term liabilities towards suppliers in the amount of EUR 4,372 for supplies and equipment delivered and services rendered in November and December 2017,

– other short-term operating liabilities in the amount of EUR 3,685 (for the duties and collective supplementary pension insurance premiums calculated for December 2017), and

– short-term liabilities towards users of the uniform chart of accounts in the amount of EUR 5,438 for the services rendered in November and December 2017 (to the Court of Audit for administrative and technical services and the use of office premises, to the Ministry of Public Administration for the completed training of a public employee for appointment to the title, and to the Secretariat-General of the Government of the Republic of Slovenia for the provision of translation and proofreading services).

As at 31 December 2017 a general fund for intangible assets and tangible fixed assets in the amount of EUR 27,355 is recorded among the Fiscal Council's own resources and long-term liabilities in its books.

As at 31 December 2017 the Fiscal Council's books also record off-balance-sheet the equipment in the total amount of EUR 3,499 that is not owned by the Fiscal Council but is held in temporary use. Thus communication technology equipment (owner Telekom Slovenije, d.d.), a multifunctional device (owner FITEH, servis in trgovina biro opreme, d.o.o.) and a water cooling and heating appliance (owner KOPIRSERVIS, d.o.o.) are located in the office premises used by the Fiscal Council.

Annex 2: Glossary

Automatic stabilisers:

Automatic stabilisers are features of public finances that react automatically to the economic cycle and thus contribute to the stabilisation of activity in the economy without adopting additional measures. The most typical automatic revenue stabiliser is a progressive tax on the household income; on the expenditure side such a stabiliser includes social transfers, in particular unemployment allowances.

Budget balance:

The balance between total public expenditure and revenue in a specific year. A positive balance indicates a surplus and a negative balance indicates a deficit. The EU uses general government aggregates (according to the ESA2010 methodology) for the monitoring of Member State budgetary positions.

Cyclical component of budget balance:

A part of the change in the budget balance that follows automatically from the cyclical conditions of the economy, due to the reaction of public revenue and expenditure to changes in the output gap.

Discretionary fiscal policy:

Change in the budget balance and/or in its components under the direct control of government. It is usually measured as the residual of the change in the balance after the exclusion of the budgetary impact of automatic stabilisers.

Discretionary revenue measures:

The estimated effect of discretionary measures that change the government revenue (e.g. increasing or reducing tax rates).

Draft budgetary plan:

Presentation of the main orientations and elements in terms of the objectives and measures at the level of the general government and its subsectors for the coming year prior to their adoption by the national parliaments. By 15 October every year the draft budget plan must be submitted by EU Member States to the European Commission and the Eurogroup for evaluation.

Excessive Deficit Procedure:

Excessive Deficit Procedure (EDP), a procedure according to which the EC monitors the development of national budget balances and the general government debt in order to assess and/or correct the risk of an excessive deficit in each Member State.

Expenditure rules:

A subset of fiscal rules that target (a subset of) public expenditure. Expenditure rules in the EU set expenditure benchmarks that are estimated by the movement of expenditure excluding the impact of expenditure on the basis of EU flows and excluding discretionary revenue measures.

Fiscal consolidation:

An improvement in the budget balance through measures of discretionary fiscal policy.

General government:
The general government sector covers state government, regional and local governments, as well as social security funds, public institutions, funds and agencies. State-owned enterprises are excluded. Such a definition of the general government sector is also used by the EC in its process of budgetary surveillance under the Stability and Growth Pact. For more details, see:
http://www.mf.gov.si/en/areas_of_work/general_government_finance/public_finances/general_goverment_sector/.

Maastricht reference values for public debt and deficits:
A 60% general government debt-to-GDP ratio,
a 3% general government deficit-to-GDP ratio.
Both reference values were specified within the framework of the Treaty of Maastricht establishing the EU (1992).

Maximum expenditure:
The maximum level of expenditures of the general government and individual budgets (state budget, the Health Insurance Institute of Slovenia – ZZZS, the Pension and Disability Insurance Institute of the Republic of Slovenia – ZPIZ, local communities), which is defined in the Framework for the Preparation of the General Government Budget. The level of expenditures depends on the cyclical position of the economy and the formula for its determination is laid down in Article 3 of the Fiscal Rule Act.

