REPUBLIC OF SLOVENIA
FISCAL COUNCIL

The medium-term fiscal framework in light of the proposed changes to the EU economic governance framework

Prepared by: Jure Brložnik

March 2023

This document was presented in the meeting of the Fiscal Council held on 3 March 2023

Document No.: 30-3/2023/2

Summary

Medium-term fiscal planning has many advantages compared to the annual budget cycle and, if certain criteria are met, can lead to a more predictable, stable and sustainable fiscal policy. The medium-term plan has a pivotal position in the European Commission's proposal regarding changes to the EU governance framework. According to the proposal, the maximum permissible level of net primary domestic expenditure should be determined for each Member State based on a debt sustainability analysis and should remain binding for a minimum of four years. The medium-term plan meets many criteria for an effective medium-term fiscal framework, as the objective would be binding for a multi-annual period, based on a simple, clearly defined variable covering the part of fiscal policy which is under direct control of economic policymakers.

The analysis assesses the suitability of the current medium-term budget planning in Slovenia and, in light of the proposed changes to the EU economic governance system, points out potential problems and potential solutions to increase the effectiveness of fiscal policy in this area. In its official responses, the Slovenian Government has welcomed the proposal, but establishing an appropriate medium-term fiscal framework based on an analysis of past experience will be a considerable challenge. This will require a thorough transformation of the approach to conducting fiscal policy at both the political and operational levels. Formal regulation of medium-term planning in Slovenia is relatively good, but there is a considerable gap between formal regulation and actual practice. The key shortcoming of the current medium-term budget documents is the systematic postponement of consolidation to a later time, which will not be possible in the proposed EU economic governance system or could lead to a loss of credibility of the domestic fiscal policy.

The framework for the preparation of general government budgets, introduced by the Fiscal Rule Act, is largely similar to the EC's proposal. We note, however, that due to the frequent changes arising from the fact that, in the absence of political commitment, the medium-term framework was subordinated to the annual budget cycle and not the other way around, as would be sensible, it was reduced to an administrative procedure without a corresponding effect on the conduct of a countercyclical fiscal policy. Another element of medium-term fiscal planning in Slovenia is the Stability Programme, which includes projections of key fiscal aggregates for a period of four years. Based on the analysis of the projections since 2008, we note that expenditure projections, especially for later years, were variable, and thus unreliable, and that to a large extent they reflected the optimistic backloading of consolidation to later years without an adequate basis in actual measures. We come to the same conclusions even after excluding the effect of large-scale discretionary measures, which in some years were the result of objective factors during exogenous shocks.

1. The definition of and criteria for an effective medium-term fiscal framework

Medium-term public finance planning can represent a significant improvement compared to annual budget planning if it is properly designed and, in particular, carried out. One of the key advantages of medium-term planning over annual planning is the limitation of opportunistic interests of individual budget users and stakeholders.[1] Furthermore, most fiscal policies require multiannual financing and produce results only after a longer period of time, but annual budgeting largely does not cover future costs and benefits. In addition, annual planning entrenches spending patterns, which makes it impossible to recognise any changing needs. Medium-term planning can thus contribute to improving the quality and stability of the decision-making process, which can result in a more predictable fiscal policy.[2] Medium-term fiscal plans contribute to limiting expectations and to more efficient spending, as they also create more stable operating conditions for budget users and, through more effective communication of fiscal policy goals, contribute to increasing its credibility.[3] Due to the need to present the multi-year effect of policies and measures, it can also contribute to improving fiscal discipline and gives timely warnings of potential risks to the sustainability of public finances.[4] The end result of properly functioning medium-term planning is thus a stable, predictable fiscal policy that ensures a sustainable public finance position.[5]

In principle, medium-term fiscal planning covers a sequence of three interrelated phases.[6] The first phase is the creation of a medium-term fiscal framework,[7] within which the basic macroeconomic parameters and fiscal parameters at the general government level are determined for a specific multi -annual period. The EC's proposal regarding the change in the economic governance system mainly covers this phase of medium-term planning (see Section 2). The next stage is a medium-term budget framework,[8] which covers the identification of the needs of individual budget users, which must be in line with the basic parameters determined in the previous phase. Basically, it is a mechanism that facilitates appropriate identification of priority areas, which should improve the allocation of financial resources and limit non-productive spending. In practice, these are the processes and tools with which multi-annual fiscal objectives are transferred into annual budget plans.[9] The third phase should include a framework for monitoring results,[10] which should emphasise the measurement and evaluation of the achievement of fiscal policy objectives. This phase is often neglected even in countries with a well-functioning financial framework.[11]

A suitable and functioning medium-term fiscal framework should meet certain criteria. International institutions[12] define these criteria somewhat differently, but the following ones are common to all. The key criterion for the success of medium-term fiscal planning is the political support of economic policyholders with the guaranteed appropriate participation of the legislative body. According to the World Bank,[13] when political commitment includes support only for the adoption of

