REPUBLIC OF SLOVENIA
FISCAL COUNCIL

Report on the Fiscal Council's operations in 2018

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FOREWORD

In 2018, the Fiscal Council carried out its activities, monitored and evaluated the documents relating to the entire budgetary cycle, which was under the strong influence of the election year, throughout the entire calendar year for the first time. This was also reflected in the Fiscal Council's activities. The absence of a fully-fledged government during one part of the previous year increased the risk for fiscal stability. This was, among other things, highlighted by the medium-term budget plan of the Stability Programme 2018, which was prepared on the basis of no-policy-change scenario. Major threats to sustainability of public finances also included attempts by political parties to win votes by making fiscally irresponsible promises.

In addition to making statutory assessments, the Fiscal Council called attention to the risks faced by public finances on a number of occasions in 2018, even before the discussion of budget documents. In March 2018, the Fiscal Council called on all the stakeholders not to exploit the current favourable conditions in order to achieve short-term and narrowly defined objectives that could jeopardise fiscal stability and to exercise due restraint in adopting legislation having effect on public finances and not being included in the existing budgetary framework. After the formation of the new government in September 2018, the Fiscal Council published an Assessment of fiscal and macroeconomic consequences of the Coalition Agreement on Cooperation within the Government of the Republic of Slovenia in the 2018-2022 term of office with a view to implementing good practices of some other independent fiscal institutions. The assessment established that consistent implementation of the measures set out in the Coalition Agreement could distance Slovenia from its medium-term fiscal objective and fiscal sustainability. The subsequently adopted budget documents were drafted more realistically and more responsibly.

Particularly worthy of mention was the December Assessment of the compliance of the Ordinance Amending the Ordinance on the Framework for Preparing General Government Budgets for the 2018–2020 period with the fiscal rules. Although this budget document and the Draft Budgetary Plan provided for an appropriate decline in the public debt-to-GDP ratio and for a nominal general government surplus, it was inconsistent with the fiscal rules in many ways. It particularly changed the target values only for 2019, which does not create a sound basis for ensuring or verifying the medium-term fiscal sustainability. In the Fiscal Council's opinion, the anticipated nominal surplus was too low to ensure the structural balance pursuant to the Fiscal Rule Act, resulting in a negative fiscal effort (deterioration of the structural balance). The revised budget adopted in January 2019 was based on this framework with unchanged anticipated expenses and with adjustments included on the revenue side, which should improve the structural balance.

While the producers must convince the buyers in the market with the quality and the prices of their goods and services, the extent and the way of the provision of products based on public expenditure are the subject of political decisions. Providers of public goods do not earn their revenue in direct contact with the buyers but indirectly through tax coercion and with the general government as intermediary. The interest shown in benefiting from public spending is generally greater than the Government's ability to reasonably allocate the tax burden among the taxpayers. Just as it has been demonstrated by fiscal history, the Government is often too weak to contain the demand for increasing public expenditure beyond reasonable limits. With this in mind, independent fiscal institutions have recently been established in the EU with the task of assessing the general government budgets and calling attention to the risks that may lead to excessive public debt accumulation. Fiscal rules enabling fiscal councils to determine the sustainability of fiscal trends have been adopted as a warning criterion. According to these rules, an independent fiscal institution such as the fiscal council is only an element of democratic decision-making process since final decisions are made by the Parliament. The purpose of the dialogue between the Government and the fiscal council is to inform the public of the budgetary decision-making, thus facilitating a more transparent and better quality decision making process.

The Fiscal Council in its capacity of democratic system institutions makes and publishes its assessments of the compliance of fiscal policy with fiscal rules and submits them to the National Assembly. The National Assembly can instruct the Government to prepare amendments to a proposed act or additional measures based on the Fiscal Council's assessment. In making assessments, the Fiscal Council wishes to pursue best practices by providing, justifying and interpreting calculations. The Fiscal Council takes into account the variability of assessments and uses a wide range of methodologies and refers to various institutions, as explained in Chapter 2.3 of the Report on Fiscal Council's Activities in 2017.

Notwithstanding the discussions about the relevance and appropriateness of the fiscal rules, we always run into restrictions on public expenditure due to the restrictions on excessive accumulation of public debt. In the period of strong economic activity when the general government sector may generate surpluses, a vital question of a quality decision about the size of expenditure is what are the levels of nominal surpluses that may be deemed sufficient. The answer is provided by the fiscal rules, while decisions on the measures on the revenue side or on the amount and the structure of expenditure remain in the domain of the politics. The quality of these decisions is the preliminary condition for fiscal stability, which in turn is the preliminary condition for the well-being of the population now and in the future.

Dr Davorin Kračun,

Chairman of the Fiscal Council

1. Report on the Fiscal Council's operations in 2018

2018 was the first full calendar year of the Fiscal Council's operation since its establishment. The Fiscal Rule Act (hereinafter: the FRA)[1], adopted in July 2015 by the National Assembly of the Republic of Slovenia (hereinafter: the National Assembly)[1], constitutes the basis for the establishment and operations of the Fiscal Council. The FRA 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. The Fiscal Council drew up its first report for 2017 in May 2018 and this chapter presents the main aspects of the Fiscal Council's operations in 2018.

1.1 The guiding principles of the Fiscal Council's operations

The Fiscal Council is an independent and autonomous state authority assessing the appropriateness of the planned and implemented fiscal policy, i.e. its compliance with the statutory fiscal rules. 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 an essential 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] Within budget planning process the Fiscal Council proposes the funds needed for its operations itself, in accordance with the FRA. 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 medium and 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 the welfare of the population.

The tasks of the Fiscal Council are defined by the FRA. They mainly include the assessment of the appropriateness of budget documents, which must ensure compliance with the statutory 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 FRA. In addition to the provisions of the FRA, the Amendment to the Public Finance Act of February 2018 (hereinafter: ZJF-H)[3] also assigned to the Fiscal Council the task of assessing the bias of the previous macroeconomic forecasts that represent the basis for preparing the budget documents. The Regulation amending and supplementing the Regulation on the documents of development planning bases and procedures for the preparation of the central government budget of May 2018[4] imposes on the Fiscal Council the task of subsequently assessing the general government sector's revenue and expenditure forecast. Further details on changes in legislation relating to the Fiscal Council adopted in 2018 are set out in Chapter 1.4.

In the second year of its existence, the Fiscal Council operated within the framework of the set regular annual operating cycle. In terms of its schedule, the annual work plan is largely defined by the FRA,

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[1] http://www.pisrs.si/Pis.web/npbDocPdf?idPredpisa=ZAKO7056&type=doc&lang=EN

[2] For more information on the operating costs and the selected components of the Fiscal Council's balance sheet for 2018 see Annex 1.

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

[4] https://www.uradni-list.si/glasilo-uradni-list-rs/vsebina/2018-01-1754?sop=2018-01-1754

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; Framework*	**FC: assess SP/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.

by the procedure of preparing budget documents and by the publication of important macroeconomic and fiscal data. In 2018, the Fiscal Council began publishing the publication "Fiscal and Macroeconomic Trends". This publication is not explicitly required by the FRA and its preparation is part of the task of monitoring the implementation of the government budget, local government budgets and the health and pension insurance fund budget referred to in point 3 of paragraph two of Article 7 of the FRA and is also part of the implementation of other tasks required for the exercise of the Fiscal Council's competences pursuant to point 9 of paragraph seven of the FRA. The publication is published generally in January and July each year after the publication of quarterly data about trends in the general government sector. In addition to a fiscal trend overview, the Fiscal Council presents in this publication its view of the cyclical circumstances in the nation's economy, by placing a special emphasis on the assessment of factors and risks which may have impact on the achievement of fiscal objectives.

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,[5] define the organisation and the method of its work. The Fiscal Council usually meets once per week at closed sessions to discuss the current

[5] https://www.uradni-list.si/glasilo-uradni-list-rs/vsebina/2017-01-1384?sop=2017-01-1384

macroeconomic and fiscal developments and, among other things, adopts decisions on the publication of opinions and/or documents.

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 FRA also provided 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. The Fiscal Council has concluded cooperation agreements with the Institute of Macroeconomic Analysis and Development (hereinafter: IMAD) and with the Ministry of Finance (hereinafter: MoF).[6] The two agreements define the data and/or documents that these institutions have to provide and the deadlines for their provision. In 2018 the two cooperation agreements concluded with IMAD and the MoF were implemented as agreed.

On several occasions in 2018, the Fiscal Council met with the representatives of domestic institutions. The cooperation agreements concluded with the MF 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 Fiscal Council's Analysis Service held meetings at the technical level with the representatives of the two institutions on a regular basis, discussing the aforementioned topics, and the Analysis Service also held one meeting with the Bank of Slovenia on macroeconomic forecasts at the technical level. In 2018, the Fiscal Council held one meeting with the Prime-Minister designate, three meetings with the Minister of Finance with a view to informing the Minister of the legislative procedures and of the challenges of fiscal policy management, and also met with the representatives of the Court of Audit of the Republic of Slovenia (hereinafter: the Court of Audit) and with the representatives of the Bank Assets Management Company.

For the purpose of its operations the Fiscal Council also needs data and information that are not available to the public. For the purpose of analysis and forming opinions the Fiscal Council, in accordance with the FRA, made requests to obtain data and information from the Ministry of Public Administration and the Statistical Office of the Republic of Slovenia, but the relevant cooperation agreements have not yet been concluded. The representatives of the Fiscal Council's Analysis Service attended the first meeting of the working group for government accounts, intended for the monitoring and addressing methodological challenges of general government statistics and organised by the Statistical Office.

In 2018, the Fiscal Council organised two consultation meetings with Slovenian economists engaged in public finances.[7] At the meeting held in March on the occasion of the Fiscal Council's first anniversary, the participants agreed that public presence was important especially in the initial phase of the existence of institutions and that continuous relations with media should therefore be established; to acquire credibility, a high professional quality of recommendations published by the Fiscal Council is necessary. In the participants' opinion, the Fiscal Council, besides performing the ongoing tasks set by the legislation, should devote more attention to mid-term challenges, especially the consequences of population ageing for public finance, the analysis of fiscal risks, an active role in the adoption of relevant legislation, and the establishment of effective relations with fiscal councils in the EU. The

[6] Both agreements are available at http://www.fs-rs.si/fiscal-council/co-operation/

[7] The records of the meetings are available at http://www.fs-rs.si/consultation-marking-the-first-anniversary-of-the-fiscal-council/ and at http://www.fs-rs.si/fiscal-council-consultation-at-the-end-of-2018/

participants in the second meeting held in December believed that the Fiscal Council should systematically use all available communication channels. Related to this, the majority of the invitees highlighted the need for educating the general public on the importance of sustainable public finances and on fiscal rules and institutions that are supervising their implementation. In the opinion of the participants in the consulting meeting, the Fiscal Council should to a greater extent contribute to the general debate on fiscal policy orientations. A number of participants in the discussion proposed that an external assessment of the Fiscal Council's work be carried out after a few years of its operation.

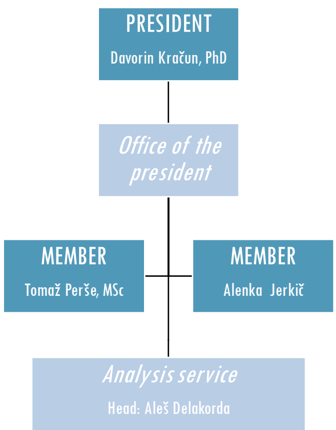
1.2 Composition of the Fiscal Council

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 FRA lays down that the function of a member of the Fiscal Council is incompatible with holding a public office and 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 FRA the President of the Fiscal Council must be employed with the Fiscal Council for at least half-time employment, whereas the members of the Fiscal Council may be employed with the Fiscal Council for not more than half-time employment. Currently, the President is employed full-time with the Fiscal Council, and the two members for 50 percent of full-time employment each.

Four public employees are employed in the Fiscal Council. This is also the maximum number of employees as laid down by paragraph five of Article 10 of the FRA. Public employees provide administrative and expert support to the Fiscal Council's members. The staffing of expert services was completed in October 2017 and remained unchanged in 2018. One public employee works in the President's office and performs administrative and organisational tasks, while three public employees work in the Analysis Service. In accordance with paragraph six of Article 10 of the FRA, administrative

Figure 1.1: Organizational chart of the Fiscal Council



Source: Fiscal Council.

and technical tasks (human resources, information technology and accounting, public relations, etc.) for the Fiscal Council are performed by the services of the 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 expenses" in Table 1 contained in Annex 1).

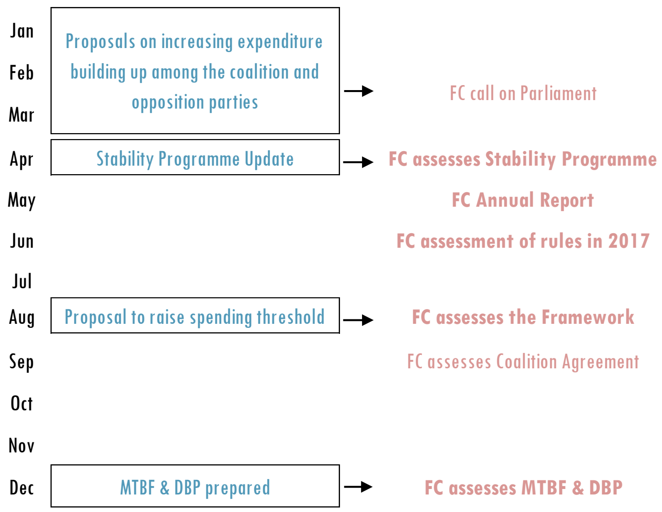
The Analysis Service provides expert assistance to the Fiscal Council's members. In this context it regularly monitors and analyses macroeconomic and fiscal developments in Slovenia and abroad and prepares working documents for the members and expert groundwork for their opinions. The priority areas of the second year's operations of the Analysis Service included database management, maintaining and upgrading of the automation of processes for the monitoring of economic indicators, the upgrading of basic analytical tools for the analysis of cyclical and fiscal trends, the renewingof the Fiscal Council's website and the design of the Fiscal Council's new publication.

1.3 The Fiscal Council's recommendations and opinions and the Government's responses in 2018

Most of the Fiscal Council's opinions and recommendations in 2018 related to its tasks defined by the FRA. It should also be noted that paragraph four of Article 7 of the FRA 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 written reasoned opinions by the Government increases the transparency of its operations while its eventual lack of response to the Fiscal Council's recommendations aggravates its political responsibility.
Acting in accordance with the FRA, the Fiscal Council made the following assessments in 2018:

- on 18 April 2018 it submitted to the National Assembly and the Government an assessment of the draft Stability Programme – Update 2018 (as laid down in point 1 of paragraph 2 of Article 7 of the FRA).

Figure1.2: Milestones in Fiscal Council's operations in 2018



Note: Bold text marks assessments that FC is obligated to prepare by the Fiscal Rule Act.
Source: Fiscal Council.

- on 30 May 2018 it submitted to the National Assembly and the Government an assessment of the draft Stability Programme – Update 2018 (as laid down in point 1 of paragraph 2 of Article 7 of the FRA).
- on 13 June 2018 it submitted to the National Assembly and the Government an assessment of compliance of the general government budgets with the fiscal rules in 2017 (as laid down in point 4 of paragraph 2of Article 7of the FRA).
- on 7 August 2018 it submitted to the National Assembly and the Government an assessment of the proposal for the Ordinance amending the Ordinance on the framework for the preparation of the general government budget for the period 2018-2020 (as laid down in point 5 of paragraph 2of Article 7 of the FRA).
- On 13 December 2018 it submitted to the National Assembly and the Government an assessment of compliance of the proposal for the Ordinance amending the Ordinance on the Framework for preparing General Government Budgets for the Period 2018-2020 (as laid down in point 5 of paragraph 2of Article 7 of the FRA).

In addition to the assessment required by the FRA, the Fiscal Council prepared the following opinions and recommendations:

- on 23 February 2018, the Fiscal Council called on all the stakeholders not to exploit the current favourable conditions in order to achieve short-term and narrowly defined objectives that could jeopardise fiscal stability in circumstances of increased risk to fiscal sustainability and on the Government and the National Assembly to ensure further consolidation of public finances.
- on 4 April 2018, the Fiscal Council made a recommendation to the National Assembly to stopall legislative procedures whose effects on public expenditure are not included in the existing budget frameworks and recommended the National Council to veto the adoption of such legislation in the event of the National Assembly's failure to observe the recommendations.
- on 18September 2018, the Fiscal Council published an Assessment of fiscal and macroeconomic consequences of the Coalition Agreement on Cooperation within the Government of the Republic of Slovenia in the 2018-2022 term of office.

During its reviews of budget documents in 2018 the Fiscal Council found, for the most part, compliance 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 terms of demographic changes. The Fiscal Council also called attention to the absence of a medium-term oriented fiscal policy and to the insufficiently defined measures aimed at ensuring the appropriate fiscal effort in structural terms. In reviewing the implementation of the fiscal policy in 2017 the Fiscal Council assessed that Slovenia complied with the fiscal rules in that year, with the exception of the both rules (the domestic and the expenditure rules, the latter of which is laid down by the Stability and Growth Pact) that determine the maximum level and the increase in general government expenditure.

The Government responded to the Fiscal Council's assessments for 2018 with public written explanations as required by law. The Government pointed out that, in the period when the government was limited to performing only its regular duties, it could not take measures that could impact the liabilities of the new government. The Government also 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 also explained that, through gradual consolidation, it intended to limit expenditure growth on the one hand, and to promote faster growth and prosperity on the other hand. Great importance 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 emphasised that it would monitor the risks highlighted by the Fiscal Council in its assessments, and respond to them accordingly.

In 2018, the Fiscal Council's recommendations related particularly to the period in which the Government was limited to performing only its regular duties. During that period, there were noticeable pressures by political parties for accelerated adoption of legislation, which, in the opinion of the Fiscal Council, could have threatened the medium-term sustainability of public finances. In the light of these developments, the Fiscal Council (i) called on and recommended to the deputies of the National Assembly in February and April 2018, respectively, not to adopt any acts that could have fiscal effects and that are not included in the existing budgetary frameworks, and (ii) recommended to the National Council to veto the adoption of such acts in the event of the National Assembly's failure to act in accordance with the recommendation referred to in the preceding point.

In 2018, the Fiscal Council started introducing good practices of some other independent fiscal institutions wishing to contribute to enhanced transparency of programmes of political parties and warning against any public finance risks arising in this connection. After the National Assembly elections and after the confirmation of the new Government by the National Assembly, the Fiscal Council presented its assessment of fiscal and macroeconomic consequences of the Coalition Agreement on Cooperation within the Government of the Republic of Slovenia in the 2018-2022 term of office. On that occasion, the Fiscal Council prepared a quantitative evaluation of the measures set out in the Coalition Agreement. It established that the basic framework of the Coalition Agreement indicated a considerable increase in the general government expenditure, where targets were presented in greater detail, and an increase in household and corporate taxation with a much less detailed plan of measures. The measures from the Coalition Agreement would in the short run provide further impetus to the relatively high economic growth at the expense of a deteriorated fiscal situation and other macroeconomic balances. The Fiscal Council also pointed to the fact that the Coalition Agreement did not sufficiently address long-term risks to fiscal sustainability and expressed its expectations that the Government will pursue fiscal sustainability in the adoption of measures.

1.4 The Fiscal Council and the National Assembly

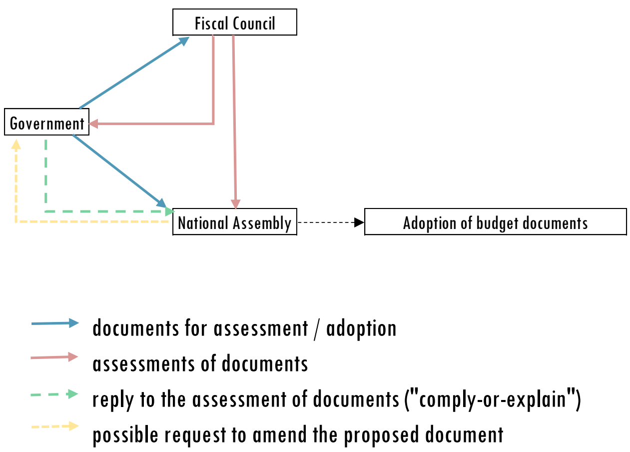
The Fiscal Council’s cooperation with legislature is extremely important. As an independent institution dealing with non-partisan analyses of economic and fiscal developments, the Fiscal Council can provide indirect support to the deputies' decisions on budget guidelines and on public finance topics.[8] In accordance with its mandate it relies in its work solely on a positive analysis and does not provide normative opinions on particular fiscal measures and/or laws. Such policy enables the Fiscal Council to maintain its non-partisan status, while at the same time ensuring the apolitical nature of its operations.

