IMAD

economic issues 2015

Economic Issues 2015
ISSN 1581-6567
Ljubljana, July 2015

Published by: UMAR, Ljubljana, Gregorčičeva 27
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Printed by: Statistical Office of the Republic of Slovenia

Since the first issue in 2007, Economic Issues has dealt with topics for which we believe that require response of economic policy. This year's publication focuses on fiscal policy issues and highlights dilemmas related to the introduction of fiscal rules and institutions for fiscal policy monitoring in Slovenia.

Economic Issues 2015 is based on statistical data, information and adopted measures known at the cut-off date of 7 July 2015.

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Summary

After the onset of the crisis, significant deviations from the established fiscal policy rules and their negative impact on other economic policies led to closer fiscal policy coordination in the EU. The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union signed in 2012 introduced a rule on a balanced government budget, which means that under normal conditions the structural balance may not be lower than -0.5% of GDP. This rule was given additional weight by the request for it to be transferred into national legislation. The treaty also set the minimum standards for the national budgetary frameworks of EU Member States. Under the new regulations, euro area countries are requested to submit their draft budgetary plans to the European Commission (EC), which monitors the execution of medium-term budgetary plans and may, in the event of serious non-compliance with EU rules, request a revised draft plan. The sanction system has become more gradual, and sanctions for not complying with the rules of the Stability and Growth Pact can now be applied at an earlier stage. The reformed framework enables better coordination of economic policies and earlier detection of imbalances, but it has also become very complex and difficult to monitor.

A significant feature of the reformed framework of fiscal policy coordination is the introduction of numerical fiscal rules, which place special emphasis on the structural balance. Reducing the deviations from the objectives and ensuring consistent fiscal governance over the entire business cycle should be achieved by incorporating binding fiscal rules into national legislation. In order to be effective, fiscal rules should be well defined, transparent, simple and enforceable. Euro area countries have already transposed the balanced budget rule into their national laws. Although the structural balance is a better indicator of the fiscal position than the actual general government balance, it also has its flaws, which are mainly related to the volatility of output gap calculations and the variations in defining one-off factors. About half of the euro area countries have complemented the balanced budget rule with an expenditure rule or a debt rule. Given their strengths and weaknesses, a combination of rules tends to be more effective than either rule alone.

The reformed framework of fiscal policy coordination also envisages the establishment of independent fiscal institutions for fiscal policy monitoring and defines their main tasks. Independent fiscal institutions monitor compliance with fiscal rules and the functioning of the corrective mechanism, produce or validate macroeconomic forecasts, and publicly release their estimates. The basic pillars of their independence and effectiveness are: an appropriate institutional model, clearly defined remits and responsibilities, independence from political interference, highly professional staff, sufficient resources, and effective communication with the public. Their organisational structure and the concretisation of tasks within these principles and rules remain the responsibility of Member States. The number, size, remit and institutional model of independent fiscal institutions thus differ across the EU. Some Member States have had independent fiscal institutions in place for decades, but most have only had independent fiscal institutions established, or thoroughly reformed, in recent years. The only EU countries without an independent fiscal institution for monitoring compliance with numerical fiscal rules (i.e. a fiscal council), or at least a legal basis for its establishment and operation, are the Czech Republic, Poland and Slovenia.

Fiscal councils in the selected countries are mainly medium-sized, with at least some permanent staff and responsibilities that go beyond the monitoring of compliance with fiscal rules. All Member States analysed (Austria, Belgium, the Netherlands, Germany, Slovakia, Latvia), except Latvia, have medium-sized fiscal councils with at least 20 members, many of whom are often outside advisors. They are appointed by the government together with non-governmental institutions, or elected by the parliament. The remits of fiscal councils go beyond the monitoring of compliance with fiscal rules and include the preparation of analyses of long-term fiscal sustainability and other economic analyses. In some Member States fiscal councils also formulate fiscal policy recommendations. In several countries, fiscal councils have their own budgets, whereas the fiscal councils in some countries are attached to another institution that provides them with professional and administrative support. In Austria, Belgium, the Netherlands and Germany, other

independent institutions, which have more staff and are therefore able to perform more demanding tasks, also play a major role in fiscal monitoring. Independent fiscal institutions with a long-standing tradition and strong public reputation have a significant impact on public debate on fiscal policy, which is a major factor in their effectiveness.