[1] WB (2013).
[2] EC (2007).
[3] EUIFI (2021).
[4] IMF (2013).
[5] EUIFI (2021).
[6] WB (2013).
[7] Medium-term fiscal framwork (MTFF).
[8] Medium-term budget framework (MTBF).
[9] EUIFI (2018)
[10] Medium-term performance framework (MTPF).
[11] WB (2013).
[12] See EUIFI (2018), OECD (2014), Sherwood, M. (2015), WB (2013).
[13] WB (2013).

the medium-term framework and not for its actual implementation, it can be reduced to a technical exercise in parallel with the adoption of the budget, which requires significant administrative resources without appropriate benefits. A functioning medium-term framework actually requires a fundamental change in the way fiscal policy is conducted, where a clear political commitment to the stability of the financial framework is of key importance.[14] The government and the parliament should play a strategic role in this process by formulating priority areas and policies, the ministry of finance should deal with the technical aspects of determining priority spending areas and managing the entire budget, while individual budget users should be responsible for preparing sectoral strategies and spending plans and for managing and evaluating the effects of programmes or policies.[15] The second criterion relates to the changeability of the medium-term framework, as it is generally accepted that a more binding framework leads to greater fiscal discipline.[16] The EUIFI's analysis showed that in EU Member States with a binding medium-term framework, the fiscal situation is more stable and predictable, and there are lower risks for the sustainability of public finances.[17] A binding framework also implies that if and when new needs or priorities arise during the period of the framework's validity, they do not result in a deterioration of the fiscal situation, but are addressed by reallocating the available resources.[18] This also represents an incentive to appropriately address medium-term challenges when preparing the plan. The third criterion is related to the basic fiscal objectives, which should be simple and clearly understandable to all stakeholders.[19] In theory and in practice, the optimum objective has been identified as the volume of expenditure in nominal terms or as the rate of expenditure growth.[20] The next set of criteria is related to the extent of coverage of the medium-term framework, in terms of both institutional units and spending areas. The comprehensive coverage of the units that impact the position of the general government sector increases the credibility of the framework.[21] At the same time, more decentralised arrangements, where the central government has no direct control over the spending of all institutional units, represent a challenge. The issue of coverage also refers to individual parts of spending, where a view has been established that, when setting a medium-term goal, it is reasonable to exclude expenditure on interest and unemployment benefits over which policymakers have no influence due to financial or cyclical reasons.[22] The next criterion for a properly functioning medium-term framework is the use of independent macroeconomic forecasts when making fiscal projections, which should be conservative.[23] The last criterion which is common to all institutions is an appropriate ex-ante evaluation of the effects of measures or policies during the entire time horizon of the framework.

2. Medium-term fiscal planning at the EU level

Council Directive 2011/85/EU[24] from 2011 represented a shift towards a greater role of medium-term planning in the EU economic governance system. It set out requirements for medium-term

[14] EUIFI (2018).
[15] WB (2013).
[16] Sherwood, M. (2015).
[17] EUIFI (2021).
[18] EUIFI (2018).
[19] OECD (2014).
[20] WB (2013), OECD (2014), Sherwood, M. (2015).
[21] OECD (2014)
[22] Sherwood, M. (2015)
[23] OECD (2014). In this case, conservatism implies lower revenue projections and higher expenditure projections.
[24] EUR Lex (2011).

budget frameworks, which the Member States had to transpose into their national legislations. The Directive defines the medium-term fiscal framework as a set of national budget procedures that extend the fiscal policy's time horizon beyond the annual budget cycle and include the determination of priority areas and medium-term objectives. The EFB notes that, despite attempts to increase the effectiveness of national medium-term planning, the actual results often lagged behind the goals, which in many cases stemmed from the opportunistic postponement of fiscal adjustment.[25] The assessment of the ineffectiveness of the existing system of medium-term planning in the EU was also given by a network of independent fiscal institutions, while acknowledging considerable differences between countries.[26] Three key reasons for the ineffectiveness of the existing system were identified: first, a significant gap between formal or legislative regulation and actual implementation; second, medium-term objectives are in many cases not binding, but rather express a desired path without adequate policies to ensure it is followed; and third, the overarching fiscal targets are often not properly integrated into the actual budgeting process. From the perspective of the three phases of medium-term planning set out in the previous section, this means that the medium-term budgetary framework is separate from the medium-term fiscal framework or, in many Member States, does not even exist. As a result of these systemic deficiencies, the current economic governance system did not produce stable, predictable fiscal policies that would lead to the achievement of medium-term fiscal sustainability.

Before the start of the epidemic, the EC initiated the process of changing the EU economic governance system and, in November of last year, presented its proposal,[27] in which a medium-term plan occupies the central position. This plan should combine the fiscal, reform and investment plans of the Member States. The plan's basic parameter should be the growth of net primary domestic expenditure,[28] determined on the basis of a debt sustainability analysis.[29] Based on this analysis, the determined growth of expenditure should be translated into the highest allowed nominal expenditure level for a minimum period of four years, during which there would be no changes to the target or any changes should go through the same EC and EU Council approval process as the original plan. In states facing a significant debt sustainability challenge, including Slovenia, according to the latest publicly available EC analysis,[30] the permitted growth of net primary domestic expenditure would be determined in such a way that (i) after the end of the four-year period of the medium-term plan, the public debt would be sustainably reduced over the next 10 years in the unchanged policy scenario and (ii) the general government deficit would not exceed 3% of GDP during the plan's validity. A Member State could apply for a three-year extension of the four-year period in the event of planned investments and reforms. Approval of the extension would require in-depth and transparent documents on how the proposed reforms and investments should contribute to the sustainability of economic growth and public finances, along with quantitative calculations of their impact on potential growth and medium-term fiscal balances. In the event of the state's disagreement with the permitted growth of net primary domestic expenditure determined by the EC and the latter not recognising the concerns of the state, the EC would use its own calculations in the process of annual monitoring of the meeting of the target. Deviations from the target should be monitored through national annual reports, and an

[25] EFB (2020).