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

The Fiscal Council's representatives attended three meetings of the Committee on Finance and Monetary Policy, one meeting of the National Assembly's Commission for the Supervision of Public Finances and two meetings of the National Council's Commission for the Economy, Craft Industry, Tourism and Finance. The Fiscal Council also submits its assessments of budget documents and fiscal trends to the Government for response and to the National Assembly for discussion. 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 or why they will not be taken into account ("comply-or-explain"). As an autonomous authority, the Fiscal Council was also invited in 2018 to some meetings held by the Commission for Public Finance Supervision, where it presented its assessments of the Coalition Agreement. The Fiscal Council also attended some meetings of the National Council's Commission for the Economy, Craft, Industry, Tourism and Finance, where it presented its opinion on the amendments to the Public Finance Act and presented the conclusions contained in the Report on the Fiscal Council's operations in 2017.

2018 saw changes in some parts of the legislation that concerns the Fiscal Council's operations. The Fiscal Council actively participated in the drafting of the Act amending the Public Finance Act regarding the medium-term budgetary framework.[9] During the transposition of Directive 2011/85/EU into Slovenian legislation, the Fiscal Council submitted proposals for adapting the requirements of mentioned Directive to the national institutional framework, coordinating its work with the Ministry of Finance. Already in September 2017, the Fiscal Council published a call for the soonest possible adoption of the Public Finance Law.[10] Amendments to the Public Finance Act related to the work of the Fiscal Council adopted in February 2018 set the deadlines in which the Fiscal Council is required to make specific assessments required by FRA, and Article 9g of the amendments imposed on the Fiscal Council the obligation to analyse the macroeconomic aggregates used in the drafting of budget documents for the previous four years every two years. Moreover, the Decree amending the Decree

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.

[9] http://www.pisrs.si/Pis.web/pregledPredpisa?id=ZAKO6975

[10] http://www.fs-rs.si/position-of-the-fiscal-council-on-the-legal-framework-for-medium-term-fiscal-planning/

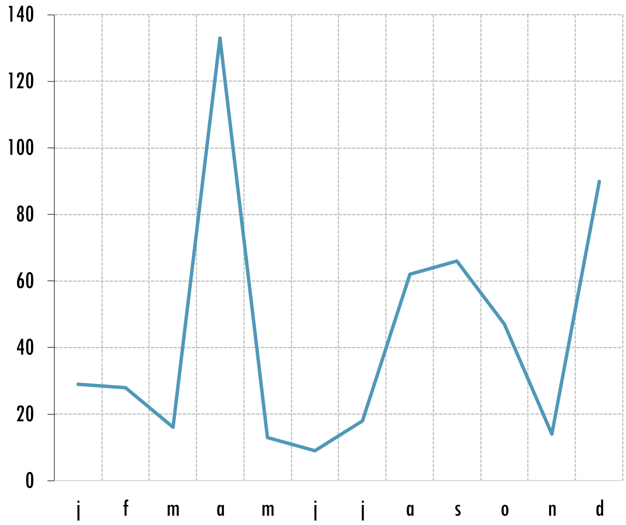
on the documents of development planning and procedures for the preparation of the central government budget of May 2018 imposes on the Fiscal Council the task of subsequently assessing the general government sector's revenue and expenditure forecast. Both tasks are subject to a transitional provision that their implementation should start in 2020.

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.

In 2018 the Fiscal Council provided information about its work to the public by publishing recommendations and opinions, holding interviews and 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 responded particularly to individual publications of the Fiscal Council's opinions and views. The media response to publications increased considerably as compared with the previous year. Their response focused on the publication of the Fiscal Council's basic assessments for which two press conferences were held. The first press conference was held in April on the occasion of the Assessment of the Stability Programme - update 2018 and the second one in December on the publication of the Assessment of the consistency of the Ordinance Amending the Ordinance on the Framework for the Preparation of the Central Government Budgets for the 2018–2020 period with the fiscal rules. The media also devoted considerable attention to the assessment of the modified framework for the preparation of the budget for the period 2018-2020 in August, and to the assessment of the Coalition Agreement in September.

Figure 1.4: Number of media reports about the Fiscal Council in 2018 by month



Source: Press Clipping d.o.o., Fiscal Council calculations.

The Fiscal Council set up its own website at the beginning of its functioning and renewed it in 2018 with a view to achieving greater transparency of documents and operations, thus providing access to the current publications of opinions, assessments, views and recommendations to a broad circle of the interested public.[11] Furthermore, the legislation associated with the work of the Fiscal Council, cooperation agreements with other institutions and interviews of its members are currently available at its website. During the renovation, a set of frequently asked questions with answers in the Fiscal Council's area of work were added to the website contents. In this way, the Fiscal Council wishes to familiarise the public in a simple way with the basic notions used in its work and communication. The majority of publications, including other basic information on its operations, are also available on its English website.

1.6 International cooperation of the Fiscal Council

Shortly after the beginning of its operations, the Fiscal Council began to join international networks of similar institutions and participated in discussions with international institutions that analyse economic and fiscal 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 European Commission (hereinafter: EC) and whose purpose is to link the institutions predominantly in terms of public finance governance and compliance with the fiscal rules laid down by EU law. The EU IFI[12], 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 EC. Among other things, it delivered an opinion on EU Council Directive implementing the Fiscal Compact into EU law[13] and an opinion regarding the Danish government's intention to move the Fiscal Council's head office, which would restrict its autonomy.[14] In 2018, the Fiscal Council's representatives attended two EUNIFI and two EU IFI meetings.

EU IFI has various working groups which were active in two areas in 2018. The first area, for which a final report had already been drawn up,[15] was the pursuit of good practices in the creation and operation of medium-term budgetary frameworks. The second area, for which the report is still under preparation,[16] related to the assessment of the output gap and of the uncertainty arising in this

[11] http://www.fs-rs.si/news/

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

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

[14] https://www.euifis.eu/eng/fiscal/218/statement-on-the-danish-economic-council

[15] Available at https://www.euifis.eu/images/MTBF_PAPER.pdf

[16] Technical working material is available at: https://www.euifis.eu/download/ogwg_paper.pdf

connection in assessing the fiscal policy implementation. The Fiscal Council did not take an active part in any of the working parties since they began their operations before the Fiscal Council's joining the EU IFI in 2017. The Fiscal Council's representatives attended the joint meeting of the working party that analysed the output gap assessment.

The Fiscal Council prepared two contributions 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.[17] For this purpose, IMAD[18] presented macroeconomic forecasts and the Fiscal Council its view on the short- and long-term fiscal trends and the related challenges, reflecting the distribution of tasks among the two institutions.

1.6.2 Contacts with other independent fiscal institutions

In December 2018 two representatives of the Fiscal Council paid a visit to the Slovak Council for Budget Responsibility with the purpose of exchanging good practice. The Slovak fiscal council[19] was established in 2012. It exceeds the Slovenian Fiscal Council by almost three times in size (four members and 14 public employees) and is one of the most active members of international associations of independent fiscal institutions. The discussion with a member and with the staff of the Slovak Fiscal Council related above all to the methodological approach and to the experience with the drawing up of a report on long-term sustainability of public finance, which must be drawn up in line with the Constitutional Act on budget responsibility at least once a year.

1.6.3 Contacts with international institutions

The Fiscal Council cooperates with the EC within the framework of the European Semester; In 2018 representatives of the EC paid a visit to the Fiscal Council twice; in April and in October. Cooperation took place at a technical level and was intended to exchange the views on the current and future budgetary developments, in particular in terms of compliance with the fiscal rules. In this context, the Fiscal Council presented its independent assessments of budget documents.

The Fiscal Council was visited by the International Monetary Fund (IMF) twice in 2018. The first visit in October 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. The discussion focused primarily on the Fiscal Council's assessments of the risks posed to public finance and on the key fiscal policy priorities. 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. During the second visit, the members of the IMF delegation presented to the Fiscal Council the possible alternative tax restructuring methods, which was also the topic of discussion.

The Fiscal Council also cooperates with the Organisation for Economic Co-operation and Development (hereinafter: OECD), within which there is a network of independent fiscal institutions[20] that provides a

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

[18] 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.

[19] https://www.rozpoctovarada.sk/eng/home

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

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[21] which, since summer 2017, has also included Slovenia, and which is intended to be a survey of the main features of independent fiscal institutions.[22]

On several occasions in 2018 the Fiscal Council met with the representatives of credit rating agencies. It met with Fitch Ratings's representatives in July and with Moody's representatives in October. The Fiscal Council delivered its opinions on the economic and fiscal situation in Slovenia at these meetings as well and presented its assessment of compliance with fiscal rules. Discussions with the representatives of credit rating agencies also included long-term challenges to public finances.

In the framework of international cooperation, the Fiscal Council's employees took part in the following events:

- "Fiscal Policy in an environment of high debt" workshop, which was organised by the EC (DG ECFIN) In Brussels in January;
- "The Future of Fiscal Integration in Europe" workshop, which was organised by the IMF Fiscal Affairs Department and IMF Europe Office in Brussels;
- meeting of the Network of Public Finance Economists in Public Administration, which was held in Brussels in March;
- the regular annual meeting of OECD Network of Parliamentary Budget Officials and Independent Fiscal Institutions, which was held in Seoul in June;
- "Stakeholders workshop for the suitability review of the Directive on national budgetary frameworks" workshop organised by the EC (DG ECOFIN) in Brussels in July;
- "Output gap working group" workshop, which was organised by the Lithuanian Court of Audit in the framework of the EU IFI network in Vilnius in September.

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

[22] 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 2018 describe certain aspects of the analyses performed by the Fiscal Council. The Fiscal Council assesses the current situation and various expectations and scenarios of the future, which are uncertain and difficult to measure. The range of selected topics in the Report on the Fiscal Council's operations in 2018 attempts to highlight certain key challenges as well as the content-related and methodological bases for its opinions. The selected topics also indicate additional tasks that the Fiscal Council will perform in the future, pursuant to the amendments to the Public Finance Act. The selected chapters of this part of the Report on the Fiscal Council's operations in 2018 will also be published as the Fiscal Council's independent analyses.

One of the fiscal policy key priorities should be improved management of the compensation of employees since it significantly impacts the achievement of sustainable public finances and the provision of quality public services. In the system of public services, which is mostly publicly funded, effective management of funds for compensation of employees as the second largest expenditure category is extremely important for the achievement of sustainable public finances. Compensation of employees has again increased faster than other expenditure since 2015 and similar trends are forecast until 2022. Their relative volume was among the largest in the EU and the rate of employment has been steadily increasing; the average increase in compensation per employee lagged that in the corporate sector over a longer period. The key deficiencies of the current system of managing compensation of employees are the absence of medium-term planning and of its resulting integration into a credible medium-term fiscal framework and the fact that the system is based on the adjustment of wages, while too little attention is dedicated to employment planning. The employment system is rigid and not sufficiently effective, and the determination of wages does not sufficiently depend on the actual ability or achievements of the staff. Moreover, the uniform wage system and a large number of formal stakeholders triggers a general wage increase in the entire general government sector, although such increase in not always justified for all employee groups. The system of managing compensation of employees in the general government sector should be reformed to make it more efficient and flexible, ensuring an appropriate quality level of public services in a cost-effective manner.

One of the parameters that determine the situation of public finances is the dependence of the general government balance on the cyclical situation of the economy. The majority of the discussions on the calculation of the structural balance which reflects the situation of public finances, independently from their position in the economic cycle, relates to the output gap assessment. In this topic we would like to shed light on the parameter which determines to what extent the economic cycle is eliminated from the nominal balance. The EC determines this flexibility parameter in regular nine-year intervals; the latest assessment of the elasticity parameter was updated in 2016 on the basis of data available until 2014. The Fiscal Council's updated assessment made on the basis of data until 2018 indicates a further decline in elasticity, primarily because of an increase of a proportion of non-tax revenue not associated with the economic cycle. Simulations show that there should be no significant changes in the assessments of the structural balance, the structural effort and the maximum expenditure despite the application of a modified elasticity parameter. The exception is represented by periods in which output gap assessments show major deviation from the balanced position.

The Fiscal Council promptly assesses compliance of the current fiscal trends with the objectives and projections set out in budget documents. One of the important tools for monitoring the implementation of fiscal forecasts during the year is the comparison between monthly or quarterly shares of fiscal aggregate components with adequate long-term averages. In this way it can be determined whether current trends deviate from the usual seasonal variations. The assessment of the development of the components with stable shares is easier than the assessment of components with no clear pattern or significant variations. A minor share of revenues and expenditures is achieved in the first part, and a major part thereof in the last part of the year. The distribution of tax revenues is more stable than that of non-tax revenues. A high year-end concentration applies principally to some expenditure components, which could also point to excessive or irrational spending of allocated funds.

The Fiscal Council must form an opinion regarding the reliability of forecast of macroeconomic and fiscal aggregates, both for the purpose of its own assessment of adequacy of the forecast and for the purpose of meeting the statutory requirements. In accordance with the Decree on the Development Planning Documents and Procedures for Preparing the Draft National Budget[23], the Fiscal Council will start preparing regular assessments of the past fiscal forecasts made by the Ministry of Finance in the fiscal planning framework in 2020. An analysis of fiscal aggregates was already made in the Report of the Fiscal Council's operations 2017; on this occasion it is expanded by an analysis of deviations of some revenue and expenditure components. It can be established that in the period 2009-2018 expenditure forecasts had largely been underestimated, which had largely been contributed to by expenditure on intermediate consumption and on compensation of employees. On the other hand, revenue forecasts are to a larger extent subject to the position of the economic cycle and thus also dependent on the accuracy of macroeconomic forecasts which were, for the most part, overestimated in the period before 2014 and underestimated in the period thereafter. The most persistent deviations throughout the analysed period is shown by the property income forecasts that had been mainly underestimated.

[23] http://www.pisrs.si/Pis.web/pregledPredpisa?id=URED5312

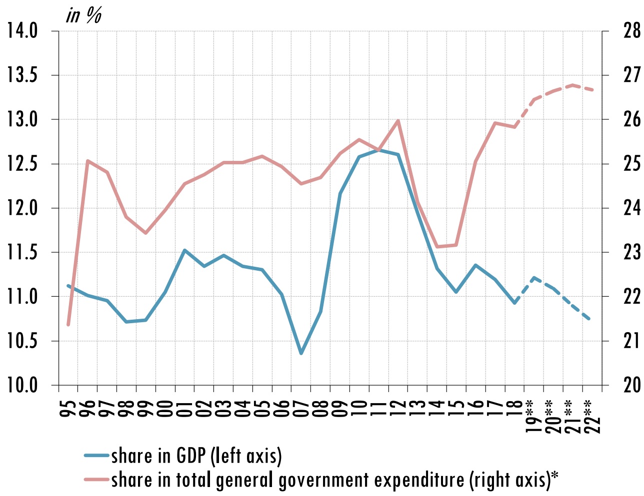
2.1 Labour costs in the general government sector

Compensation of employees as the second largest category of expenditures in the general government sector[24] significantly impacts fiscal sustainability. At the same time, the provision of quality public services depends on the efficiency of their management. Owing to a considerable increase in general government debt since the onset of the crisis and owing to marked demographic changes the manoeuvring space in the area of public finances has become increasingly limited. In the system of public services, which is mostly publicly funded, effective management of funds for compensation of employees is extremely important for the achievement of sustainable public finances. In Slovenia, these objectives, i.e. the achievement of sustainable public finances and effective management, are often mutually exclusive. An effective system of managing funds for compensation of employees that will ensure an appropriate quality of public services in a cost-effective manner thus represents one of the key structural changes required for the achievement of long-term sustainability of public finances and increasing the well-being of the population. The brief analysis consists of three parts: (i) a review of the movement of funds for compensation of employees in the past and international comparisons; (ii) assessment of their impact on public finances and on the pursuit of a counter-cyclical fiscal policy; (iii) assessment of the effectiveness of the system of managing funds for compensation of employees in Slovenia.

2.1.1 An overview of trends in general government compensation of employees and international comparison

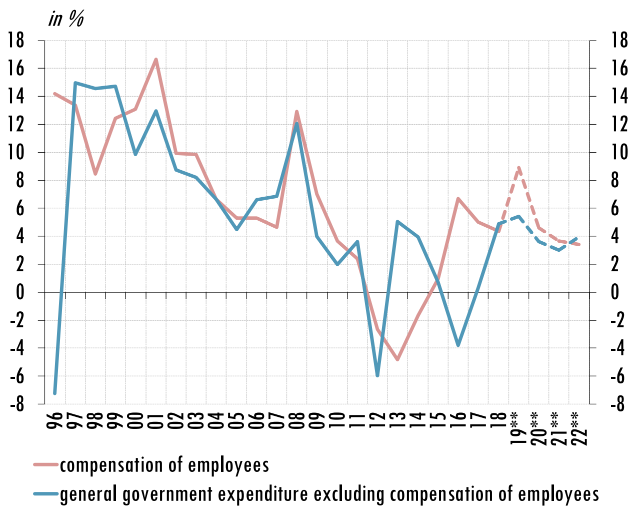
The dynamics of compensation of employees were crucially influenced by two events: by the introduction of a uniform wage system in 2008 and by the adoption of austerity measures in 2012. Before 2008, their share in the total expenditure and GDP was fairly stable, which, in addition to negotiations to establish a uniform wage system, was also due to ensuring macroeconomic stability before the adoption of the euro.[25] The introduction of a uniform wage system in 2008, which coincided

Figure 2.1: Share of compensation of employees in GDP and in general government expenditure



*Notes: *excluding expenditure for bank rescue in 2013 and 2014. **projection MoF Stability Programme 2019 (Apr. 19)*
Source: SORS, MoF, FC calculations.

Figure 2.2: Growth of compensation of employees and expenditures* excluding compensation of employees



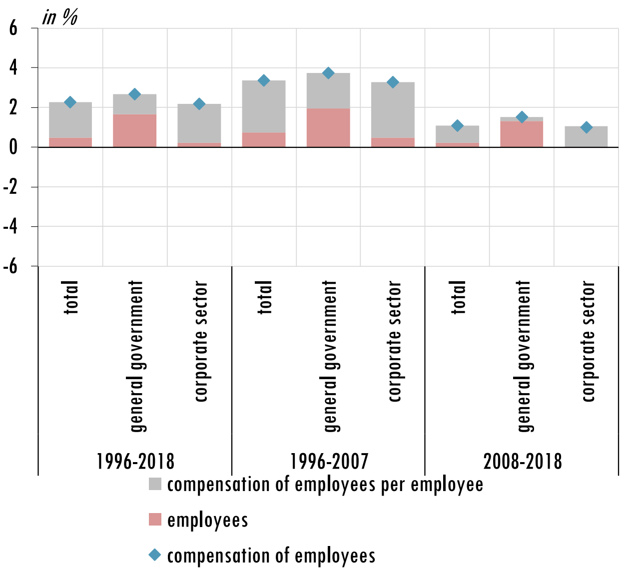
*Notes: *excluding expenditure for bank rescue in 2013 and 2014. **projection MoF Stability Programme 2019 (Apr. 19)*
Source: SORS, MoF, FC calculations.