Slovenia also faces the challenge of incorporating the reformed fiscal framework of the EU into its implementing legislation. The government proposal of the implementing act based on the amendment to the Constitution of the Republic of Slovenia from May 2013 has been in the parliamentary procedure for over half a year, for the most part in the absence of public debate or an exchange of expert opinions. It includes most of the requirements of the EU legislation and the inter-governmental fiscal compact regarding the fiscal rule and the fiscal council, but lacks solutions that are based on good practices in other countries and that take into account the existing institutional arrangement and the factors which are specific to Slovenia in this area. The current proposal for the parameters and the functioning of the fiscal rule includes certain ambiguities, on which the relatively small fiscal council will have to take a clear stand. It also lacks broad public acceptance and support**.** The proposed method of establishing and organising the fiscal council could raise doubts about its independence and therefore damage its credibility. Alongside the fairly broad range of tasks envisaged by the law, a special challenge to the operation of a small fiscal council is the increased complexity of fiscal policy monitoring in the last few years.

Fiscal sustainability has been an issue in Slovenia for several years. Slovenia has recorded a structural deficit for at least 15 years and was therefore unable to generate a general government surplus even when its GDP growth was at its strongest. After the onset of the economic crisis, the deficit increased further amid the stronger operation of automatic stabilisers because of the crisis and the government measures put in place for mitigating its effects and stabilising the banks. Public debt thus rose from 22% of GDP in 2008 to over 80% of GDP by the end of 2014.

Consequently, the main fiscal policy objective in the years to come is fiscal consolidation, which will eliminate the structural imbalances accumulated. Thus far the fiscal consolidation measures have mainly been saving-oriented in nature. They were adopted in times of high uncertainty in Slovenia's economy when Slovenia had difficulties in accessing finance on foreign markets. However, their extension into the years that followed has revealed their weaknesses, such as their negative impact on economic activity and the undermining of other policies (e.g. the wage policy in the public sector). An even greater flaw of this approach is that it does not offer more permanent solutions for establishing fiscal sustainability, which is to be achieved by eliminating problems at their source.

The Stability Programme 2015 (SP 2015) outlines medium-term consolidation, but does not sufficiently address fiscal policy challenges. Despite the envisaged reduction in the general government deficit in the next few years, the structure of measures fails to address the main problems. In the years to come Slovenia will also not make the sufficient fiscal effort as measured by a decline in the structural deficit. Although the SP 2015 retains the focus of consolidation on the relative reduction in expenditure, it has once again significantly changed the method of consolidation. It anticipates a medium-term decline in expenditure to 2014 levels due to the envisaged reduction in interest expenditure, which is expected to compensate entirely for the increase in primary expenditure in this period. On the other hand, the PS 2015 anticipates growth in revenue for all years except 2016, when revenue will fall due to significantly lower revenue from the EU budget. Its growth will be the result of the expected recovery in economic activity, while in 2015 and 2016 it will also be due to discretionary measures: increasing the tax burden, broadening the tax bases and improving the efficiency of tax collection. The risks associated with this approach are related to the assumption of lower interest payments in the next few years amidst the persistent general government deficit, which is otherwise on the decline, but will require further borrowing. At the same time, no other measures that could reduce the debt have been defined. As in previous years, a number of measures underpinning the projections of primary expenditure are undefined and excessively focused on saving instead of a sustainable structural adjustment to the changing macroeconomic and demographic circumstances.