[26] EUIFI (2021).

[27] EC (2021).

[28] Total expenditure excluding interest expenditure and cyclical unemployment expenditure, taking into account the impact of discretionary measures on the revenue side, while simultaneously excluding expenditure financed by EU funds.

[29] For more information on the characteristics and challenges of debt sustainability analysis, see Delakorda (2021), and for information with an emphasis on the challenges related to the changed EU economic governance system, see Delakorda (2023).

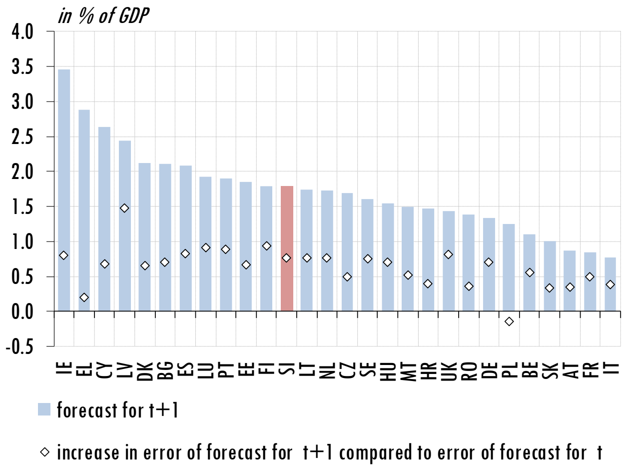
[30] EC (2022).

identified significant deviation of debt sustainability from the plan would lead to automatic initiation of the excess deficit procedure, as already established in the current regulation. If there were a deviation from the set goal in a Member State requesting a longer adjustment period due to planned reforms and investments, the deviation would lead to stricter measures, along with the possibility of financial sanctions. In the EC's opinion, strict observance of the permissible limit of expenditure growth would enable the counter-cyclical functioning of the fiscal policy, which was one of the main areas of complaint regarding the existing system of fiscal rules at the EU level.

The proposal meets many criteria for an effective medium-term public finance framework as defined in the literature. The proposed medium-term fiscal plan can be defined as a medium-term fiscal framework, or as the first phase of medium-term planning, where a medium-term goal is determined on the basis of independent macroeconomic and fiscal projections. The objective should be binding and based on independent projections. Its definition as the nominal level of net primary domestic expenditure corresponds to the criterion of a simple, clear and comprehensible target; moreover, it is appropriately defined in terms of expenditure which is under direct control of economic policymakers Its implementation in practice will require the Member States to create an appropriate medium-term budget framework, i.e. the second phase of medium-term planning, which, based on the past experience of many countries, will probably be a considerable challenge. The proposal's success will depend crucially on the political commitment to the changed economic governance system.

Despite its many advantages, the proposed medium-term framework has certain shortcomings. The proposal envisages that the Member States should prepare a four-year plan in the spring of the year before the plan comes into force. In practice, this means that they should draw up a stable and binding plan for a period of five years. Past experience shows that both macroeconomic forecasts and fiscal projections prepared by Member States and the EC are unreliable over a longer period, which is largely related to objectively uncertain economic conditions. The average errors are relatively large and increase significantly even for the next year's projections (t+1) compared to those for the current year (t). This could pose a dilemma in terms of the timeline set for the creation and entry into force of the medium-term fiscal plan, since the forecast for t+1 would actually be a forecast for only the first year of the medium-term plan's validity. The next dilemma is related to the question of how to take

Figure 2.1: Mean absolute error of EC spring forecast with relation to the first available outturn in the 2004-2019 period



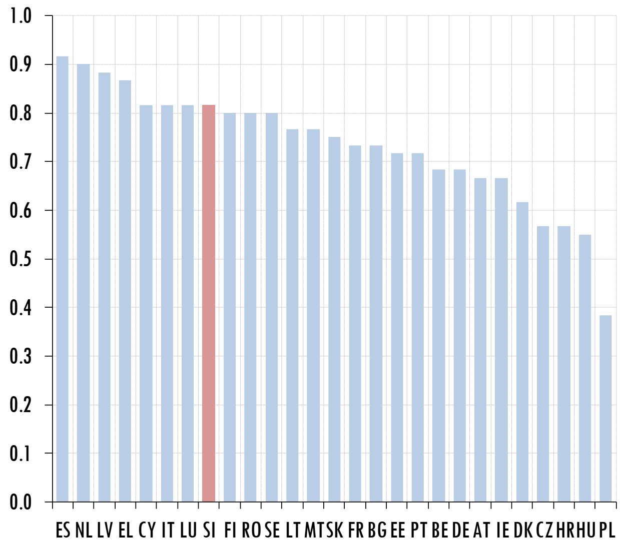
Source: EC, FC calculations. Note: Countries ranked according to the MAE of forecast for the next year. the calculation of MAE the same number of forecasts is taken into account for all countries.