[24] In 2018, compensation of employees accounted for 25.8% of total general government expenditure, while social benefits as the largest expenditure category accounted for 39%.
[25] For more details on the wage bill movement in the public sector since 2002 see IMAD, Economic Issues 2018, p. 11–13.

with the onset of the economic crisis, accelerated the increase in funds for compensation of employees and, compounded by a sharp decline in revenue and operation of automatic stabilisers, enhanced the deterioration of the general government balance. The adoption of austerity measures in 2012-2014 resulted in a reduction of compensation of employees. This was the only period in which compensation of employees lagged the increase in other expenditure. The period after 2014 was marked by a gradual mitigation of austerity measures, and the increase in compensation of employees considerably exceeded the increase in other expenditure after 2016. According to the projections of the Stability Programme 2019, similar trends are expected to continue in the following years, reaching the highest share in total expenditure ever recorded. In this way, the need to ensure sustainable public finances limits the possibility of increase in other expenditure and reduces the fiscal policy's room for manoeuvre. Experiences from the past financial crisis show that, in circumstances of potentially lower than forecast economic growth, it is difficult to achieve a reduction in compensation of employees, which can have a negative impact on both the quality of public services and the pursuit of an appropriate counter-cyclical fiscal policy.

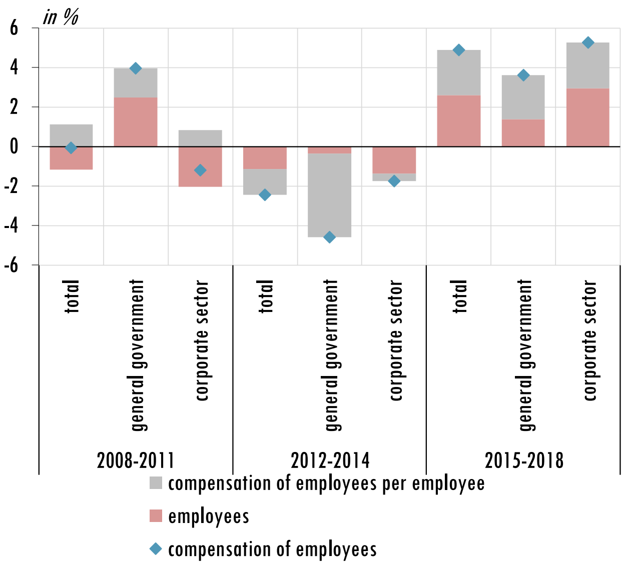
In the period after 2000, the total increase in funds for compensation of employees in the general government sector was similar to that in the corporate sector with a considerably different growth structure.[26] Until 2000, the increase in funds for compensation of employees in the general government sector considerably exceeded that in the corporate sector, particularly due to a sharp drop in employment in the latter. After 2000, real growth in the general government sector was largely due to the similar increase in employment and compensation per employee, and in the corporate sector solely due to the increase in compensation per employee. After 2008, the increase in compensation of employees slowed down considerably in both sectors and can be distributed over three sub-periods with different dynamics. In the first period of crisis (2008-2011), a further increase in funds for compensation of employees was recorded. In addition to a high increase in employment, the elimination of wage disparities resulted in an increase in compensation of employees. The second period of the crisis (2012-2014) was marked by a decline which was due in particular to a reduction in compensation per employee resulting from austerity measures in 2012. The decline in the corporate

Figure 2.3: Average annual real growth



Source: SORS, FC calculations.

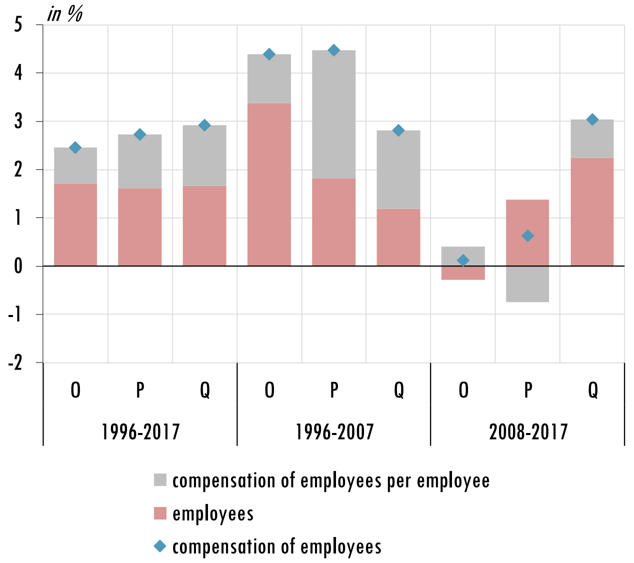
Figure 2.4: Average annual real growth



Source: SORS, FC calculations.

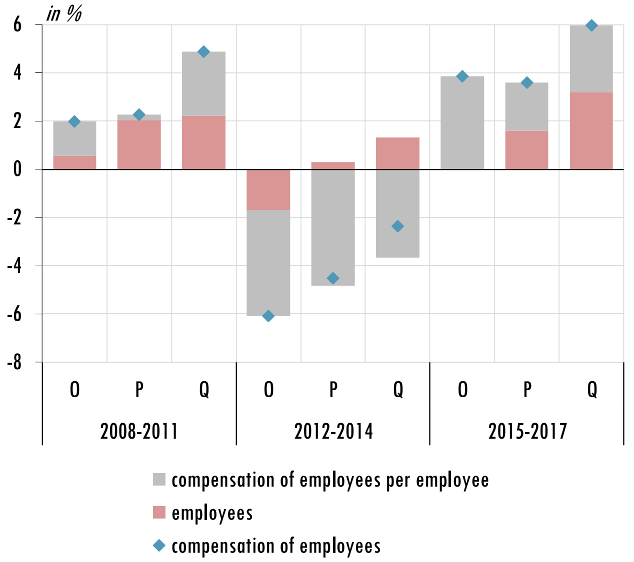
[26] The overview divides the national economy into the general government sector and the private sector and public companies, tagged corporate sector.

Figure 2.5: Average annual real growth



Source: SORS, FC calculations.

Figure 2.6: Average annual real growth



Source: SORS, FC calculations.

sector was the result of the decline in employment throughout the crisis until 2014. Since 2015, the real growth in the total funds for compensation of employees intensified, exceeding the pre-crisis level. The increase in compensation of employees in the general government sector was largely a result of the mitigation of the austerity measures in the area of wages, while in the corporate sector it was evenly distributed among wages and employment.

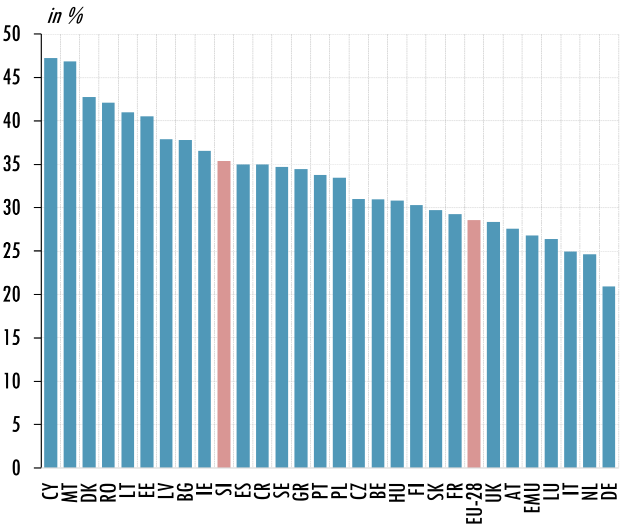
The dynamics of compensation of employees in individual public service activities varied considerably from one period to another.[27] Up to 2007, the increase in funds for compensation of employees in public administration and education in real terms exceeded the increase in health and social work activities. The increase in compensations declined considerably in public administration and education[28] after 2008 and remained at the pre-crisis average level in health and social work activities. The period 2012-2014 was marked by austerity measures in the area of compensation of employees in all three activities; employment declined only in public administration. After 2015, the gradual loosening of austerity measures and restrictions on employment pushed the average annual increase in compensation of employees to the pre-crisis level and exceeded it in health and social work activities. The increase in compensation of employees in public administration was entirely the result of the increase in compensation per employee that was also the largest in all three public service activities. The increase in education, health and social work activities was distributed more evenly.

The relative amount of funds for compensation of employees in the general government sector in Slovenia is one of the largest in the EU. The amount of funds for compensation of employees in the general government sector depends on the social and political agreement on the appropriate size of the public sector. Its relative size also depends on the on the size of the country since smaller countries must ensure a similar scope of public services, which requires a higher amount of funds for compensation of employees. The relative amount of funds for compensation of employees in the

[27] Due to the limited availability of data, we analysed the compensation of employees developments in public service activities O (public administration and defence, compulsory social security), P (education) and Q (health and social work activities). These three activities employ 91% of the total workforce in the general government sector. At the same time, employees in the general government represent 83% of the total workforce in these three activities.

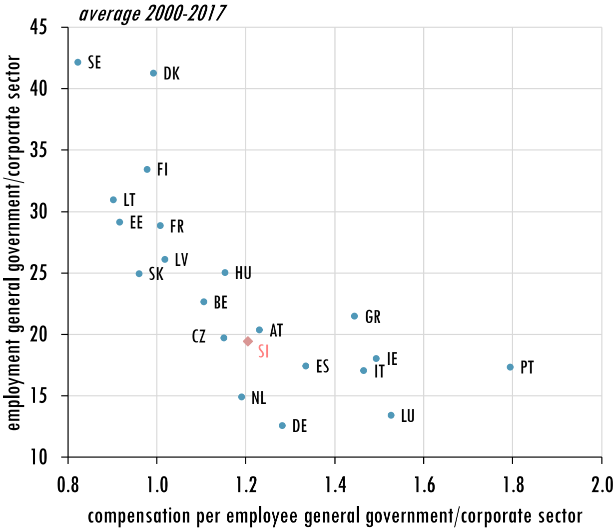
[28] At the introduction of a uniform wage system, the increase in funds for compensation of employees in the public administration activities was based on the increase in funds for compensation per employee, while in education it was based on employment in education, since compensation per employee only increased markedly in education during the negotiations on the uniform wage system.

Figure 2.7: Share of compensation of employees in other general government expenditure* (2017)



*Note: *expenditure excluding other capital transfers.*
Source: Eurostat, OECD, FC calculations.

Figure 2.8: Employment and compensation per employee in general government relative to corporate sector



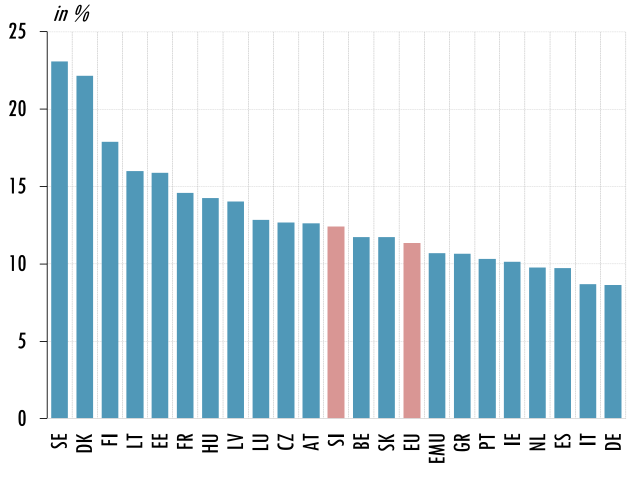
Source: SORS, Eurostat, OECD, FC calculations.

general government sector varies significantly by country. The share of these funds in GDP ranges from approximately 7% in Ireland to more than 15% in Denmark, Slovenia with approximately 11% ranks in the top half of the list of EU Member States. In the past few years, the share of these funds in GDP has slightly declined and is below the multi-annual average both in the EU average and in Slovenia. The both main components, i.e. relative employment and relative wage level in Slovenia are in the average range in the EU. The share of funds for compensation of employees in the general government's other expenditure increased during the past three years in Slovenia again and reached one of the highest levels so far, which points to a relatively less important role of compensation of employees in fiscal consolidation after 2015. In the past few years, the share of these funds in GDP showed a similar trend in other “new” Member States but remained low in "old" EU Member States after a decline at the onset of the crisis.

The relative share in the total number of employees of the general government sector was at the average EU level according to different comparisons but has increased over the past few years.[29] The share of general government employees in the working age population (15-64 years) has been growing steadily except in 2012-2015. It exceeded the EU average, where this share is rather stable, at the onset of the crisis. The increase is mainly due to the ageing of the population, i.e. the shrinking working age population. In light of the expected continuation of such demographic trends, proper planning and management of employment in the general government sector will become increasingly important. Effective management of employment in the general government sector is also important for ensuring the appropriate workforce without excessively precluding the private sector from access to it. As compared with the corporate sector, employment in the general government sector has increased almost steadily since 2000 and exceeds the EU average, which showed a slight tendency of decline over a longer period. In the past few years, employment in the general government sector in most countries somewhat declined, which was due to the fact that the increase in employment in the corporate sector was higher as economic activity recovered. As concerns ensuring long-term fiscal sustainability, attention should also be called to the structure of employment in public service activities.

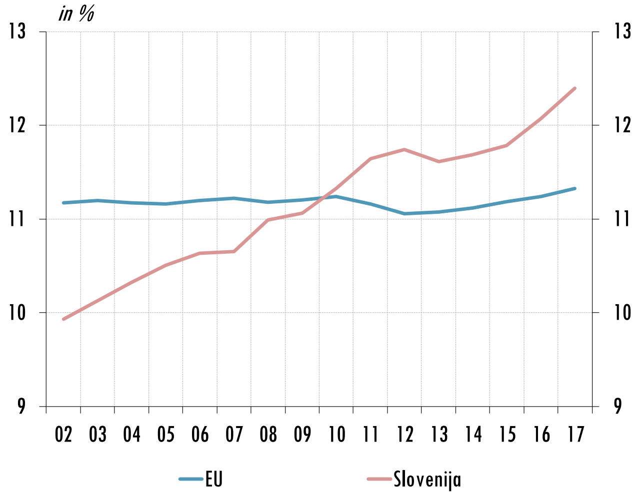
[29] Data on employment in the general government sector are available for 21 EU Member States, and the EU average mentioned in the analysis relates to those Member States, There is no data available for Bulgaria, Cyprus. Croatia, Malta and Romania and are only available for a limited period of time for Poland and the United Kingdom.

Figure 2.9: Employment general government relative to working-age population (2017)



Note: EU and EMU average on the basis of data for 21 countries with available data for general government employment.
Source: SORS, Eurostat, OECD, FC calculations.

Figure 2.10: General government employment relative to working-age population

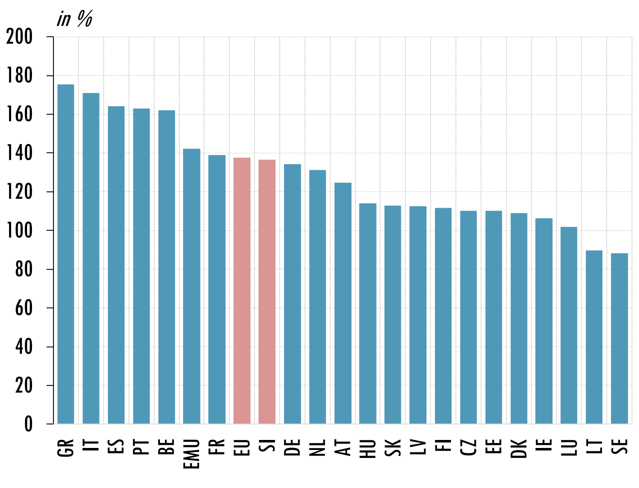


Note: EU average on the basis of data for 21 countries with available data for general government employment.
Source: SORS, Eurostat, OECD, FC calculations.

Employment in public service activities that are not included in the general government sector in Slovenia is one of the lowest in the EU.[30] This share is gradually increasing and was 17% in the past year. In public service activities, health and social work activities employ over one third, and education more than one tenth of workforce outside the general government.

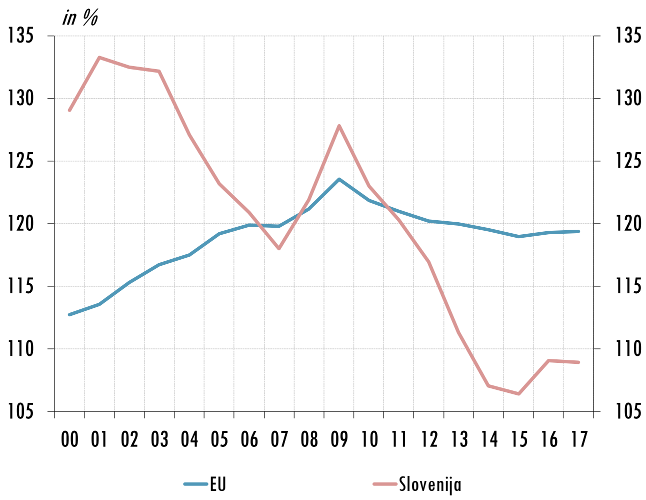
The relative amount of funds for compensation of employees per employee in Slovenia is also at the EU average level and has been on a decline in the past few years. The amount of funds for compensation per employee in the general government sector in terms of per capita GDP shows the wage level with regard to the standard of living and thus facilitates assessing whether or not this level is (too) high. This ratio has almost constantly declined in Slovenia, except during the first three years after the onset of the crisis. The ratio between compensation per employee in the general government

Figure 2.11: General government compensation per employee relative to GDP per capita



Note: EU and EMU average on the basis of data for 21 countries with available data for general government employment.
Source: SORS, Eurostat, OECD, FC calculations.

Figure 2.12: General government compensation per employee relative to corporate sector



Note: EU average on the basis of data for 21 countries with available data for general government employment.
Source: SORS, Eurostat, OECD, FC calculations.

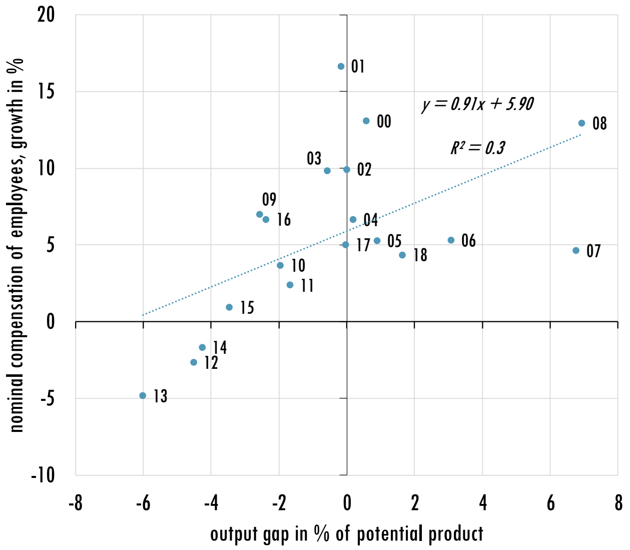
30 Availability of accurate data is however limited. The claim assumes that most of the employees in the general government sector are employed in these three public service activities. The comparison shows that, on the EU average, more than one third of employees in public service activities are not employed in the general government sector.

and the corporate sector is also an important factor in estimating the competitiveness of wages and avoiding the situation in which the general government sector would inappropriately compete with the corporate sector in luring employees. Around 2000, funds for compensation per employee in the general government sector exceeded those in the corporate sector by approximately 30%. After 2014 this difference declined to less than 10%.

2.1.2 Impact of compensation of employees on conducting a counter-cyclical fiscal policy

The dynamics of compensation of employees should not additionally enhance the procyclical nature of fiscal policy. Compensation of employees is not the most suitable tool for conducting a counter-cyclical fiscal and macroeconomic policies since the adjustment of wages and/or employment in the general government sector is linked to lengthy administrative procedures and consequently also delayed effects. Nevertheless, due to its relatively large share in the total public expenditure, the movement of funds for compensation of employees significantly impacts the general government balance and could potentially neutralise stabilisation measures in other fiscal policy areas. Procyclical movement of funds for compensation of employees thus increases economic activity fluctuations instead of helping to stabilise them. The IMF calls attention to wage increase funded by higher revenue during the cyclical expansion period, which additionally increases demand and, as a result, undermine the fiscal policy's stabilising role.[31] Moreover, procyclical movement of funds for compensation of employees negatively impacts the public finance quality. According to the ECB's findings, it is characteristic of the euro area countries that they more frequently increase the amount of funds for compensation of employees and social transfers in periods of economic growth, while in periods of economic downturn they achieve fiscal consolidation principally by cutting investments.[32] The management of funds for compensation of employees should be long-term and should normally not be responsive to the cyclical movement of the economy. In this way, it could automatically have a stabilising effect on economic cycles with less negative consequences for the quality or structure of public finances.