Medium-term budgetary framework:
An institutional fiscal device that lets policy-makers extend the horizon for fiscal policy making beyond the annual budgetary calendar, typically for a period from three to five years. Targets can be adjusted under medium-term budgetary frameworks (MTBF) either on an annual basis (flexible frameworks) or only at the end of the MTBF horizon (fixed frameworks).

Medium-term budgetary objective (MTO):
According to the reformed Stability and Growth Pact, Member States must present a medium-term objective in stability programmes and convergence programmes. It is country-specific to take into account the diversity of economic and budgetary positions and developments as well as of fiscal risks to the sustainability of public finances, and is defined in structural terms.

Minimum benchmarks:
The lowest value of the structural budget balance that provides a safety margin against the risk of breaching the Maastricht reference value for the deficit during normal cyclical conditions. Minimum benchmarks do not cater to other risks such as unexpected budgetary developments and interest rate shocks. They are estimated by the EC and they are also a lower bound for the medium-term budgetary objectives.

One-off and temporary measures:
Government measures and transactions having a transitory budgetary effect that does not lead to a sustained change in the budgetary position.

Output gap:
The difference between actual output and estimated potential output. In the average of the entire normal economic cycle, this difference is zero.

<u>Potential GDP:</u>
The level of real GDP in a given year that is consistent with a stable rate of inflation. If actual GDP rises above its potential level, then constraints on capacity begin to bind and inflationary pressures build; if GDP falls below potential, then resources are lying idle and inflationary pressures abate. In terms of methodology the measuring of potential output is associated with significant risks, wherefore the estimates of potential GDP may be subject to change.

<u>Primary budget balance:</u>
The budget balance net of interest payments on general government debt.

<u>Primary structural budget balance:</u>
The structural budget balance net of interest payments.

<u>Pro-cyclical fiscal policy:</u>
A fiscal stance that amplifies the economic cycle by increasing the structural primary deficit during an economic upturn, or by decreasing it in a downturn. A neutral fiscal policy keeps the cyclically-adjusted budget balance unchanged over the economic cycle but lets the automatic stabilisers work.

<u>Public debt:</u>
Consolidated gross debt for the general government sector. It includes the total nominal value of all debt owed by public institutions in the Member State, except that part of the debt owed to other public institutions in the same Member State.

<u>Significant deviations:</u>
Under EU law significant deviations in terms of budgetary developments are deemed to be those in which deviations from the adjustment path towards the medium-term budgetary objective is at least 0.5 percentage point of GDP in one year or 0.25 percentage point of GDP in the two year average. The same applies to deviations from the expenditure rule. If a significant deviation is established ex post, it may trigger a significant deviation procedure, which may also result in the imposition of fines on the Member State that violates the rules.

<u>Stability and Growth Pact (SGP):</u>
Approved in 1997 and reformed in 2005 and 2011. It is a set of rules which are to ensure the proper functioning of fiscal policies in EU Member States. It transposes the requirements of the Maastricht Treaty regarding the surveillance of Member State budgetary policies into EU legislation. A detailed description of the application of the SGP's provisions is published annually by the EC in the publication Vade Mecum on the Stability and Growth Pact.

<u>Stability programme:</u>
Medium-term budgetary strategies presented annually to the EC by those Member States that have already adopted the euro. The stability programme must be drafted in accordance with the provisions of the Stability and Growth Pact. In Slovenia the stability programme as a key medium-term budget document is also defined by the Fiscal Rule Act. Slovenia must submit it to the European Commission by the end of April every year.

<u>Stock-flow adjustment:</u>
The stock-flow adjustment (also known as the debt-deficit adjustment) ensures consistency between the net borrowing (flow) and the variation in the stock of gross debt. It includes the accumulation of financial

assets, changes in the value of debt denominated in foreign currency, and remaining statistical adjustments.

<u>Structural budget balance:</u>

The actual budget balance net of the cyclical component and one-off and other temporary measures. As a result, the structural budget balance, in comparison with the budget balance, gives a better measure of the underlying trend in the budget balance, and the offset structural balance in the long run creates conditions for the functioning of the general government without borrowing.