into account the updated debt sustainability assessments. Namely, it is not clearly defined what would happen to the permitted net primary domestic expenditure growth if the annual update of the debt sustainability assessment indicated a significantly different permitted adjustment path than the original assessment used when preparing the medium-term plan. Past experience shows that the assessment of debt sustainability can change significantly over the years.[31] In addition to the use of the assumptions applied in the debt sustainability analysis, the dilemma is also related to possible additional differences in the calculations of the EC and of the Member States regarding certain key assumptions that may occur despite the same methodology being used. Even in the proposed amended economic governance system, certain assumptions are supposed to play an important role, which was an important reason for disagreements between the Member States and the EC already under the existing system. This was also one of the reasons why the existing system did not work as expected. These are mainly the long-term potential growth and output gap projections, where, in the case of Slovenia, significant differences arose in the past between independent calculations made by IMAD and those made by the EC despite them using the same methodology. In the proposed system, this may have important implications for the calculation of the permitted growth of net primary domestic expenditure and thus the manoeuvring space for the fiscal policy during the period of validity of the medium-term plan. The network of independent fiscal institutions also draws attention to the shortcomings of the current proposal, in particular to the need for a more accurate definition of certain key parameters on which the proposals operability will depend in practice.[32]

3. Medium-term fiscal planning in Slovenia

From a formal point of view, medium-term fiscal planning in Slovenia is relatively well regulated. The part of Council Directive 2011/85/EU which refers to the medium-term fiscal framework has been transposed into the Slovenian legislation mainly by Article 9 of the Act Amending the Public Finance Act (ZJF-H).[33] In accordance with the Directive, this Act determines the timeline and the obligatory

Figure 3.1: MTBF index 2021



Source: EC.

[31] See, for example, the transition of individual states between groups of states with different debt risk assessment in Figures I.2.27 and I.3.5 in EC (2022).

[32] EUIFI (2023).

[33] Official Gazette of the Republic of Slovenia (2018).

components of the medium-term fiscal framework. In practice, the provisions of this Article are implemented by adopting a Stability Programme, which the State is obliged to send to the EC by no later than 30 April each year, following a preliminary assessment by the Fiscal Council and adoption by the National Assembly. Another document related to medium-term planning is the Framework for the preparation of the general government budgets (hereinafter: the Framework), which is determined by Article 6 of the Fiscal Rule Act (ZFisP).[34] This is largely similar to the criteria proposed by the EC in the modified economic governance system, as it determines, among other things, the nominal ceiling on government expenditure. It differs from the EC's proposal in terms of the time period, which in the current national legislation is one year shorter than in the EC's proposal, and includes all expenditure, whereas the EC's proposal excludes certain expenditures beyond direct government influence. In addition, the Framework also determines the balance or the level of expenditure of individual budgets and is thus broken down in more detail than envisaged by the EC's proposal. The formal regulation in individual Member States is monitored by the medium-term budgetary framework index, which is updated annually by the EC.[35] On the basis of this index, we can conclude that medium-term fiscal planning in Slovenia has improved in formal terms in recent years and is also relatively well organised compared to other Member States. Nevertheless, we consider that, in practice, the existing medium-term fiscal planning has a number of shortcomings, which are similar to those identified in the analysis of the network of independent fiscal institutions[36] regarding the effectiveness of the EU's current medium-term framework. There is a considerable gap between formal regulation and practice, the goals were not binding and changed frequently, and the Framework was not properly integrated into the annual budgeting process, i.e. it is the medium-term Framework that adapted to the annual budgeting instead of vice versa, as a result of which it did not serve its underlying purpose.

The Framework for the preparation of general government budgets according to the ZfisP could be an important factor in ensuring the countercyclical operation of fiscal policy, but in practice it has been reduced to a merely technical procedure due to numerous changes. If the Framework were binding in practice and consequently stable throughout the three-year period of its validity, negative or positive deviations of the actual nominal GDP or income from the forecast would be reflected in the corresponding cyclical adjustment of the balance, with unchanged expenditure. Paragraph six of Article 6 of the ZfisP allows the Framework to be changed in the event of a change in the circumstances that pertained at the time when the original Framework was adopted. The lack of an accurate definition of what constitutes changed circumstances in the legislation has resulted in frequent changes to the Framework, even a number of times in a single year, and the parameters have generally not been adjusted for the entire period of the Framework's validity, but only for individual years.