Figure 2.13: Cyclicality of general government compensation of employees



Source: SORS, FC calculations.

Figure 2.14: Cyclicality of general government compensation of employees per employee

Source: SORS, FC calculations.

[31] IMF Fiscal implications of government wage bill spending (2019), p. 5.

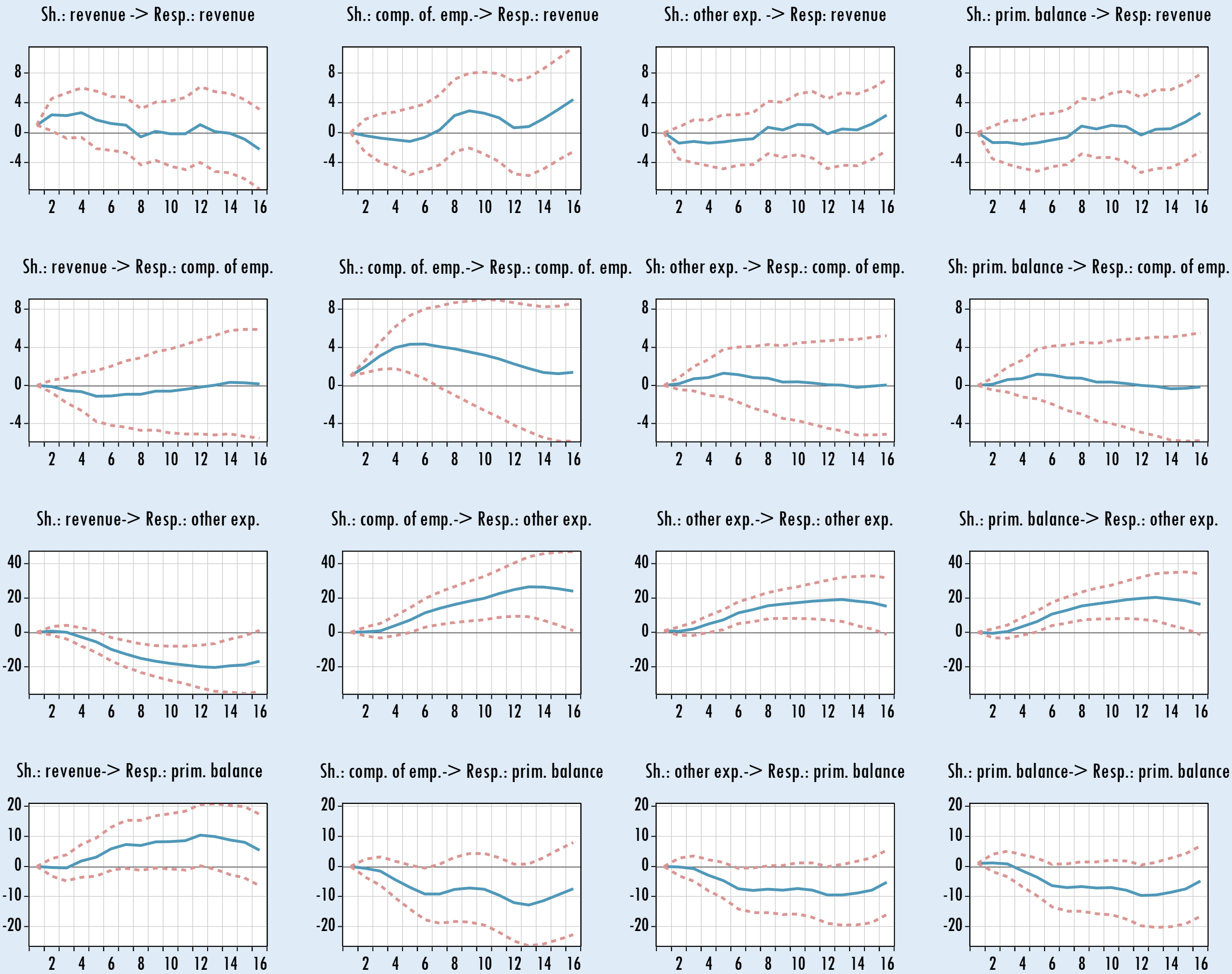
[32] ECB Public wages in the euro area: towards securing stability and competitiveness (2010), p. 20.

Box 2.1: Compensation of employees and the main aggregates of the general government sector

We used a simple VAR model to assess the link between compensation of employees in the government sector and the main fiscal aggregates. The model was assessed for Slovenia following the model of Dybzcak and Garcia Escribano (2019), who created the panel VAR from data for 137 countries over a period of more than twenty years. The model includes the main fiscal aggregates, such as the general government revenue, compensation of employees in the general government sector, expenditure excluding compensation of employees and interest expenditure of the general government sector (hereinafter: other expenditure) and the primary balance. We eliminated the effect of one-off measures (e.g. bank capital increase). For the purpose of comparison and for the purpose of eliminating non-stationarity as an year-on-year change, we expressed all endogenous variables as a share of GDP. Shocks are defined as a change in the appropriate endogenous variable in one year by one percentage point of GDP. We also included two dummy variables as exogenous variables into the model: one for the years before National Assembly elections and the other for the quarters in which real GDP declined during the global financial crisis (around 2009 and 2012). The assessment period covers the years 2001-2008 on a quarterly basis, and the number of delays was selected with regard to the test averages that determine optimum delay periods, a total of six quarters.

Model assessments show that the compensation of employees in the general government sector is not determined in accordance with macroeconomic circumstances. The response functions of the

Figure: Impulse responses of the VAR model



Note: Cumulative quarterly impulse responses (blue) are shown with confidence intervals (red) the size of two standard errors.
Source: Fiscal Council.

assessed VAR model indicate that compensation of employees in the general government sector does not respond in a statistically significant manner to changes in revenue and to changes in other expenditure and primary balance either in a short or a medium term (shown in the second line of the Figure).[1] Such dynamics are not recommended in terms of medium-term fiscal sustainability and fiscal policy management, in particular because, taking into account the assessed response functions, the increase in compensation of employees also encourage an increase in other expenditure. The response functions also show a statistically significant increase in other expenditure when primary balance improves, while the responses of other expenditure are also the only ones whose response in a medium term exceeds the initial shock.

Simulation results show that the primary balance deteriorates when the compensation of employees increases, and this deterioration is relatively greater than the increase in other expenditure when taking into account a relatively low share of wages in total expenditure. This is due to the fact that other expenditure increases simultaneously with the increase in compensation of employees. A higher amount of compensation of employees does not lead to a statistically significant revenue response, which results in the absence of the usually expected mitigation of the deterioration in primary balance triggered by shocks of higher expenditure by means of higher revenue.

The results of simulations of a simple VAR model indicate that increases in compensation of employees in the general government sector should be undertaken with great care. According to the obtained assessment and statistical confidence measures, higher compensation of employees primarily causes a deterioration in the general government balance, indirectly also through encouraging the increase in other general government expenditure. For this reason, decisions to increase compensation of employees should also be based on higher efficiency of their recipients and measures should be taken to prevent or restrict a simultaneous increase in other expenditure. Response calculations take into account only short-term and medium-term links, which is why the results do not reveal, for example, increased employee efficiency and a higher level of social welfare and education resulting from higher wages.

[1] These results are also corroborated by the performed causality tests, according to which none of the above variables had a statistically significant impact on compensation of employees with a delayed influence period of up to three years.

International estimates and data for Slovenia indicate that the movement of funds for compensation of employees is prone to procyclicality. The IMF established that compensation of employees is usually the most affected by short-term cyclical factors, which in real terms increase by 0.2 percentage points on the 1 percent output gap increase.[33] Simultaneously, procyclicality is more typical of developed economies, where the increase is stronger in periods of cyclical upswings than at the cyclical downturn. The procyclicality of compensation of employees was also characteristic of the majority of the euro area member states before the crisis, where an increase in the output gap by one percentage point was linked by an increase in funds for compensation of employees by as much as 0.8 percentage point.[34] In the euro area average the movement of funds for compensation of employees and per employee was procyclical with one year's delay, and employment response to the change in the cyclical position of the economy was less intense and followed the cycle with a two year's delay.[35] Data for Slovenia in 2009-2017 show a similar situation. The output gap increase by one percentage point in Slovenia is linked to an increase in funds for compensation of employees by 0.9 percentage points.[36] The procyclical nature of compensation of employees and both its components in Slovenia is strong and similar to that in the euro area with somewhat different delays.[37] 2008 was an outstanding year in terms of procyclicality since the introduction of a uniform wage

[33] IMF Managing government compensation and employment – institutions, policies, and reform challenges (2016), p. 12.

[34] ECB Public wages in the euro area: towards securing stability and competitiveness (2010), p. 9. The explanatory power of Regression is indeed low, since the value of $R2$ is only 0.09.

[35] ECB Public wages in the euro area: towards securing stability and competitiveness (2010), pp. 16-19. The subject of the analysis was the link between the real GDP growth per capita and the rate of unemployment.

[36] The explanatory power of regression for Slovenia is relatively low, but higher than that shown in the ECB's study. The value of $R2$ is 0.32, while it was 0.09 in the ECB's study.

[37] The compensation per employee responds to the changes in economic cycle with a one-year delay, total assets with a two-year and employment with a three-year delay.

system just before the close of the period of high economic growth coincided with the onset of the economic crisis. In light of the deteriorated fiscal position in the second wave of the crisis in 2012-2014, austerity measures were adopted in the area of compensation of employees, which were, in terms of counter-cyclical policy, inappropriate. Procyclicality is also indicated by the policies adopted in 2018 and the policy plan for 2019 as a result of the reached wage agreements.

2.1.3 Assessment of the compensation of employees management system in the general government sector

A fiscally sustainable system for managing compensation of employees, which simultaneously ensures the provision of quality public services, depends on compliance with some key requirements. The IMF indicates appropriate fiscal planning, competitive payment and flexible and effective employment system as the key components of such system.[38] In Slovenia, the system of managing compensation of employees is based on the uniform wage system introduced in 2008 in the entire public sector, while the scale of employment is determined separately on an annual level on the basis of human resource plans of individual budget users. The Ministry of Public Administration (hereinafter: MPA) performed an analysis establishing that the wage system reform succeeded in achieving some of the set objectives, while leaving some of them only half way achieved or even distancing itself from them.[39] The accomplished objectives included the introduction of a uniform, transparent and fiscally manageable system. The objective of establishing an appropriate relationship between public employee's wages is considered to have been achieved only in part, while the objective of ensuring a flexible and stimulating wage system remained unachieved, resulting in inadequate link between the wage level of public employees with their actual performance. The MPA also established that, due to a variety of intervention measures taken on the onset of the economic crisis, the wage system reform had never been carried out in the manner envisaged by the new system. The OECD's 2012 evaluation of the Slovenian wage system identified some significant deficiencies of the system which would have occurred even if there had been no crisis. One of the

Table 2.1: Framework of an effective system for managing compensation of employees

FISCAL PLANNING	COMPETITIVE COMPENSATION	FLEXIBLE AND EFFICIENT EMPLOYMENT SYSTEM
fiscal and budgetary framework for managing the wage bill	legal rights to organize and strike	employment systems
medium-term forecasting	individualization of wage determination	flexibility in adjusting employment
extent of automatic indexation	mechanisms for comparing public and private private sector pay	flexibility in staff management
budget execution rules and payroll controls		performance pay systems
wage bargaining system		merit-based hiring and promoting procedures

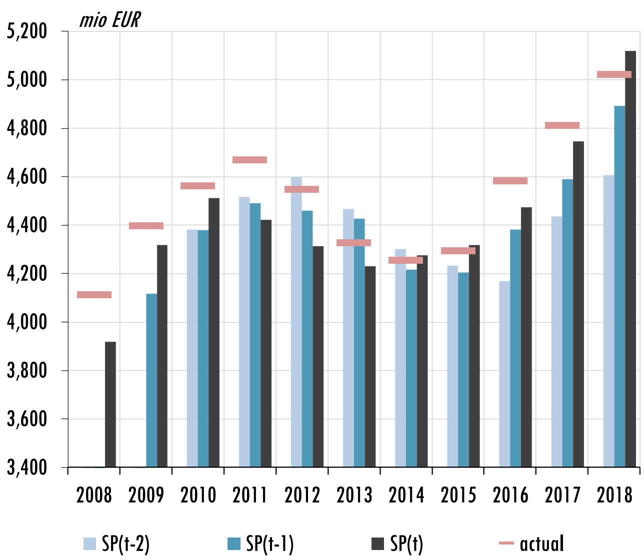
Note: elements that are according to FC assessment fulfilled are marked with green, the ones that are not are marked with red.
Source: IMF Managing government compensation and employment – institutions, policies, and reform challenges (2016), p. 22.

[38] IMF Managing government compensation and employment – institutions, policies, and reform challenges (2016), p. 7.
[39] MPA Analiza plačnega sistema javnega sektorja (2015), p. 92. The basic objectives of the introduction of a new payment system included the setting up of a common payment system for public employees and high officials, the setting of appropriate relations between the wages of public employees and high officials, the setting up of a flexible wage system that will closely link the amount of wages to efficiency and work results and the setting up of a transparent and controllable wage system in terms of public finances.

alleged key weaknesses of the system is that it was primarily set up to determine wages and that it does not facilitate human resources management.[40] The MPA[41] and IMAD[42] also pointed to the rigidity of the system that ensures inadequate flexibility to individual budget users and to the management. In the following paragraphs we will attempt to present a short evaluation of the system of managing compensation of employees in terms of meeting some key requirements for the efficiency of the system defined by the IMF (see Table 2.1).[43]

From the viewpoint of appropriate fiscal planning, the key weakness of the current system is the absence of credible medium-term planning. Appropriate planning of compensation of employees means that decisions on the amount of wages and employment level in the general government sector are incorporated into a medium-term fiscal framework with a view to ensuring sufficient funds without endangering fiscal sustainability. The centralised wage system introduced in 2008 is indeed more fiscally manageable than the previous arrangement since all its essential components are set out in regulations at the national level, while individual employers' potential to increase wages are highly limited.[44] Nevertheless, a review of the projections of compensation of employees in the years after the end of the crisis shows that these were systematically underestimated despite having been centrally controlled. This is largely due to the lengthy and almost annual negotiations on the wage policy. Article 5 of the Public Sector Salary System Act determines that negotiations should start no later than before 1 May each year and end 30 days before the deadline set for the submission of the draft state budget to the National Assembly. Ever since the onset of the crisis, agreements were reached in most cases only at the end of the year and generally for one or maximum two years.[45] This way of determining wages raises doubts about the credibility of the proposed budget documents and causes unpredictability of fiscal policy management.

Figure 2.15: General government compensation of employees



Source: SORS, MoF, IMAD, FC calculations.

[40] OECD Public sector salary system in Slovenia (2012), p. 70.

[41] MPA Analiza plačnega sistema javnega sektorja (2015), p. 89.

[42] IMAD Economic Issues (2018), p. 13.

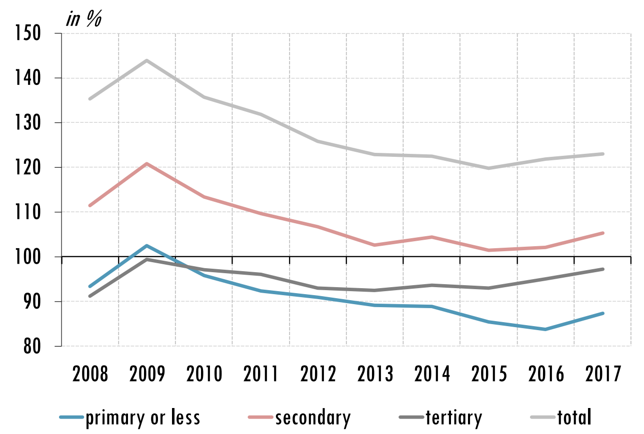
[43] IMF Managing government compensation and employment – institutions, policies, and reform challenges (2016), p. 7.

[44] MPA Analiza plačnega sistema javnega sektorja (2015), p. 88.

[45] http://www.mju.gov.si/si/delovna_podrocja/place_v_javnem_sektorju/interventni_ukrepi/

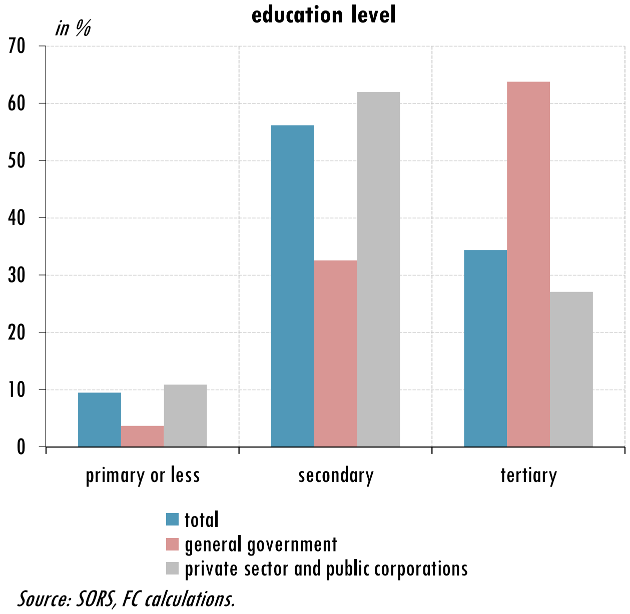
As regards guaranteeing competitive payment, the current system lacks primarily individual determination of wages and a suitable mechanism for comparing wages in the general government and in the corporate sector. The system appropriately guarantees legal *protection for integration and strike*.[46] There are currently 41 representative trade unions in Slovenia's public sector, compared to 27 in 2008. A large number of trade unions restricts the effectiveness of the negotiation process and, in the light of preservation of a centralised wage determination process, allows the possibility of general wage increases even when they are not justified in terms of effectiveness of employees or fiscal sustainability. There is no *individualised determination of wages* in the current system since wages are determined only centrally. According to the OECD and the MPA, this is one of the key weaknesses of the system. The OECD notes that the system is based on an implicit assumption that a consistent increase in wages in all parts of the public sector is desirable, although the market value, i.e. the suitable payment for various tasks and competences shows a different trend throughout the public sector.[47] As a result, it is difficult to adjust to these differences or impossible without elements of decentralisation. According to the MPA's estimate, one of the key issues of the current system is the setting of a clear boundary between the necessity of uniform and centrally adopted rules for the operation of the wage system and the necessity to grant autonomy to the management. The management should be given the possibility to optimise human and financial resources within the available funds and, in general, the budget users' operations.[48] There is currently *no mechanism in place for comparing the level of public and corporate sector wages*[49] that would reduce the risk of wage raises in the public sector influencing the raise in the private sector and thus negatively impact competitiveness. Analyses show a relatively strong connection between the public sector wage developments and nominal unit labour costs in the euro area,[50] which can also be observed in

Figure 2.16: Average wage according to attained education level general government/private sector



Note: Total average wage in general government is higher that in the private sector mainly due to the composition effect. The share of employed in the general government ith high or higher education that have in principle higher wages is significantly higher than in the private sector
Source: SORS, FC calculations.

Figure 2.17: Employment structure according to education level



Source: SORS, FC calculations.

[46] Article 8 of the Representativeness of Trade Unions Act determines that those trade union associations and confederations in which at least 10% of the workers from an individual industry, activity or profession are members thereof are considered representative.

[47] OECD Public sector salary system in Slovenia (2012), p. 70.