Frequent changes to the Framework resulted in significant deviations of the Framework objectives from the outturn.[37] In the period 2017–2019, i.e. before the start of the epidemic, the deviation between the realised general government expenditure and that envisaged in the originally adopted Framework ranged between EUR 0.5 and 2.4 billion per year. Deviations also occurred when comparing the actual realisation in a particular year with the latest changes approved in the previous

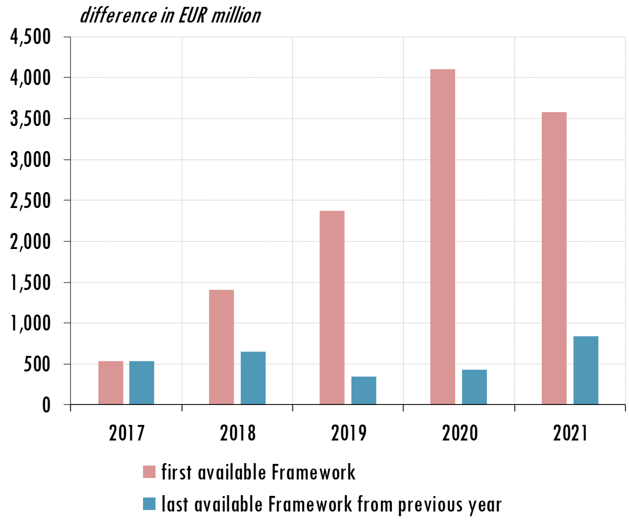
[34] Official Gazette of the Republic of Slovenia (2015).

[35] Methodology and results are available at: https://economy-finance.ec.europa.eu/economic-research-and-databases/economic-databases/fiscal-governance-database_en#medium-term-budgetary-frameworks.

[36] EUIFI (2021).

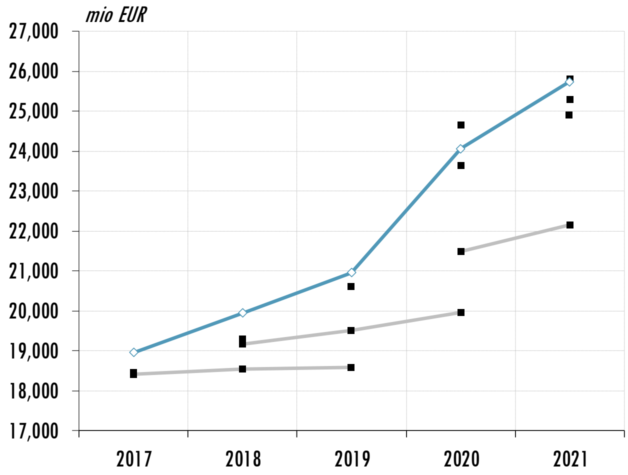
[37] The Fiscal Council regularly draws attention to the problematic nature of frequent and incomplete changes to the Framework in its evaluations of budget document proposals. The Fiscal Council analyses projection deviations over a longer period every two years in accordance with the legislation. See FC (2020) and FC (2022).

Figure 3.2: Comparison of general governement expenditure outturn and the Framework



Source: SORS, Official Gazette of the Republic of Slovenia, FC calculations.

Figure 3.3: General government expenditure - outturn and Frameworks including changes*



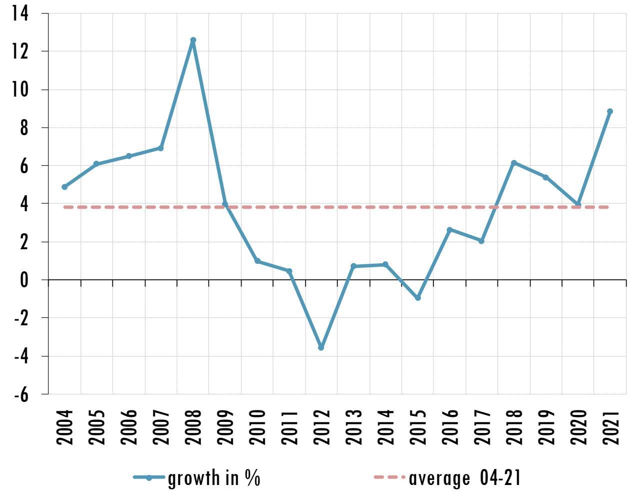
*Source: SORS, Official Gazette of the Republic of Slovenia. Note: * comprehensive Frameworks are represented by a line, partial corrections are shown as unrelated points.*

year (range between EUR 0.3 and EUR 0.7 billion). Thus the Framework was reduced to a technical exercise without any real effect.[38] This was largely due to the fact that the Framework adapted to the annual budget cycle and not the other way around. The fact that, at least until now, the Framework has not been realised in practice as planned or forecast has mainly been due to the fact that Slovenia's fiscal policy is not medium-term but annually oriented, with frequent changes and economic policy responses to current challenges having a significant impact on the movement of key fiscal aggregates. The Framework's inadequacy in practice can also be ascribed to its fundamentals. In the event that, when determining the maximum permissible expenditure limit, certain expenditures over which economic policymakers have no influence were excluded, it would be more difficult to justify changes to the entire Framework even in the case of minor changes in macroeconomic forecasts during the period of its validity, which also occurred in the years before the onset of the epidemic.