[48] MPA Analiza plačnega sistema javnega sektorja (2015), p. 89

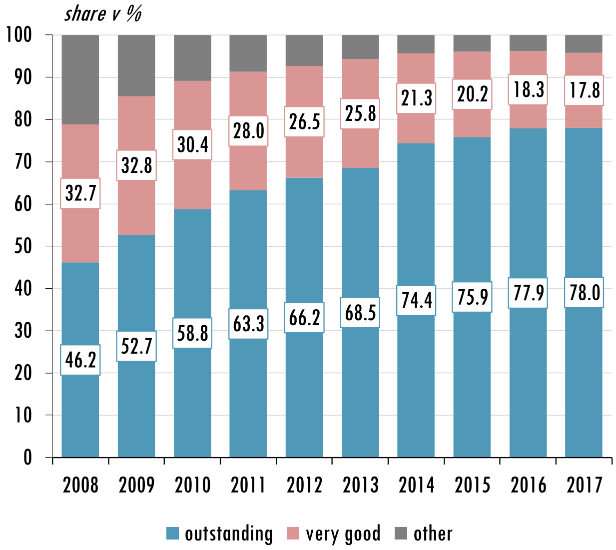
[49] According to the research conducted by the IMF and based on a questionnaire sent to 42 countries, one third of the countries occasionally compares wages between the public and the private sectors, less than 10% of them makes such comparisons systematically once a year or every two years (IMF Managing government compensation and employment – institutions, policies, and reform challenges (2016), p. 25).

[50] ECB Public wages in the euro area: towards securing stability and competitiveness (2010), pp. 13-14 .

Slovenia. It generally holds true that private sector wages have a stronger impact on wages in the public sector, but, in certain conditions, this trend can be reverse.[51] IMAD has determined that indirect effect of public sector wages was the main factor in the private sector wage increase in the past few years.[52] In this way, the movement in compensation of employees in the general government sector is also directly or indirectly important for maintaining competitiveness of the entire economy, which is so much more important in a small open economy. In 2017, average wages in the general government sector were approximately one-tenth higher than in the corporate sector, due to different educational structure of employees.[53] IMAD's analysis of comparability of wages at the level of comparable professions has shown that, along with the increase in wages, the wage premium in the public sector decreases and eventually even becomes negative.[54]

The system of employment in the general government sector is not flexible enough; there are also reserves in its efficiency. One of the preliminary conditions for the provision of quality public services is ability of adjusting the extent and the structure of employment to the cyclical and structural changes in the economy. This flexibility is subject to the rules of employment, transfer and dismissal and to the employment protection level. The latter is high in the public sector of developed economies, including of Slovenia. The result of this is a rather rigid system in which the absence of control can result in uncontrolled employment growth in individual activities or in the entire general government sector. The reduction or restriction of growth in compensation of employees in Slovenia was based on wage reduction, while employment in the general government sector increased by 15% since the onset of the crisis until last year. Employment increased particularly in health and social work activities and decreased only in public administration. This is also typical of other developed economies, in the same way as the inability to adjust employment to demographic changes.[55] In the IMF's estimate,

Figure 2.18: Assessment of public servants in public administration



Source: MPA, FC calculations.

[51] A higher wage increase in the general government sector can strengthen the negotiating power of private sector employees, but can also cause a reduction in employment and an increase in average wages (ECB Public wages in the euro area: towards securing stability and competitiveness (2010), p. 29).

[52] IMAD Economic Issues (2018), p. 17.

[53] For more details on wage differentials between the public and the private sectors see IMAD, Economic Issues 2018, pp. 18-23 and Roter, Lindič, Vodopivec: Wage differential between public and private sector in Slovenia (2017).

[54] IMAD Economic Issues (2018), p. 22.

[55] IMF cites further employment growth in the area of education despite a declining number of children as an example of inability to adapt to demographic changes (IMF Managing government compensation and employment (2016), p. 20). This is a characteristic of Slovenia, where the number of students included in formal education (nursery schools, elementary and secondary schools, short-cycle higher education and higher education) declined by 3.4% or 15,000, and the number of persons employed in education increased by 11.4%.

employment flexibility is associated with the decentralised system for determining wages and employment level, which is a position-based employment.[56] In the OECD's estimate, employment policy in Slovenia is not sufficiently based on actual competences since employment criteria are predominantly defined by formal education level.[57] Two important components of an effective employment system are *performance-based payment* and *employment and achievement-based promotion*. The Slovenian wage system is, particularly in the public sector, designed to give preference to seniority over performance. According to the data provided by the MPA, performance payment represents only 2% and seniority almost 5% of the public sector wage bill. Moreover, performance bonus was the first wage component to have been abolished on the onset of the crisis and can still not be paid. These measures negatively impact the motivation of employees and do not contribute to enhancing productivity and the quality of public services. At the same time, doubt arises as to whether public employee promotions are actually based on credible assessment criteria. The proportion of employees of state administration bodies rated as "outstanding" and "very good" was 89.8% in 2008 and rose to as much as 95.8% by 2017.[58] From such deviations from the normal distribution of employee assessments it could be deduced that Slovenia has a highly efficient public sector; however, given the response from the users of its services the picture is much less positive.[59]

2.1.4 Conclusion

One of the fiscal policy's key priorities is improved management of the compensation of employees as it significantly impacts the achievement of sustainable public finances and the provision of quality public services. After the second wave of the crisis in 2012-2014, which was the only period of decline, compensation of employees again increased faster than other expenditure, and similar trends are forecast until 2022. Their share is one of the largest in the EU while their two components exhibited different trends. The rate of employment steadily increased, while the average increase in funds for compensation per employee lagged behind that in the corporate sector over a longer period. We have identified a number of deficiencies in the compensation of employees management system. The key deficiencies are the absence of medium-term planning and of the resulting integration into a credible medium-term fiscal framework and the fact that the system is based on the adjustment of wages, while too little attention is dedicated to employment planning. Determination of wages depends too little on competence or performance of employees and the uniform wage system and a large number of formal stakeholders triggers a general wage increase in the entire general government sector, although such increase is not always justified for all employee groups. Wage negotiations paid little attention to employment dynamics and their impact on total compensation of employees and the fiscal situation. The employment system is rigid and insufficiently effective. Systemic deficiencies in managing compensation of employees contribute to its procyclical nature and decisions are predominantly not made by taking into account macroeconomic situation. In light of the risk posed by demographic changes to the achievement of sustainable public finances, the reform of the system of managing compensation of employees in the general government sector should be the priority of the fiscal policy with a view to enhancing effectiveness and flexibility.

[56] IMF Managing government compensation and employment – institutions, policies, and reform challenges (2016), p. 29.

[57] OECD Public sector salary system in Slovenia (2012), p. 46.

[58] MPA Report on assessing work performance for 2017 and promotions in 2018 in state administration bodies. These are annual employee assessments performed by superiors. High ratings are a condition for regular promotion.

[59] In 2018, Slovenia was ranked 37th out of 63 countries according to IMD World Competitiveness Rankings. Government and bureaucracy was ranked even lower, 49th and 50th, respectively (IMD World Competitiveness Rankings 2018).

2.2 Estimates of the dependence of nominal general government balance on the business cycle

2.2.1 Introduction

The structural balance reflects the fiscal position that is not dependent upon the business cycle and one-off factors. This is a non-measurable economic category and is thus assessed by eliminating the cyclical effects and one-off effects[60] from the nominal general government balance. Revenue developments largely depend on economic fluctuations, i.e. macroeconomic bases such as general consumption, wages, employment and inflation. Macroeconomic bases have a lesser impact on the expenditure, to the most extent via unemployment, since expenditure is largely determined according the political preferences of each government.

Despite criticism of the methodology of calculating the structural balance it remains one of the basic fiscal position indicators and one of the fundamental elements of the current fiscal rules in Slovenia and in the EU. Criticism mainly relates to output gap assessment which represents the basis for determining the cyclical position of the economy and neutralising the impact of the business cycle on fiscal outcome. The output gap assessment depends on the selected methodology and may alter significantly over time, in particular during a major shift of the economy away from the balanced position.[61] Less criticism is usually made of the assessment of another parameter which in the calculation of the structural balance determines the share of the estimated output gap that is eliminated from the nominal balance.

In addition to output gap assessment, the elimination of cyclical effects from the nominal balance requires an assessment of the nominal balance's sensitivity to the business cycle level. To this end, the elasticity of the general government nominal balance with regard to the cyclical position of the economy and of the output gap must be determined. The link between the cyclically adjusted and the nominal balance may be represented as:

cyclical balance $= B - a*OG$,

While the structural balance is determined by subtracting the cyclical part and one-off effects (K) from the nominal balance:

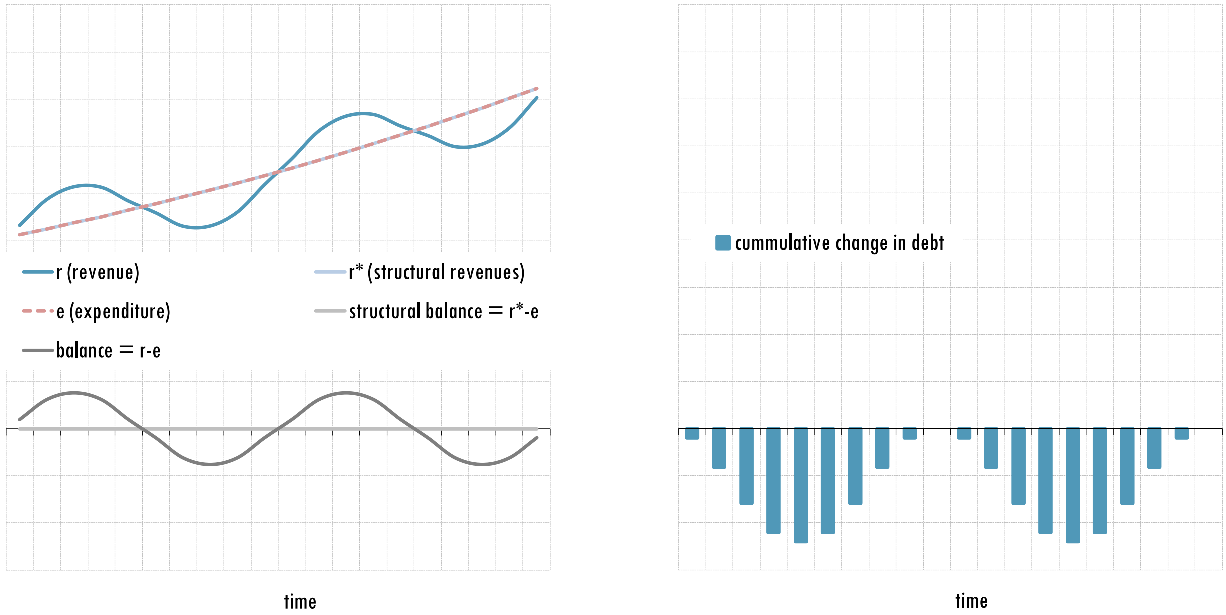
structural balance $= B - a*OG-K$

In the above equations, *B* represents the nominal balance, and $a*OG$ the cyclical part of the nominal balance. OG stands for the estimated output gap, and the coefficient a for the elasticity of the nominal balance to the output gap. The coefficient a thus shows how much of the nominal balance is due to the economic cycle as expressed by the output gap estimate. This coefficient is determined by assessing the link between individual revenues and expenditures and the economic cycle. This assessment and the shares of individual revenues and expenditures serve as the basis for calculating the weighted sum of the relation between total revenues and expenditures and the economic cycle. The elasticity coefficient also appears in the mathematical equation used in the Fiscal Rule Act to determine the maximum expenditure limit for the general government sector and is also expressed as parameter a in points 3 and 4 of Article 3 of that Act.

The relation between the nominal and the structural balance and the change in debt is shown below. In the upper left part, *r* is used to denote structural revenue the increase of which equals long-

[60] More details in the Annual Report of the Fiscal Council 2017 (Chapter *Selected Topics* 2.4).
[61] More details in the Annual Report of the Fiscal Council 2017 (Chapter *Selected Topics* 2.3).

Figure 2.19: Nominal and structural balance (left) and public debt (right) over the business cycle



Source: Fiscal Council.

term economic growth or the potential output growth that is independent from cyclical factors. Parameter *a* is in general used to remove a cycle from revenue series (*r*) to determine structural revenues. When expenditure (e) grows at the same pace as structural revenue and the slope of the curves (*r**) and (e) in Figure 2.19, as shown in the lower left part is the same, the structural balance equals 0, and the nominal balance (the difference between nominal revenues and expenditures) changes and symmetrically fluctuates around 0 during the economic cycle. In the event of a balanced structural balance, the cumulative level of government debt, shown on the right-hand side, does not change over a business cycle.

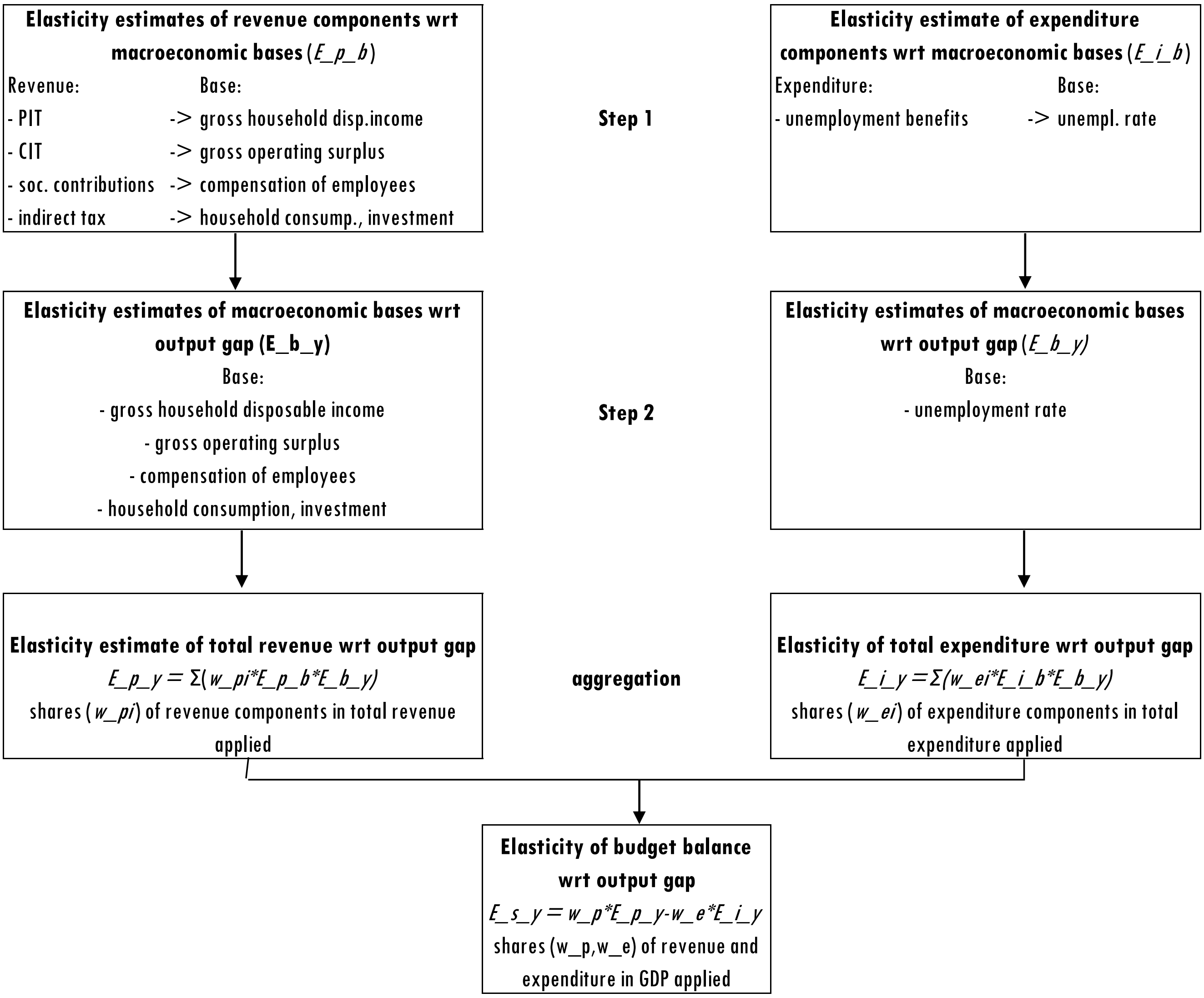
The EC updates individual components of the parameter which determines the fiscal balance's cyclical sensitivity in various time periods. The weight values are thus updated every six years, while econometric estimates of elasticities of individual revenue and expenditure components are updated every nine years.[62] The EC updated the weight values this year and used the agreed 10-year period in its calculation, which included the latest data taken into account for 2017. The econometric estimates of elasticities, where Member States are also involved via the participation in technical groups within the EU, were last updated by the EC in 2016; the next update being scheduled for 2025. The update estimation cycles are linked to the determination of the fiscal policy's medium-term objective, where their relatively low frequency is intended to preserve the predictability of parameters that determine fiscal policy trends while observing the current fiscal rules. This contribution presents the method of eliminating cycle effect from the nominal balance and assesses the parameters used in removing cyclical effects within the EU economic governance for Slovenia. The EC's elasticity calculations are updated and the sensitivity of domestic and EU fiscal rules to the elasticity of the general government nominal balance with regard to the output gap is presented.

[62] See European Commission (2019): Report on Public Finance in the EMU 2015 2018.

2.2.2 Methodology

Elasticity, i.e. dependence of the general government balance on the business cycle was assessed by the same method that is regularly used by the EC. The methodology is presented in greater detail in Moure et al. (2014)[63] and in Price et al. (2014)[64]. The basis for calculating elasticity are calculations of elasticity of the selected revenue and expenditure components with regard to the output gap, which follow a two-stage procedure. Elasticity estimates for individual revenue and expenditure categories facilitate the monitoring of the cyclicality of these components, not only the cyclicality of the entire balance. Our first step was to determine the elasticity of each revenue to its macroeconomic basis, while the second step was to determine the elasticity of the macroeconomic basis to the output gap. The result of the product of the two elasticities is the elasticity of individual types of revenue to the output gap. The total elasticity of revenue and expenditure to the output gap is obtained by means of a weighted sum of the elasticity estimates of individual types of revenue, where

Figure 2.20: Procedure of estimating the sensitivity of budget balance with regard to output gap



Source: Fiscal Council.

[63] Moure, G., Astarita, C. and Princen, S.: Adjusting the budget balance for business cycle: the EU methodology. European Economy, Economic Papers 536. November 2014.

[64] Price, R., Dang, T.-T. and Guillemette, Y.: New Tax and Expenditure Elasticity Estimates for EU Budget Surveillance. OECD Economics Department Working Papers No. 1174. OECD Publishing, Paris.

the weights represent long-term averages of the shares of individual types of revenue in the total revenue, or individual types of expenditure in the total expenditure.

There is also a possibility of assessing elasticity by directly assessing the balance's dependence upon the business cycle; however, the advantages of the applied methodology probably outweigh its weaknesses. The weakness of the approach employed is that the macroeconomic base of a particular type of revenue or expenditure must be determined in the first step. The determination of the macroeconomic base can be problematic since the application of this method could mean underestimation of the cyclical part of expenditure which is restricted solely to unemployment expenditure. Nevertheless, the two-stage procedure is probably more appropriate or accurate than direct assessment of elasticity of individual revenue and expenditure components to the output gap since it better reflects the actual situation in which fiscal aggregates are directly impacted by the movement in macroeconomic bases that depend on the cyclical position of the economy.

The aforementioned methodology was used in the calculation of the elasticity of five revenue categories and one expenditure category. The calculated elasticities are static, although also subject to cyclical fluctuations under certain conditions. On the revenue side, elasticities of the household income tax, corporate income tax, social contributions, indirect taxes and non-tax revenues are estimated. The method assumes that only unemployment expenditure is sensitive to the movement of the business cycle. It is assumed that the elasticity of total revenue to macroeconomic bases is close to one since revenue is generally cyclical and therefore dependent on changes in GDP or on aggregates associated with it. At the same time, expenditure, except expenditure relating to unemployment benefits, does not depend on the movement in GDP; therefore, it may be assumed that the elasticity of the entire expenditure to macroeconomic bases is close to 0. The same applies to the elasticity of non-tax revenues. An exception from the described procedure of elasticity calculation is the calculation of the elasticity of the household income tax on a macroeconomic basis. Here, the macroeconomic base is represented by the gross disposable income which, in addition to revenues from employment, also includes other receipts such as transfers, income from self-employment, capital income and capital gains. In a similar way as Moure et al. (2014)[65], we used the detailed data that were available for dividing revenue into various income groups and were subject to various income tax rates.[66]

Estimates of elasticity coefficients were selected on the basis of various econometric assessments. Estimation methods are similar to those in Price et al. (2004)[67] who use the error correction model (ECM) which facilitates assessment of short-term and long-term elasticities. Moreover, we also assessed the coefficients solely on the basis of the short-term model, model AR(1) and on the basis of extending the ECM model by an AR(1) element. The parameters used in determining the elasticity of the entire elasticity of revenue or expenditure had been selected on the basis of the statistical significance of elasticity coefficients in individual models.

[65] Annex I to the aforementioned document.

[66] Analysis of the Ministry of Finance of the Republic of Slovenia (2018): Basic statistical information from income tax assessments for 2016. Available at: http://www.mf.gov.si/fileadmin/mf.gov.si/pageuploads/javne_objave/Statisticna_analiza_2016.pdf (Table 2, p.8).

[67] Annex II Price et al. (2004).

2.2.3 Estimates

In this part, we present econometric assessments of individual steps in assessing the elasticity of revenue and expenditure to the output gap. By following the two-stage procedure, we first show elasticity estimates of revenue and expenditure to macroeconomic bases and then elasticity assessments of macroeconomic bases to the output gap. The assessments were made on the basis of time series of national accounts for the period 1995-2018.

Elasticity coefficients used in the calculation of the balance's elasticity to the business cycle may not necessarily always be the result of econometric assessments. In some cases, for example, the elasticity estimate for some countries was not statistically significant including due to short time series, the EC used the average elasticity estimate for the EU. The EU used such an assumption in assessing the elasticity of social contributions, and took into account the value 1 in indirect taxes. This assumption may be questionable since the collection of the value added tax with regard to the development of household consumption is not necessarily uniform if there are two VAT rates and if the higher rate is applied to more income-elastic products. In that case, elasticity of demand could be greater than 1and has also been taken as such in our calculations. The EC's assessment, made according to the Price et al. (2014) methodology, points to the elasticity of indirect taxation to consumption of approximately 0.6. In this regard, it should be taken into account that the assessment was made on the basis of only 11 (annual) data points, while the Fiscal Council's assessment, which is shown in Table 2.2 and represents step 1 as shown in Figure 2.20, is made on the basis of the series that cover a time period that is twice as long. The elasticity of income tax proceeds to the macroeconomic basis, which represent the gross household revenue, differs from the assessment made simultaneously on the basis of microeconomic data. The estimate of elasticity of personal income tax proceeds to the weighted average of the ratio between the marginal tax rate by individual revenue categories is almost twice higher than the direct econometric estimate made on the basis of the ratio between the personal income tax and the gross disposable household income. This difference in assessment is due to the consideration of exemptions, allowances and progressiveness in the case of a detailed data analysis. Similar results are also found in Moure et al. (2014), where elasticity estimates of the personal income tax to household income range between 1.1 and 2.5.[68] Table 2.2 also shows comparisons with

Table 2.2: Elasticity estimates of revenue and expenditure to macroeconomic bases

revenue/expenditure	Model								FC estimate	EC 2014	Diff FC-EC
	Short-term		ECM		AR(1)		ECM+AR(1)				
personal income tax	1.25	***	1.20	***	1.27	***	1.29	***	1.97	2.14	-0.17
corporate income tax	2.42	***	2.14	**	2.12	***	1.82	*	2.23	2.72	-0.49
social contributuions	0.79	***	0.89	***	0.74	***	0.87	***	0.82	1.00	-0.18
indirect taxesď	1.12	***	1.17	***	1.13	***	1.31	***	1.18	1.00	0.18
unemployment benefits	0.97	***	1.06	***	0.97	***	1.03	***	1.01	1.00	0.01

*Note: Fiscal Council's estimate is a result of a simple average of regression estimates presented with an exception of Personal Income Tax elasticity, which is based on microeconomic data. Macroeconomic bases of revenues and expenditures are defined in Figure 2.20. Signs *, ** and *** stand for 10%, 5% and 1% statistical significance of estimated coefficients respectively.*

Source: Moure et al. (2014) and FC estimates.

[68] The analysis in Moure et al. (2014) additionally takes into account the average of three types of households (one person household, married couple without children living on a single income, and a married couple with two children living on a single income of one-third of the average income).

Table2.3: Elasticity estimates of macroeconomic bases to the output gap

	FC estimate	EC estimate 2014	Difference
gross disposable household income	0.73	0.77	-0.04
gross operating surplus	1.34	1.38	-0.04
compensation of employees	0.68	0.66	0.02
household consumption, investment	1.00	1.00	0.00
unemployment rate	-2.62	-2.81	0.19

Source: Moure et al. (2014) and FC estimates.

Table 2.4: Weights of individual revenue and expenditure components

	revenue shares (w_pi in Figure 2.20)					expenditure shares (w_ei in Figure 2.20)	
	PIT	CIT	SSC	Inidrect tax	Non-tax revenue	Unemployment benefits	Other exp.
FC	12.5	3.8	34.0	33.0	16.8	1.4	98.6
EC 2014	14.5	4.9	33.8	34.4	12.4	1.4	98.6
EC 2019	13.8	3.8	33.9	32.8	15.7	1.4	98.6
Differences:							
FC-EC2014	-2.1	-1.1	0.2	-1.4	4.4	0.0	0.0
FC-EC2019	-1.3	0.0	0.1	0.1	1.1	0.0	0.0

Sources: European Commission (2019), SORS; FC calculations.

elasticity coefficients for individual revenue and expenditure categories, which are currently used by the EC in calculating the elasticity of the balance to the business cycle.

Elasticity estimates of macroeconomic bases to the output gap point to different cyclicality of some revenue components. These estimates, which represent Step 2 referred to in Figure 2.20, show that the most cyclical category of individual types of revenue is the corporate income tax, reflected in the highest elasticity to the output gap, while the elasticity coefficient of the macroeconomic basis of the personal income tax (gross disposable household income) and social contributions (funds for employee compensation) to the business cycle is less than 1. Assessments of these parameters deviate from the latest EC assessments by approximately 3% to 5%. Although elasticities decrease in three cases and increase in one case, the impact on the decrease in total elasticity of the balance to the output gap with regard to the share of individual types of income in the total income is negligible. We assume that non-tax revenues are not dependent upon the cycle, therefore the value of their elasticity to the output gap is 0.

There are no significant differences between the Fiscal Council and the EC regarding the shares of individual revenue and expenditure components used in the weighing of the sum of total revenues and expenditures. The EC's and the Fiscal Council's calculations cover the periods 2008-2017 and 2009-2018, respectively. Alongside a reduction in all other revenue components, an increase is indicated in the share of non-tax revenues whose elasticity to the cycle is 0. While the share of non-tax revenue in total revenue decreased in the period before the economic crisis and reached approximately 12% shortly before the onset of the crisis, it increased during the crisis and even exceeded 18% of the total revenue level in 2015. In the past few years, it has been hovering at above 15%. Such an increase in the share of non-tax revenue alongside other unchanged assumptions reduces the sensitivity of the entire balance to the output gap.

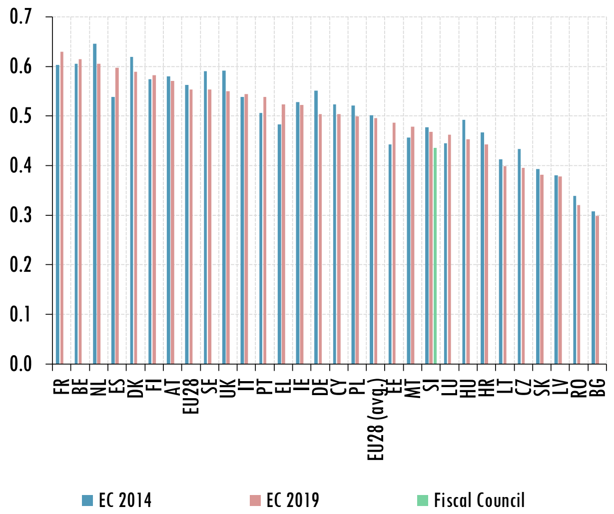
Table 2.5: Calculation of elasticity of budget balance to the output gap and comparison with EC calculations

	elasticity				shares (% GDP)		semi-elasticity		
	revenue	expenditure	revenue/GDP	exp./GDP	revenue	exp.	revenue	expenditure	balance
	a	*b*	*c=a-1*	*d=b-1*	*e*	*f*	*g=c*e/100*	*h=d*f/100*	*i=g-h*
FC	0.873	-0.037	-0.127	-1.037	43.7	47.4	-0.056	-0.492	0.436
EC 2014	0.988	-0.038	-0.012	-1.038	43.5	46.5	-0.005	-0.483	0.478
EC 2019	0.919	-0.039	-0.081	-1.039	43.7	48.5	-0.035	-0.504	0.469
Differences:									
FC-EC 2014	-0.116	0.002	-0.116	0.002	0.0	0.1	-0.051	-0.009	-0.042
FC-EC 2019	-0.047	0.002	-0.047	0.002	0.1	-1.1	-0.020	0.013	-0.033

Sources: European Commission (2019), SORS; FC calculations.

The Fiscal Council's estimate of the sensitivity of budget balance to the business cycle is lower than the one that the EC updated this year and intends to use it in the future. A calculation of the aggregate elasticity of budget balance to the business cycle based on the weighted elasticity of individual types of revenues and expenditures by taking into account macroeconomic bases referred to in Table 2.2 and a calculation of the elasticity of macroeconomic bases to the output gap referred to in Table 2.3 by means of weighting referred to in Table 2.4 are shown in Table 2.5. This table also shows the comparisons between aggregate data and calculations performed by the EC. Columns (a) and (b) show aggregate elasticities of revenues and expenditures ("aggregation" shown in Figure 2.20). The sum of the weighted elasticities using shares of revenues and expenditures in GDP[69] is shown in columns (g) and (h), while column (i) shows the final result, i.e. the aggregate elasticity of budget balance to the business cycle. While according to the EC's estimate elasticity coefficient is at 0.468, the Fiscal Council's estimate is 0.436. The elasticity comparison points to the differences that are relatively small in absolute, but rather significant in relative terms. Compared with the previous

Figure 2.21: Comparison of estimates of elasticity of budget balance to output gap with EC estimates for EU MS



Source: Report on Public finance in EMU 2018, estimates Fiscal Council.

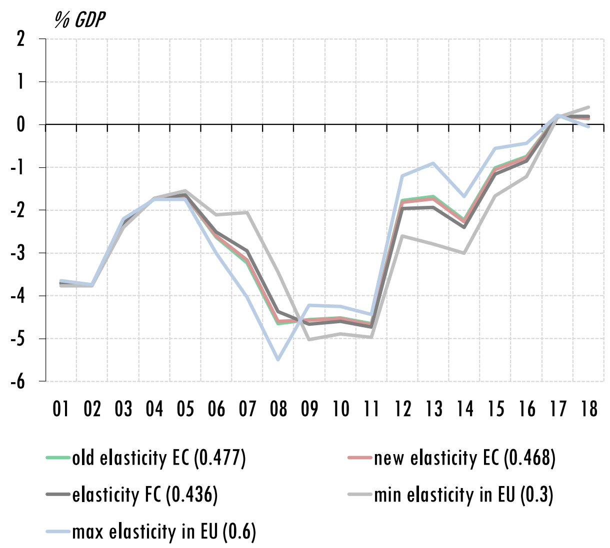
[69] Major difference between the expenditure weight level in GDP assessed by the Fiscal Council and by the European Commission in 2019 is due to the consideration of different periods in long-term averages which serve as the basis for the Fiscal Council's assessments. Aggregate elasticity calculated by taking into account equal long-term revenue and expenditure shares in GDP (with the values indicated in columns (e) and (f) remaining the same) would be 0.448.

elasticity estimate, the new EC's estimate for Slovenia is lower by almost 2%, while the Fiscal Council's estimate is lower by almost 9%. In both the Fiscal Council's and the EC's estimates, the elasticity of budget balance to the business cycle for Slovenia is in the lower third among the EU Member States, but close to the EU average. Elasticities are generally lower in the new EU Member States and decreased further in about two thirds of the Member States in this year's update of the assessment. In this update, the changes of estimates made by the EC are a result of changes in weights used in calculating the sum of elasticity contributions of individual revenue or expenditure. The changes were insignificant in the EU average: they ranged between -0.06 (Germany) and +0.05 (Spain). The change in the estimate for Slovenia was among the lowest in the EU at -0.009.

2.2.4 Elasticity estimates and fiscal policy position

Changes in the estimates of elasticity of budget balance to the output gap could impact the assessment of fiscal policy position. In this part we check whether this assumption holds by presenting the impact on the assessment of the structural balance pursuant to the fiscal rules currently in force and the impact on the assessment of the maximum expenditure level of the general government sector pursuant to the national fiscal rule. We simulate a structural balance calculated on the basis of various assumptions of elasticity of budget balance to the output gap. We take into account the EC's old and new estimates, the Fiscal Council's estimate, and the minimum and the maximum values of elasticity estimates in the EU Member States. For the sake of comparability and exclusion of the impact of other factors on the structural balance, the calculation takes into account the Fiscal Council's assessment with regard to the output gap and one-off factors.

Figure 2.22: Dependence of structural balance on elasticity estimates of budget balance with regard to output gap



Source: Fiscal Council estimates.

The simulations show that the calculated structural balance level does not change significantly despite relatively significant changes in elasticity estimate. An exception occurs only in the application of maximum and minimum values of the elasticity estimates during the period in which the output gap significantly deviated from a balanced position, i.e. in 2006-2008 and 2012-2015. There were no significant changes in the assessment of the fiscal policy situation based on the Fiscal Council's

Table 2.6: Maximum permitted expenditure level with various estimates of elasticity of balance to the output gap

	elasticity	expenditure (EUR mio)	deviation (EUR mio)
Expenditure Government		20,610	
Baseline (old EC elasticity estimate)	0.477	20,343	267
FC elasticity estimate	0.436	20,384	226
EC elasticity estimate (new)	0.469	20,350	260

Sources: European Commission (2019), SORS; FC calculations.

estimate compared to the EC's updated elasticity estimate except in 2009. Structural balance assessments based on the previous elasticity estimate point to the existence of a relatively neutral fiscal policy, while the assessment of the fiscal policy based on the updated elasticity estimate points to a countercyclically expansion-oriented fiscal policy in that year.

There were also no changes in the assessment of the maximum permitted expenditure level due to a change in elasticity estimate. In line with the existence of the sensitivity parameter of the structural balance to the cyclical movements (coefficient a) in the Fiscal Rule Act, we simulated an impact of the modified assumptions to the determination of the maximum expenditure level. The simulation was made only for 2019 where the baseline is represented by the calculation published by the Fiscal Council within the assessment of the Ordinance Amending the Ordinance on the Framework for the Preparation of the Government Budgets for the 2018–2020 period with the fiscal rules.[70] The general government expenditure level proposed by the Government and adopted by the National Assembly in December 2018 was set at EUR 20,610 million for 2019. The simulations show that, in accordance with the Fiscal Council's elasticity estimate presented in this analysis, the excess of the permitted expenditure level with regard to the expenditure determined as the maximum for 2019 in accordance with the Fiscal Rule Act would decrease from approximately EUR 270 million to approximately 230 million. The application of the elasticity updated by the EC, the excess expenditure would total EUR 260 million.

2.2.5 Conclusions

The structural balance is a generally accepted basic indicator of the fiscal policy position also by the current fiscal rules in force in Slovenia and in the EU. This is a nominal balance from which cyclical impacts and one-off effects have been excluded. The determination of cyclical impacts is exposed to a number of uncertainties since it takes into account non-measurable and at the same time variable indicators, such as the output gap.

In addition to the output gap estimate, the parameter used in neutralising the effects of the economic cycle from the nominal balance also plays an important role in the assessment of structural balance. This parameter is elasticity which indicates to what extent the nominal balance results from the cyclical effects given the output gap assessment. The analysis evaluated the updated elasticity estimate with regard to the parameter assessed by the European Commission at relatively long time intervals.

[70] http://www.fs-rs.si/opinion-of-the-fiscal-council-proposal-for-the-ordinance-amending-the-ordinance-on-the-framework-for-preparing-general-government-budgets-for-the-period-2018-2020/

We assessed the elasticity by using a two-stage method that had also been used by the OECD and the EC in their calculations. This calculation method first considers the elasticity of individual revenue and expenditure components to macroeconomic bases and then the elasticity of the macroeconomic bases to the business cycle. The total elasticity is determined by weighing individual revenue and expenditure components with regard to their shares in the total revenues and expenditures. Econometric estimates of the two stages of determining elasticity took into account a period twice as long than that taken into account by the EC in its current calculations.

We have determined that our elasticity estimate was lower than that by the EC. The differences arise from estimating time series of different lengths, from taking into account a longer period of time in determining the weights as well as from the increase in and the persistence of a higher proportion of non-tax income not linked to the economic cycle. The estimates show that weights and elasticity of macroeconomic bases with regard to the output gap underwent only a slight change. However, there are greater deviations in the elasticity of individual revenue and expenditure categories to the macroeconomic bases. The difference between the Fiscal Council's and the EC's old elasticity estimate amounts to approximately 8%, while the difference with regard to the EC's new assessment, which, compared to the previous estimate, uses different weights, is at approximately 7%.

Despite different elasticity estimates, there are no significant changes in the assessment of the structural balance and the structural effort. As a result of the calculation which includes an assessment of the output gap, the largest differences appeared in the period in which the output gap deviated the most from the equilibrium level, i.e. immediately before the economic crisis in the periods 2006-2008 and in 2012-2015.

There would be no significant changes to the assessments of the maximum permitted expenditure level under the Fiscal Rule Act, taking account of the updated elasticity estimates for Slovenia. The deviation from the expenditure level forecast for the general government sector by the adopted budgetary documents would, in this case, change by several tens of millions of euros compared to the estimates of their consistency with the fiscal rule made by the Fiscal Council in December 2018 and in January 2019.

Although the impact of changes in elasticity assessments on the assessment of observance of fiscal rules is relatively modest, one should also be aware of the uncertainties of point estimates of elasticity. Even in the application of point estimates of the government budget elasticity to the output gap, regular verification of the consistency of budgetary documents with fiscal rules must take into account that all econometric estimates, including parameters that represent a basis for determining elasticity, are subject to uncertainties. Structural balance assessments, which are relatively variable due to the methodological problems associated with output gap estimates, should be therefore treated with care, by taking into account a wider range of factors than only a mathematically determined assessment of the structural balance.

2.3 Comparison of within-year distributions of fiscal aggregates with long-term averages

The Fiscal Council promptly assesses compliance of the current fiscal trends with the objectives and projections set out in budget documents. Pursuant to Article 7 of the Fiscal Rule Act, the Fiscal Council's duties also include the assessment of fiscal policy's sustainability and its compliance with the fiscal rules on the basis of the Stability Programme and budgetary documents and the monitoring of the implementation of the government budget, local government budgets and the health and the pension insurance fund budget. The monitoring of the current developments is also important for eventual activation of the correction mechanism in the event of a significant discrepancy from achieving medium-term balance. The Fiscal Council employs several methods to assess the appropriateness of forecasts.