Another element of medium-term fiscal planning in Slovenia consists of projections from the Stability Programme, which, even excluding the impact of objective exogenous factors, are quite variable and therefore unreliable, with a clear tendency to postponing consolidation to later years. The Stability Programme is prepared on the basis of IMAD's independent macroeconomic forecasts and includes projections of all key revenue and expenditure categories of the general government sector with an assessment of the impact of discretionary measures for the current year and the coming three-year period. According to the EC's proposal, the medium-term plan should cover a one-year-longer period in the changed EU's economic governance system and begin in the second year of the forecasting horizon within the current Stability Programme. An overview of the projections from the Stability Programmes adopted since 2008 (inclusive) shows that medium-term fiscal projections in Slovenia are highly variable and unreliable, even excluding the effect of objective exogenous factors that had an impact on the deviation of the outturn from the projected objectives. Since, according to the EC's proposal, the basic criterion for monitoring the sustainability of public finances in the changed EU economic governance system should be primary domestic expenditure, our attention in the review of deviations from the Stability Programme projections is focused on

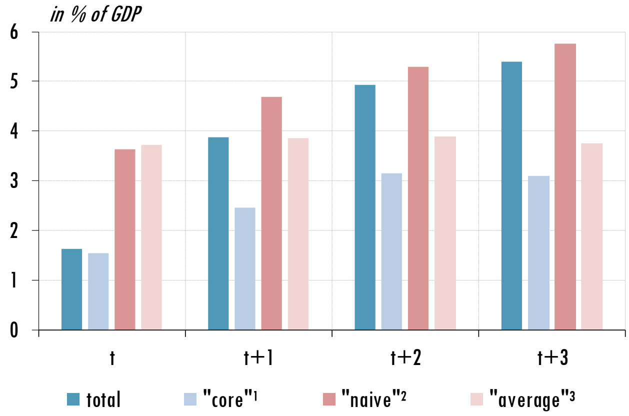
[38]In accordance with the World Bank's expectations in the absence of an appropriate political commitment to respecting the fiscal framework (WB, 2013).

Figure 3.4: Net primary domestic expenditure (excl. COVID)



*Source: SORS, IMAD, EC, FC calcualtions. Note: *total expenditure excluding interest expenditure, cyclical unemployment expenditure and one-off factors (which include COVID), taking into account the effect of discretionary measures on the revenue side while excluding expenditure financed by EU funds.*

Figure 3.5: Mean absolute error (MAE) of the projections of expenditure share in GDP



Note: SORS, MoF, FC calculations. Notes: [1] excluding the effect of bank recapitalisation in 2011-2014 and the effect of measures for mitigation of consequences of the epidemic in 2020 and 2021. [2] last known outturn at the time of each forecast preparation is taken as forecast. [3] average of known outturns at the time of each forecast preparation is taken as forecast.

expenditure. In this regard, we note that the growth in primary domestic expenditure was quite volatile over a long period and that, on average for the period, it slightly lagged behind the average growth of nominal GDP. The first conclusion of the analysis of deviations from the projections is that the mean absolute errors[39] (MAE) of the projections of all key variables[40] included in the review, expressed both as a share of GDP and in nominal terms, increase as the time horizon of the projections extends. For all the variables covered, the MAE increases significantly with projections for t+1 compared to projections for year t, which represents a considerable challenge in the light of the EC's proposal, when year t+1 is supposed to be the first year of the medium-term plan's validity. The mean absolute error for expenditure projections for the period t+1 to t+3 is as much as 4.7% of GDP. We also compared the MAE of official projections with the "naïve"[41] and "average"[42] projection. We note that in the expenditure projections for years t+2 and t+3, the mean absolute error of the official projection is even higher than that in the "average" projection. Due to the numerous external shocks in the period after 2008, to which the fiscal policy responded with extensive discretionary action, we also calculated the MAE in projections by excluding the impact of these shocks. We excluded the cost of bank recapitalisation in the period 2011–2014 and the impact of measures to mitigate the consequences of the epidemic in 2020 and 2021. In this case, the MAEs in official expenditure projections were smaller than in "naive" and "average" projections, but they nevertheless increased with the lengthening of the time horizon and, in the case of expenditure, they were on average around 3% in the period between t+1 and t+3.

Deviation in expenditure projections expressed as a share of GDP was largely the result of deviations in projections of fiscal variables. Considering that findings of deviations of projections of fiscal indicators, expressed as a share of GDP, can be related to both deviations in forecasts of nominal fiscal variables and deviations in GDP forecasts, we divided the projection errors into the

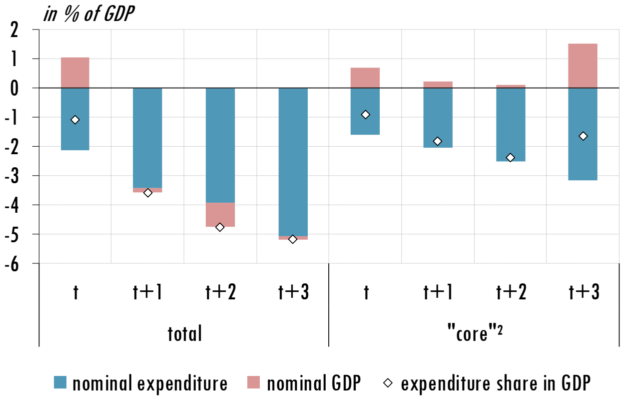
[39] The mean absolute error (MAE) is used to measure the accuracy of projections and, by taking into account the absolute values of the error, eliminates the deficiency of the mean error indicator, which can display low values with equally large directional change errors. For more, see, for example, Section 2.2.1 in FC (2020).