One of the important tools for monitoring the implementation of fiscal forecasts during the year is the comparison between monthly or quarterly fiscal aggregate components shares and long-term averages. This method is also used by other independent fiscal institutions, such as the Office for Budget Responsibility in the UK (OBR). In OBR's opinion, the advantages of this method compared to the use of year-on-year rates include the absence of distortions that could be caused by the base effects (Taylor and Sutton, 2018).[71] By using this method we estimate whether the current developments deviate from the usual seasonal fluctuations of fiscal revenues and expenditures. The assessment of the components with stable monthly proportions is easier than the assessment of the components with no clear pattern or significant variations. The monitoring of cumulative values by periods of the year facilitates, in addition, the monitoring of how realistic a forecast is or whether unusual movements of an aggregate in the remaining part of the year are required to achieve the annual forecast.[72]

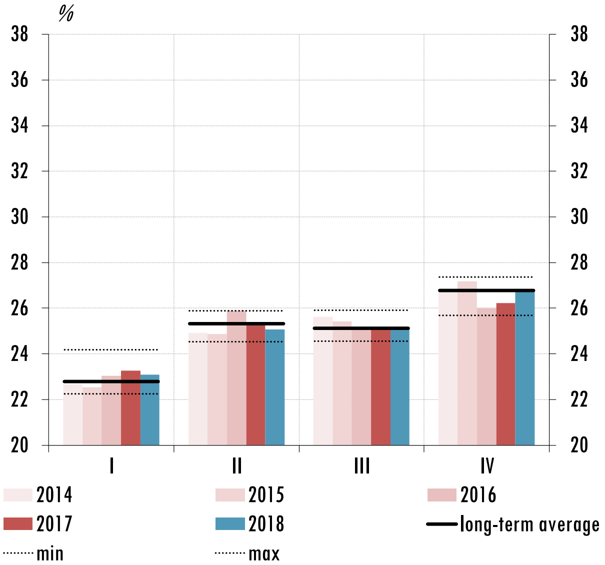
Revenues and expenditures are not necessarily evenly distributed over the year since each of the components is characterised by fluctuations that may be more or less constant during the year. In this case we can talk about normal seasonal fluctuations. A typical example of obvious seasonal fluctuations is increased VAT revenue at the end of the year which usually coincides with increased household consumption. Deviations from the usual seasonal fluctuations can also be found in fiscal aggregates with stable seasonality, for instance due to the tax rate change. Moreover, deviations can result from delayed payments (a large enterprise is one business day late in payment of taxes on goods and services). Some monthly and/or quarterly fiscal aggregates however do not show any normal seasonal fluctuations in the long-term (a typical example are proceeds from sale of equity holdings that are not related to a particular time period).

The Fiscal Council monitors two sets of data about fiscal aggregates, for which the forecasts are prepared by the Ministry of Finance. Fiscal developments in the general government sector are shown in accordance with the European System of Accounts methodology (ESA, 2010) — also used for the monitoring of EU fiscal rules — which are published quarterly within national accounts statistics by SORS. Central government budget data are published monthly by the Ministry of Finance, in accordance with the International Monetary Fund methodology for monitoring government finance

[71] Taylor and Sutton: In-year fiscal forecasting and monitoring, Working paper No. 13, Office for Budget Responsibility https://obr.uk/docs/dlm_uploads/In-year_fiscal_forecasting_and_monitoring_2.pdf

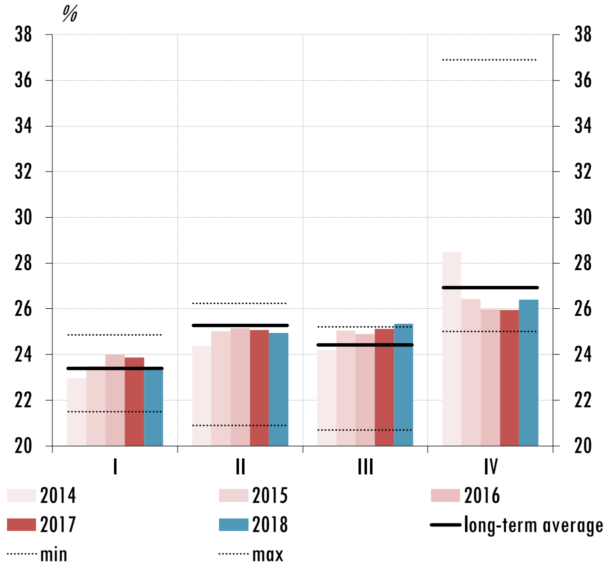
[72] A simple example of such an analysis is included in the Fiscal Council's publications with calculated implicit growth rates for individual aggregates in the remaining part of the year in order to achieve the annual forecast value (e.g. for the second half of 2018 based on known facts for the first half of the year in Table 4.2, document entitled Assessment by the Fiscal Council: Proposal for the Ordinance amending the Ordinance on the Framework for Preparing General Government Budgets for the Period 2018–2020 , available at http://www.fs-rs.si/wp-content/uploads/2018/12/Assessment_-December_2018.pdf).

Figure 2.23: Revenue by quarter as share of annual total



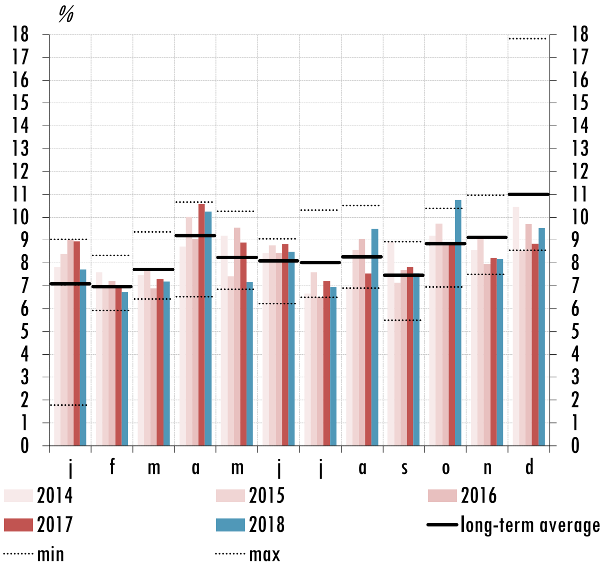
Source: SORS, FC calculations.

Figure 2.24: Expenditure by quarter as share of annual total



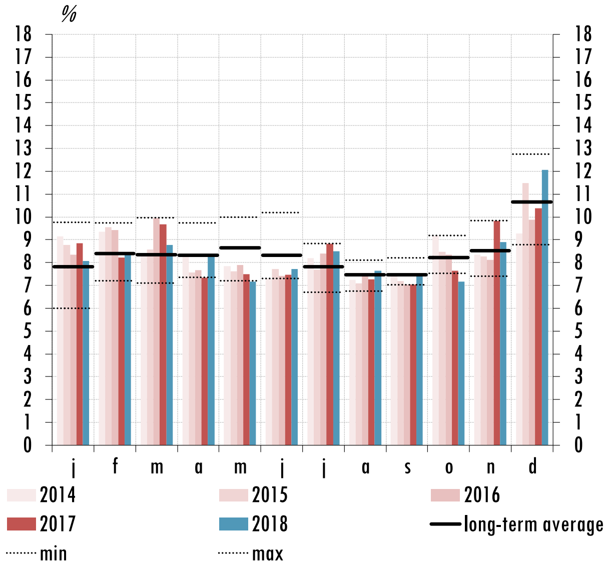
Source: SORS, FC calculations.

Figure 2.25: Revenue by month as share of annual total



Source: MoF, FC calculations.

Figure 2.26: Expenditure by month as share of annual total



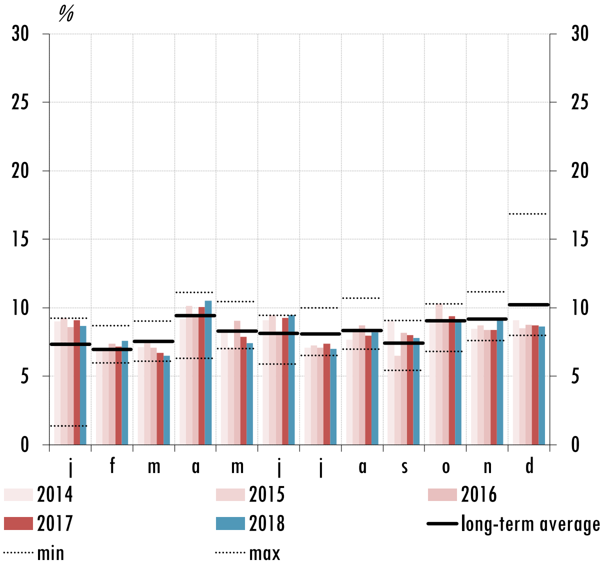
Source: MoF, FC calculations.

Note: The figures show the shares of revenue and expenditure by quarter/month in the annual total in the years 2014-2018 and their long-term (1999-2017) average. In case of uniform distribution by quarter each share would equal 25% and in monthly case 8,3 %

statistics (GFS) based on the cash flow principle. The main difference between these data sets is the method of capturing transaction data with regard to the occurrence of the event (in case of ESA 2010) or with regard to the occurrence of the cash flow (GFS) as well as the scope of the data. Moreover, ESA 2010 incorporates into the general government sector a much wider range of institutions than the GFS.[73] Some basic facts about the distribution of revenue and expenditure) on a quarterly basis (the general government sector, ESA 2010 methodology and on a monthly basis (central government budget, GFS methodology) with regard to the total annual turnover are presented below.

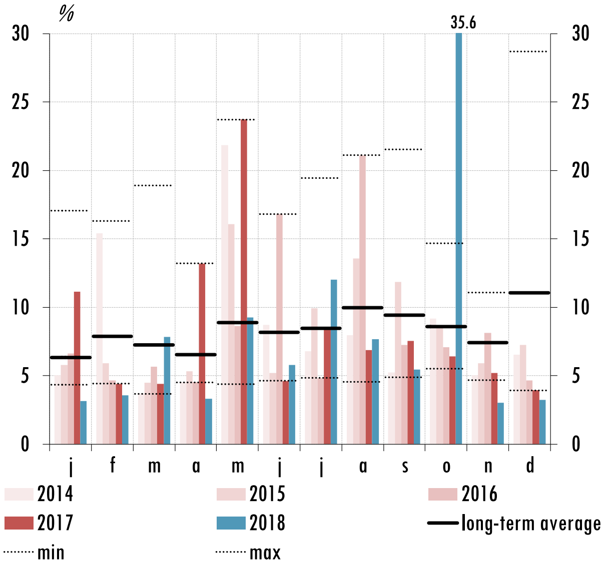
[73] The difference between the data captured by the two approaches is shown in http://www.mf.gov.si/en/areas_of_work/general_government_finance/public_finances/general_goverment_sector/

Figure 2.27: Tax revenues (70) by month as share of annual total



Source: MoF, FC calculations.

Figure 2.28: Non-tax revenues (71) by month as share of annual total

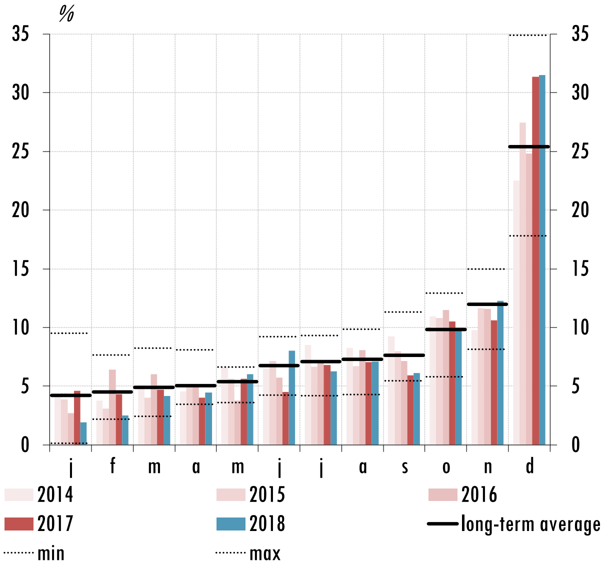


Source: MoF, FC calculations.

In both methodologies, smallest share of revenues and expenditures was recorded in the first part of the year, and a biggest part thereof in the last part of each year in the average of the 1999-2008 period. The distribution of tax revenues was more stable than that of non-tax revenue since the latter were predominantly of one-off nature, although changes in tax legislation have in some instances led to major shifts between months in tax revenue as well. Expenditure components with stable shares by month include expenditure on wages and transfers to individuals, while a greater variance is observed in investment expenditure and transfers as well as subsidies.

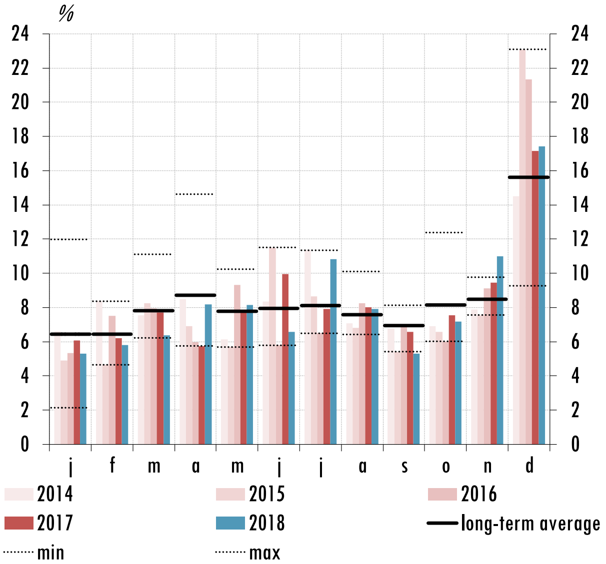
The largest central government revenues in the past few years were recorded in April. This is due to tax revenue, where the major and the increasing part is represented by corporate income taxes as a result of favourable economic conditions and the related balancing payment of tax for the previous year. In 2018, the largest share of revenue in a particular month was recorded in October, which was

Figure 2.29: Capital expenditure and transfers (42+43) by month as share of annual total



Source: MoF, FC calculations.

Figure 2.30: Expenditure on goods and services (402) by month as share of annual total



Source: MoF, FC calculations.

due to one-off non-tax revenue associated with the distribution of NLB's profits. In October 2018, the share of revenue in the item "Participation in profits and property income" was thus almost five times (50% share in total revenues in this category compared to the long-term average of 10%) higher than the long-term average for the share of this type of revenue in October. Similarly high, and therefore unpredictable, fluctuations are also recorded in revenues in the item "Receipts from the EU budget" with an outstanding deviation in August 2018, when the funds from the past financial perspective were paid into the central government budget.

Analysis of the share of fiscal categories in particular time periods during the year is not useful only due to assistance in assessing the plausibility of forecasts or achieving objectives. It may also serve as an indicator of irrational or excessive spending. Some expenditure components exhibit a high year-end concentration of spending. In some categories (expenditure on goods and services in the central government budget are almost twice as high in December than in any other month of the year) this could also point to irrational use of the allocated funds. Similar conclusion also applies to other flexible expenditure categories such as subsidies or investment expenditures and transfers.

2.4 Contribution of revenue and expenditure components to the accuracy of forecast of aggregates

The Public Finance Act[74] and the amended Decree on Development Planning Documents and Procedures for the Preparation of the National Budget[75], updated in 2018, impose on the Fiscal Council the obligation to prepare a subsequent evaluation of the forecast of macroeconomic and fiscal aggregates. In the context of preparing for regular evaluation, which must be initiated in 2020 after a transitional period, the Fiscal Council drew up an overview of deviations of fiscal forecasts from the actual outcome at an aggregate level as part of its 2017 Report.[76] The main finding of that analysis was that the deviation of the fiscal revenue forecast was in large part due to the deviation of the actual GDP from the projected one. In addition, in the period of favourable macroeconomic conditions expenditures followed the increase in revenue forecasts. One of the findings of the 2018 analysis was that expenditure was underestimated by most forecasts.

On this occasion, the analysis is extended to examine the contribution of revenue and expenditure components to the accuracy of forecast of aggregates. The analysis compares nominal forecasts of revenue and expenditure components of the general government sector specified in Stability Programmes (SP) and Draft Budgetary Plans (DBP) to their outcome for 2009-2018.[77] It includes the forecasts that were published generally not more than two years before the year to which they relate (t-2).[78] There are thus maximum six fiscal aggregate forecasts available for each year (three years (t-2, t-1, t) in two publications (SP, DBP)). The Ministry of Finance shows fiscal aggregate forecasts in accordance with the EU rules[79] as a percentage of nominal GDP derived from IMAD's macroeconomic forecasts. Nominal data are calculated as the product of the data on the share of the fiscal aggregate in the nominal GDP from the SP or the DBP and the nominal GDP level predicted in IMAD's forecast, which was taken into account in their preparation.[80] For the purpose of comparison, data on the deviation of the forecast from the actual outcome are also shown as a percentage of GDP.

Nominal expenditure shown in the forecasts of the Ministry of Finance was mainly underestimated in the observed period. Forecasts of intermediate consumption and compensation of employees were the most frequently underestimated types of expenditure, but they were still underestimated less times than total expenditure forecasts. Unlike the revenue developments, which largely depended on macroeconomic conditions, the expenditures were less sensitive to the economic cycle. Exceptions to the aforementioned underestimation were forecasts for 2012, which was the year of the adoption of austerity measures, as well as forecasts included in some of the latest budgetary documents for 2017 and 2018. In the period 2012-2014, components with overestimated forecasts included those relating to social benefit expenditure, while the largest proportion of the significant deviation for 2013 was due to bank recapitalisation expenditure which was included in "other expenditure". For 2015 and 2016, gross fixed capital formation forecasts were mainly overestimated.

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[74] The Public Finance Act (ZJF), Official Gazette of the Republic of Slovenia [*Uradni list RS*], No. 13/2018

[75] Official Gazette of the Republic of Slovenia [*Uradni list RS*], No 35/2018.

[76] http://www.fs-rs.si/wp-content/uploads/2018/05/Report-on-the-FC-operations-in-2017.pdf

[77] The analysis does not include expenditure for 2009 in SP (t-2), as their forecasts before December 2007 were reported with a somewhat different structure.

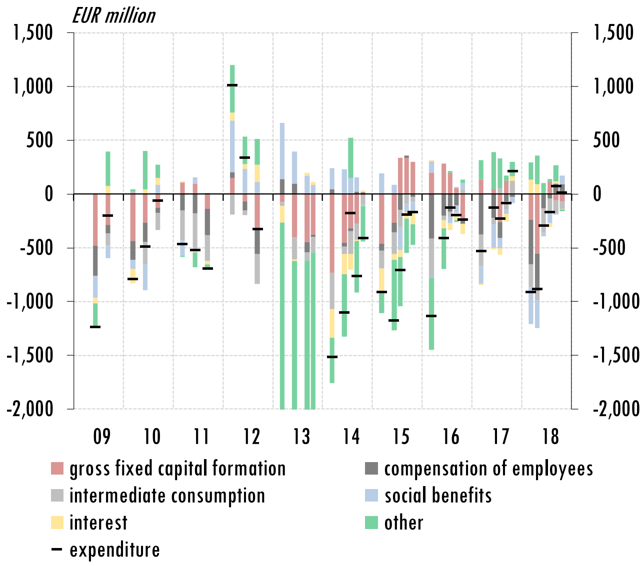
[78] The first two Stability programmes included and drawn up in December 2006 and 2007 represent an exception.

[79] Code of conduct of the Stability and Growth Pact (http://data.consilium.europa.eu/doc/document/ST-9344-2017-INIT/en/pdf) and

Code of conduct of the Two-Pack (http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/coc/2014-11-07_two_pack_coc_amended_en.pdf)

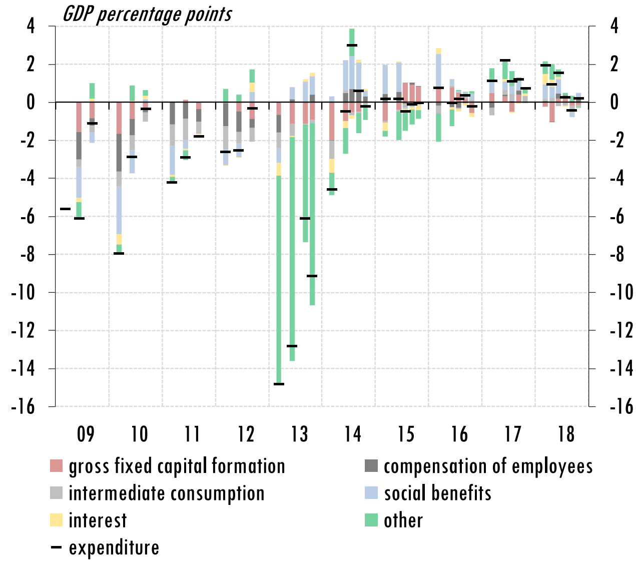
[80] Deviations of actual outcome of nominal GDP and other macroeconomic aggregates from IMAD's forecasts affect the accuracy of fiscal aggregate forecasts as a share of GDP both directly due to the difference in the denominator and in the numerator, particularly on the revenue side.

Figure 2.31: Contributions to forecast deviations - general government expenditure



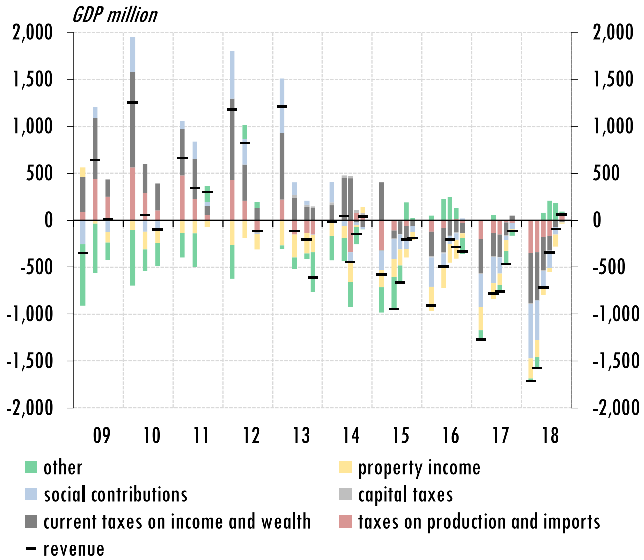
Sources: SORS, MoF forecasts, FC calculations.

Figure 2.32: Contributions to forecast deviations - general government expenditure



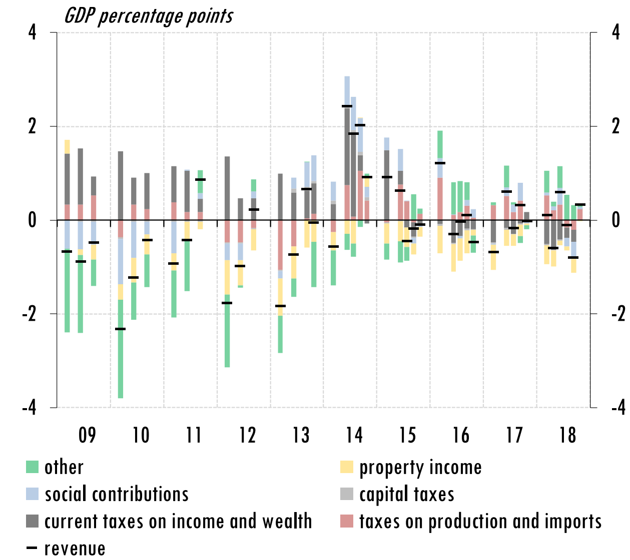
Sources: SORS, MoF forecasts, FC calculations.

Figure 2.33: Contributions to forecast deviations - general government revenue



Sources: SORS, MoF forecasts, FC calculations.

Figure 2.34: Contributions to forecast deviations - general government revenue



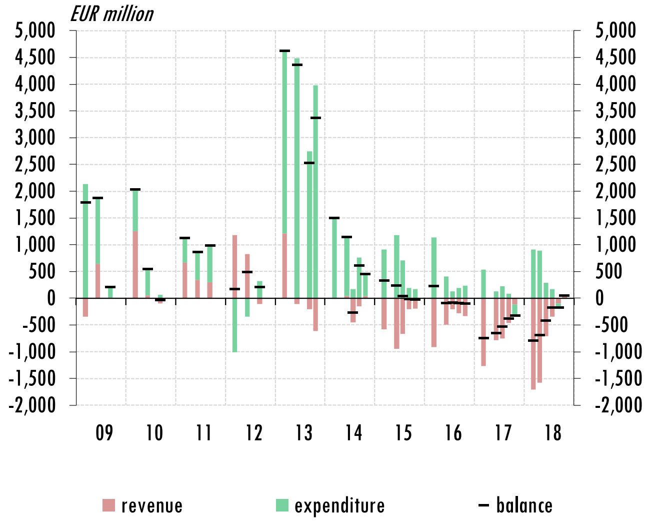
Sources: SORS, MoF forecasts, FC calculations.

Notes:

- Figures 2.31 to 2.36 show the differences between forecasts for the current year (t), the following year (t-1) and the year after the following year (t-2), e. g. the forecasts from SP 2016 for 2018) that were published in Stability Programmes (SP) and Draft Budgetary Plans (DBP), and the last published outcome. SP forecasts are available for the entire reviewed period, and the first DPB was not drafted until the end of 2013. DPB usually published forecasts for the current and for the following year only, the only exception being the DPB 2017.
- A positive value means the forecast was overestimated, i.e. that the forecast exceeded the outcome. The exception is expenditure shown in graphs which display the balance and where their positive value reflects the underestimated forecast.
- Forecasts for each year are shown in the same order in which they were made: SP (t-2), DBP (t-2), SP (t-1), DBP (t-1), SP (t), DBP (t).
- In mid-2014, the implementation of the European System of Accounts 2010 did not impact the value the general government balance, but it did impact the value of some implemented components.

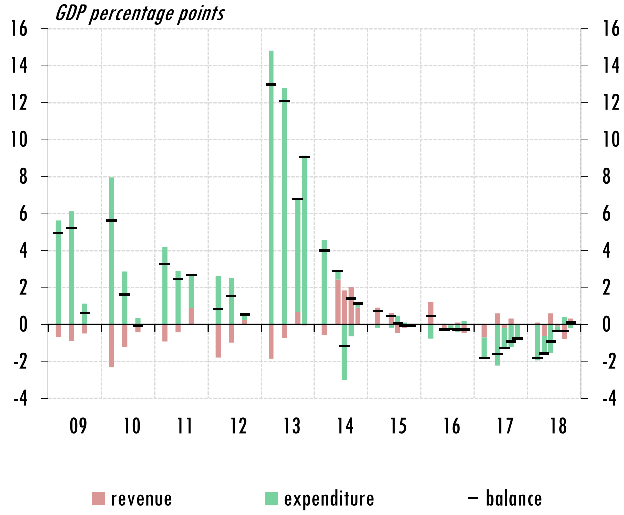
Revenue forecasts largely depend on their macroeconomic bases and consequently also on the economic activity, which makes deviations of revenues from the forecast values also largely dependent upon the deviation of the actual GDP from the forecast level. Revenue forecasts before

Figure 2.35: Contributions to forecast deviations - general government balance



Sources: SORS, MoF forecasts, FC calculations.

Figure 2.36: Contributions to forecast deviations - general government balance



Sources: SORS, MoF forecasts, FC calculations.

2013 were generally overestimated. After the upturn of the cycle in 2014, the underestimated forecasts of economic growth also contributed to the underestimation of revenue forecasts. Expenditure growth also exceeded the forecasts although the improvement of the position within the cycle reduced

Table 2.7: Share of overestimated forecasts for the 2009-2018 period

	v %		
	in EUR million	in % of GDP	no. of forecasts*
BALANCE	**57.1**	**57.1**	**42**
REVENUE	**31.0**	**38.1**	**42**
Taxes on production and imports	42.9	73.8	42
Current taxes on income and wealth	50.0	57.1	42
Capital taxes	23.8	23.8	42
Social contributions	28.6	59.5	42
Property income	4.8	7.1	42
Other	33.3	45.2	42
EXPENDITURE	**11.9**	**40.5**	**42**
Gross fixed capital formation	34.1	39.0	41
Compensation of employees	22.0	51.2	41
Intermediate consumption	14.6	24.4	41
Social benefits	46.3	65.9	41
Interest	39.0	41.5	41
Other	48.8	48.8	41
GDP (nominal level)	**31.0**	**-**	**42**

Note: The relative overestimation shown in this table reflects the ratio between the absolute overestimation and the number of analysed forecasts (medium-term budgetary documents). The absolute overestimation has been calculated on the basis of comparison between the forecasts shown in individual documents with regard to the current estimate of the outcome of individual aggregates and reflects the cases when the forecasts exceeded the outcome.

**The analysis does not include expenditure for 2009 in SP (t-2), as the forecasts before December 2007 were reported with a somewhat different structure.*

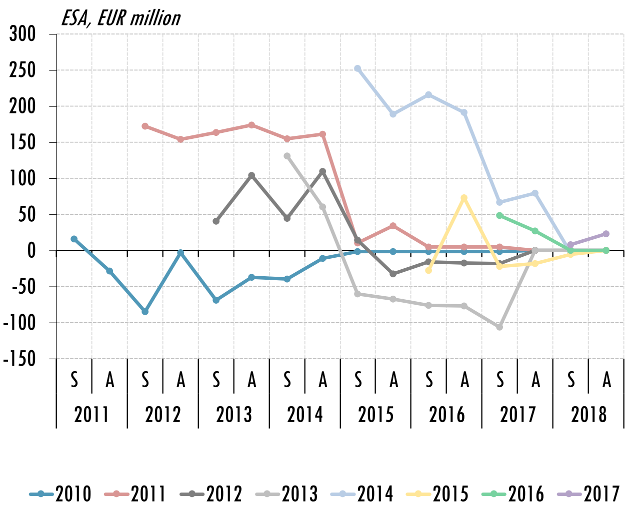
Sources: SORS, forecasts: MoF, IMAD, FC calculations.

Box 2.2: Revisions of data on general government fiscal aggregates (ESA methodologies)

As regards the analysis of forecast accuracy, attention should be called to some challenges associated with the fact that data on the outcome change in time because of revisions that may also be methodological. Some major changes occurred, for instance, in some components due to the introduction of the new European System of Accounts (transition from ESA95 to ESA2010). As it has been mentioned in the First Publication of the Main General Government Aggregates following the introduction of ESA2010 (SORS, 30 September 2014), there was no change in the values of both general government deficit and debt because of the change of methodology, but there was increase in the volume of government investment particularly due to the calculation of expenditure on research and development and armament as fixed capital formation. As after the ESA change GDP rose in nominal terms by approximately 2%, there was a relative decrease in shares of the main general government aggregates in GDP. Regular revisions of data about general government fiscal aggregates is carried out alongside the publication of such data twice a year; additional adjustments may also be required due to reconciliation with Eurostat data in the framework of EDP reporting, when revised data are published simultaneously with the Excessive Deficit Procedure Report in April and October each year. Extraordinary revisions may affect a longer period of time, or in the case of a change in methodology, the entire time series.[1]

The figure shows the differences between the general government balance outcome available in a particular year on the drawing up of budgetary documents[2] and the current outcome.[3] Data for each year in the period 2010-2016 changed by at least EUR 50 million. In this respect the most significant change was recorded in 2014, when the balance according to the currently available data (EUR -2,072 million) was by approximately EUR 250 million more negative than that published in the April Excessive Deficit Procedure Report for 2015 (EUR -1,819 million). The reasons for the for the change in the published general government balance for 2014 mentioned in various reports by The Statistical Office of the Republic of Slovenia (SORS) include recording of adjustments for financial transactions, correction of recording advances, adjustment of estimate of income tax, improved calculation of capital transfers into loss-making companies, amended methodology of presenting current transactions by the bad bank, revisions of non-produced non-financial assets and other

Figure: Difference between published vintages of outcome on general government balance and last available data



Source: SORS, spring (S) and autumn (A) vintages of AMECO (EC) 2011-2018.

[1] For more details see: Methodological explanation Main Aggregates of the General Government (SORS, https://www.stat.si/StatWeb/File/DocSysFile/8080)

[2] The data are taken from the spring and autumn vintages of AMECO database. AMECO database comprises macroeconomic data published by DG-ECFIN. Its database archive is available at: http://ec.europa.eu/economy_finance/db_indicators/ameco/archive_en.htm.

[3] For example, a point for 2010 series in S 2011 means that data on the general government balance for 2010 recorded in the spring issue of AMECO database for 2011 is more positive (or less negative) than the current outcome by approximately EUR 20 million .

property income receivable in accordance with the Eurostat Guidance Note Amending the MGDD 2016, the inclusion of the EU financial corrections data, namely funds that were spent in an unjustifiable way in the context of the EU financial perspective 2007–2013 and adjustments for cross-currency swaps.

the need for activating automatic stabilisers; at the same time, the forecast of gross fixed capital formation for 2015 and 2016 was overestimated. In the analysed period, the same direction of deviation was most frequently recorded in property income forecasts which were mostly underestimated. All revenue components were generally underestimated since the forecasts for 2015 except "other revenue".

The forecasts of the general government deficit were most underestimated in the crisis years, when the expenditure forecasts were underestimated and the revenue forecasts were overestimated. The forecasts of nominal revenue and expenditure nevertheless deviated mainly in the same direction. In the analysed period, this happened in 70% of the forecasts. Forecasts of the nominal balance were most accurate for 2015 and 2016.

Annex 1: The Fiscal Council's business operations in 2018

(Summary of the document "Obrazložitve zaključnega računa proračuna za leto 2018" – "Explanation to the Annual Financial Statement of the Budget of the Republic of Slovenia for 2018").

The Revised Budget of the Republic of Slovenia for 2018 (Official Gazette of the Republic of Slovenia [*Uradni list RS*], No. 71/17) allocated funds totalling EUR 626,800 to the Fiscal Council for its activities. The Fiscal Council carried out its tasks in 2018 with full staff composition. As it was established that the funds allocated in the adopted financial plan will not be fully used, funds totalling EUR 115,000 (Decision of the Government of the Republic of Slovenia No. 41012-69/2018/3 of 20 November 2018) were reallocated to the current budgetary reserve while EUR 80,000 (Decision of the Government of the Republic of Slovenia No. 41012-79/2018/2 of 13 December 2018)were allocated to precautionary budgetary reserve of the state budget. As at 31 December 2018, the financial plan for 2018 thus totalled EUR 431,800. EUR 409,139.92 was used, accounting for 94.75% of the planned funds.

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 2018 and 2019 Act (ZIPRS1819), 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. Employees received a holiday pay in the amount of the minimum wage pursuant to the provisions of Article 131 of the Employment Relationship Act. 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, 26/11 and 105/12-ZSDH). The collective supplementary pension insurance premiums were paid in 2018 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*], No. 88/16) and in accordance with the Decision Adjusting the Supplementary Pension Insurance Premium for Public Employees (Official Gazette of the Republic of Slovenia [*Uradni list RS*], No. 80/17).

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 sq. m. 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 2018, EUR 46,023.75 was used for this purpose (EUR 40,223.38 for administrative and technical assistance and EUR 5,800.37 for the use of premises and certain equipment). In 2018, the staff attended various conferences,

presentations, discussions, workshops, expert meetings in Slovenia and abroad. Attendance of these events was free of charge, the only costs incurred were the costs of accommodation, subsistence allowance and other travel-related expenses. Statutorily required First Aid training and training for handling documentary material were also organised in 2018.

3) Additional computer hardware and software required for normal operation was purchased in 2018 (laptop computers, LCD screens, licence software and office furniture (ergonomically shaped office chairs for the Analysis Department). The MS EA software is rented.

As at 31 December 2018 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.

Table 1: Fiscal Council expenditure

	2017 EUR	2018 EUR	share in total expenditure (%, 2018)
Expenditure on salaries and duties			
Salaries, supplements and other	120,259	261,677	64.0
Annual allowance	1,654	5,057	1.2
Restitutions, work-related bonuses	10,742	15,285	3.7
Social security contributions	20,249	42,604	10.4
Collective supplementary pension insurance according to ZKDPZJU	557	2,261	0.6
Total	153,461	326,883	79.9
Material expenditure			
Stationery and general goods and services	5,855	13,217	3.2
Special goods and services	1,243	1,029	0.3
Energy, water, communal services and communications	1,460	3,224	0.8
Transport costs and services	83	78	0.0
Expenses on business travel	3,193	6,692	1.6
Regular maintenance	2,522	3,262	0.8
Business rents	627	3,693	0.9
Other operative expenditure	44,298	40,653	9.9
Total	59,281	71,846	17.6
Expenditure on investment and investment maintainance			
Hardware computer equipment	21,005	5,008	1.2
Intangibles (computer software)	7,389	3,653	0.9
Telecommunication equipment	850	1,749	0.4
Total	29,244	10,410	2.5
Total expenditure	**241,986**	**409,140**	100.0

Source: Explanation to the Annual Financial Statement of the Budget of the Republic of Slovenia for2017 and 2018.

Table 2: Value of tanglible and intangible fixed assets in 2018

	Intangible assets	Immovable assets	Equipment and other tangible assets	Total
PURCHASE VALUE				
As at 1 January 2018	9,382	0	22,543	31,926
Direct acquisition	3,228	0	6,175	9,404
Removal – transfer	0	0	0	0
As at 31 December 2018	12,611	0	28,719	41,330
VALUE ADJUSTMENT				
As at 1 January 2018	567	0	4,004	4,571
Reduction of value due to exclusions or transfers			0	0
Value adjustment	2,141	0	12,192	14,705
Value adjustment stationery			372	
As at 31 December 2018	2,708	0	16,568	19,277
RESIDUAL VALUE				
As at 31 December 2018	**9,903**	**0**	**12,150**	**22,053**

Source: Explanation to the Annual Financial Statement of the Budget of the Republic of Slovenia for2018.

Equipment in the value of EUR 9,403.78 was purchased in 2018, of which small tools cost EUR 372.00. The purchase of license software totalled EUR 2,353.38 (payment was made in three equal instalments, the first instalment was due in 2018, the second instalment falls due in 2019, and the third instalment in 2020) and the cost of update of the Fiscal Council's website EUR 875.00. The purchase of computer hardware totalled EUR 4,598 (laptop computers totalling EUR 4,479 and a printer totalling EUR 119). The cost of purchase of office furniture totalled EUR 935 (chairs). As at 31 December 2018, the present value of intangible assets and tangible fixed assets was EUR 22,053.

As at 31 December 2017, the Fiscal Council also reported in its annual financial statement outstanding expenses in the amount of EUR 36,874, which were settled at the beginning of 2018.

As at 31 December 2018, the Fiscal Council also reported in its annual financial statement outstanding expenses in the amount of EUR 32,473, which were brought forward to 2019. These claims relate to the following:

- calculated and yet unpaid salaries, duties and reimbursement of work-related expenses for December 2018 in the amount of EUR 27,181 (of this, EUR 22,376 for salaries and allowances, EUR 988 for other benefits, EUR 197 for collective supplementary pension insurance premiums and EUR 3,621 for duties),
- services rendered and supplies delivered in the amount of EUR 5,097,
- supplied low-value equipment in the amount of EUR 107,
- receivables from the Health Insurance Institute of Slovenia arising from the calculated and paid sick leaves for December 2018 totalling EUR 88.

Outstanding expenses shown on the balance sheet as at 31 December 2018 fall due for payment in 2019.

As at 31 December 2018 a general restricted tangible and intangible fixed assets fund totalling EUR 22,053 was shown on the Fiscal Council's books among own funds and long-term liabilities. Long-term operating liabilities arising from the purchase of Microsoft software in the period 21 May 2018 - 31 December 2020 totalling EUR 1,569 in two instalments falling due in 2019 and 2020, respectively.

As at 31 December 2018, 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. This equipment includes communication technology equipment (owner Telekom Slovenije, d.d.), a Canon multifunctional device (owner FITEH, servis in trgovina biro opreme, d.o.o.) and a water cooler and heater (owner KOPIRSERVIS, d.o.o.).

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.

<u>General government:</u>
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/.

<u>Maastricht reference values for public debt and deficits:</u>
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).

<u>Maximum expenditure:</u>
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.

<u>Medium-term budgetary framework:</u>
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).

<u>Medium-term budgetary objective (MTO):</u>
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.

<u>Minimum benchmarks:</u>
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 while also being one of the determinants for the medium-term budgetary objectives. Minimum benchmarks do not cater to other risks such as unexpected budgetary developments and interest rate shocks. They are estimated by the EC.

<u>Neutral fiscal policy:</u>
This orientation of fiscal policy ensures that cyclically adjusted budgetary balance remains unchanged over the business cycle, while allowing for the operation of automatic stabilisers.

<u>One-off and temporary measures:</u>
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.

Potential GDP:

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.

Primary budget balance:

The budget balance net of interest payments on general government debt.

Primary structural budget balance:

The structural budget balance net of interest payments.

Pro-cyclical fiscal policy:

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.

Public debt:

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.

Significant deviations:

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.

Stability and Growth Pact (SGP):

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.

Stability programme:

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.

Stock-flow adjustment:
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.

Structural budget balance:
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.