[40] We included in the review nominal GDP as a key macroeconomic basis for making fiscal projections, and among the latter, the review includes the balance, revenues, expenditures and also individual key expenditure categories (compensation of employees, social benefits, intermediate consumption, investments, and other expenditures).

[41] A naive projection takes the last known realised value of a variable as the forecast value.

[42] The average projection takes as the projected value the average value achieved in all previous years, which were known at the time of the preparation of each projection.

Figure 3.6: Contributions of nominal expenditure projections and nominal GDP forecasts to mean error (ME) of projections of expenditure share in GDP[1]



Source: SORS, MoF, FC calculations. Notes: [1]negative contribution of nominal expenditure reflects projection being lower than outturn while negative contribution of nominal GDP reflects GDP forecasts being higher than outturn and vice versa. [2]excludes 2013, 2020 and 2021, when the effect of discretionary measures was substantial.

contribution of the numerator (forecast error for nominal fiscal variables) and the contribution of the denominator (nominal GDP forecast error).[43] Projections of the share of expenditure were on average underestimated in the period after 2008, the underestimation gradually increased as the time horizon of the projections lengthened and was mainly the result of an underestimated nominal expenditure level. The conclusions are the same with the inclusion of the basic projections for all years in the assessment, and also with the exclusion of the years 2013, 2020 and 2021, when the outturn deviated significantly from the projections due to extensive discretionary action following exogenous shocks that could not have been predicted at the time the medium-term projections were formulated.

The inadequate approach to the preparation of medium-term projections is also highlighted by the analysis of the forecast direction and the direction of outturn. The results indicate a strategy of postponing fiscal consolidation to the last years of the validity of the projections. In all Stability Programmes included in the analysis, a reduction in the share of expenditure in GDP was forecast for the years t+1, t+2 and t+3. Although this was achieved in most cases, such a single-based approach with a continuously forecast decrease in the share of expenditure points to its inadequacy and, to a certain extent, to the unrealistic nature of medium-term projections. A further indicator of postponing consolidation to later years is the comparison of the expected nominal level of expenditure in individual years of projections with the outturn. It can be seen that, as a rule, as the projection year approached, the expected expenditure level gradually increased, but it was still behind the actual final outturn in most years. Considering that, according to the EC's proposal, expenditure should be binding and stable for at least a four-year period, the continuation of the current approach, with frequent changes of projections, will most likely lead to non-compliance with commitments.

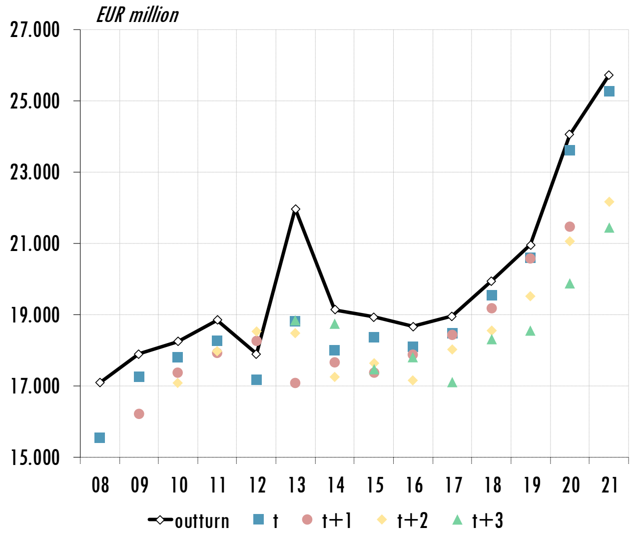
[43] In this case, we used the approach of Hauth et al. (2018), in which the mean error is calculated in order to measure the forecast deviation bias. The main drawback of the mean error indicator is that positive and negative forecast deviations can nullify each other, which allows this indicator to show low values even in cases of a large directional change error. When interpreting such a breakdown, account must be taken of the different meanings of the numerator and denominator signs: the negative value of the numerator's contribution reflects the under-forecast of the nominal fiscal variables, while the negative value of the denominator contribution reflects the GDP over-forecast and vice versa.

Figure 3.7: The accuracy of the forecast direction of projections of expenditure share in GDP

		outturn: decrease	outturn: increase
t	forecast: decrease	7	3
	forecast: increase	1	3
t+1	forecast: decrease	7	5
	forecast: increase	0	0
t+2	forecast: decrease	8	4
	forecast: increase	0	0
t+3	forecast: decrease	7	2
	forecast: increase	0	0

Source: SORS, MoF, FC calculations.

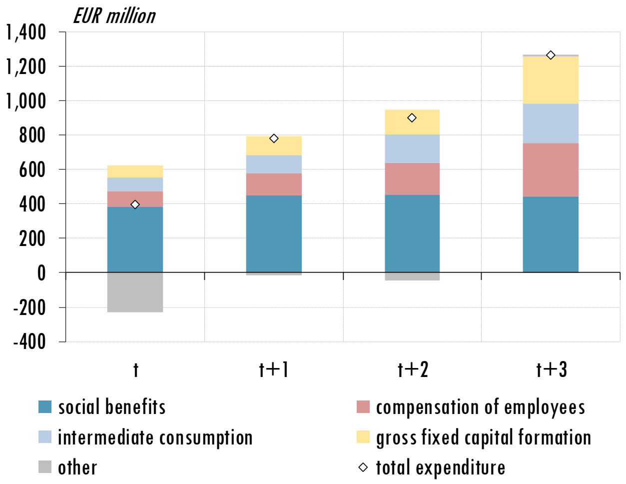
Figure 3.8: Outturn and projections of nominal level of expenditure



Source: SORS, MoF, IMAD, FC calculations.

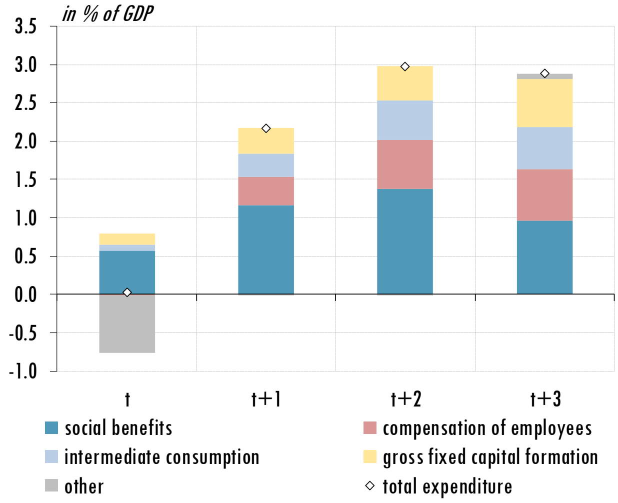
The deviation from expenditure projections was to the greatest extent the result of deviations from social benefit projections. Deviations from the total expenditure projection derived from all key expenditure categories and, as a rule, increased in all categories as the time horizon of the projections lengthened. Almost half of the mean error (ME) in the projection of total expenditure as a share of GDP for the period encompassing the years t+1 to t+3 was due to errors in social benefit expenditure projections. Considering the category's average share in GDP, the errors were highest in the projections of investment expenditure and social benefits. The Fiscal Council regularly draws attention to the inadequate planning of these two expenditure categories, in particular when evaluating budget documents.

Figure 3.9: Contrbutions of categories to mean error (ME) of "core" expenditure projections[1]



Source: SORS, MoF, FC calculations. Note: [1]excluding the effect of bank recapitalisation in 2011-2014 and the effect of measures for mitigation of consequences of the epidemic in 2020 and 2021. Positive sign denotes that the outturn was higher than the projection.

Figure 3.10: Contributions of categories to mean error (ME) of "core" expenditure projections[1]



Source: SORS, MoF, FC calculations. Note: [1]excluding the effect of bank recapitalisation in 2011-2014 and the effect of measures for mitigation of consequences of the epidemic in 2020 and 2021. Positive sign denotes that the outturn was higher than the projection.

Based on previous experience with medium-term planning, the potential establishment of a new EU economic governance system as proposed by the EC will be a considerable challenge for Slovenia. As shown by the experiences of some other states, it will be of key importance to make economic policymakers aware that a properly functioning system of medium-term planning has many advantages over the established annual budget cycle. Without adequate political support and awareness of the need for medium-term fiscal policy planning, including from the viewpoint of legislation, even an impeccably established medium-term framework cannot have any substantive effect in operational and technical terms. In the current planning system, there are also many operational drawbacks that primarily, but not entirely, fall within the responsibility of the Ministry of Finance. In the Slovenian system, the Ministry of Finance, i.e. the Government, is responsible for the sustainability of the balance of the entire general government sector, while at the same time, it can directly control less than half of the total expenditure.[44] An important part of the total expenditure stems from municipal budgets, both social insurance funds and other institutional units. An additional challenge is the thorough improvement of the method of and increased transparency in assessing the financial effects of discretionary measures, which is largely the responsibility of the Ministry of Finance but also requires the involvement of individual line ministries. When making the medium-term projections, it will be necessary to eliminate certain technical deficiencies, such as systematically underestimating expenditure on, especially, social benefits, which form the largest expenditure category. Considering the importance of various assumptions in determining the maximum permitted expenditure and thus the fiscal policy's room for manoeuvre, a more proactive stance will also be needed in the process of preparing the starting points for medium-term plans. Under the present system, Slovenia often disagreed with some of the key parameters of the EC's assessment of compliance with the rules. This concerned, in particular, certain key input assumptions for calculating debt sustainability and, consequently, the maximum permitted growth of primary domestic expenditure, which should also play an important role in the proposed renewed EU economic governance system.

[44] The structure of general government expenditure is shown in the quarterly review of the Ministry of Finance ("Četrtletni pregled javnofinančnih prihodkov in odhodkov"), available at: https://www.gov.si/teme/fiskalna-in-javnofinancna-politika/ (Only in Slovene)

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