In order to ensure fiscal sustainability, Slovenia will therefore need to deal with the consequences of population aging and the accumulated public debt. Although Slovenia has one of the fastest ageing populations in the EU, the social protection systems in place have yet to be adapted to the changing circumstances. On the one hand, this causes difficulties in terms of providing social protection for the population while, on the other, it exerts additional pressure on public finances. As a result of the widening gap between contributions paid and pensions received, despite the reforms of 2013, the transfer from the budget to the pension fund is rising – in 2014 this figure was as high as EUR 1.6 bn. This indicates the pressing need for more radical pension reform in order to ensure more sustainable financing of the pension system. An increase in public debt to over EUR 30 bn, which reflects high general government deficits in the last few years and the extensive recapitalisations of banks and enterprises, also reveals inefficient management in state-owned enterprises. A change in management practices, or indeed privatisation, could therefore improve the efficiency of these enterprises and reduce the likelihood of further recapitalisations with public funds.

With regard to other categories of expenditure, a more selective approach to its reduction – instead of linear cuts – would ensure a more sustainable fiscal situation. This entails a detailed overview of expenditure and a programming approach to budgetary planning which would allow for a more substantive debate on the allocation of limited public resources to priority areas. This means the implementation of policies that are least harmful to the economic recovery or strengthen the economy's long-term potential.

1 Fiscal rules and institutions for fiscal policy surveillance in the EU

1.1 Enhanced fiscal policy surveillance in the EU

The deterioration of the fiscal situation after the onset of the financial crisis exposed the weaknesses in the European rules for coordinating fiscal policies in the euro area and hastened their reform. Since 2008 almost all EU countries have been in breach of at least one of their commitments under the Treaty on European Union (1992)[1] and the Stability and Growth Pact concluded in 1997 (i.e. to keep general government deficits below 3% of GDP and debts below 60% of GDP). Some countries[2] had already breached their obligations before the financial crisis, which, together with the increased diversity of EU Member States after the enlargement, led to the first reform of the pact in 2005. The revised pact redefines the medium-term objective for fiscal policies[3] in EU Member States – which was previously "to achieve a budgetary position close to balance or in surplus" – as a structural balance (with a lower limit of -1% of GDP for euro area countries), which accounts for the cyclical fluctuations in economic activity and one-off factors, and is determined separately for each country.[4] The structural balance has thus become one of the key indicators in the fiscal policy surveillance system at the EU level and, subsequently, at the national level. With weak supervision at the EU level and an ineffective sanction system, a number of countries violated this rule and entered into the financial crisis without the adequate resilience of their fiscal policies to shocks. The expansion of fiscal deficits and debts in the EU after 2008 required the adoption of new rules for the better coordination of fiscal policies and stricter fiscal surveillance at the EU level. The new regulations reinforced the role of the structural balance and introduced complementary fiscal rules. At the same time, the minimum standards for national fiscal frameworks were set, which have since strengthened the role of independent institutions in budgetary planning and control.

By signing the Fiscal Compact, the euro area countries committed themselves to transposing the balanced budget rule into their national legislation, which gave the structural balance additional weight. The Fiscal Compact is part of the intergovernmental treaty (TSCG), through which euro area countries and some other EU countries[5] committed themselves to ensuring their budgets were either balanced or in surplus in ordinary circumstances. According to Article 3 (1b) of the TSCG, this goal is achieved if the annual structural balance of the general government is at its country-specific medium-term objective, with a lower limit of 0.5% of GDP for the structural balance (or 1% of GDP for countries with debt-to-GDP ratios significantly below 60% of GDP). The countries committed themselves to transposing this rule – which is more stringent than the requirements of the Stability and Growth Pact[6] – into their national legal systems through binding, permanent and, preferably, constitutional provisions by 2014. The signatory countries are also required to implement the independent monitoring of compliance with the balanced budget rule and to introduce a correction mechanism that is to be triggered automatically if significant deviations from the medium-term objective, or the adjustment path towards it, are observed.[7]

The reformed Stability and Growth Pact also strengthened the role of fiscal rules, which complement the main structural deficit rules. The EU's new legislative package, known as the Six-pack,[8] gave greater weight to the upper limit of general government debt and defined a sufficient decline in excessive debt in quantitative terms. The excessive deficit procedure can therefore also be triggered for a country with an annual deficit of less than 3% of GDP if its debt exceeds 60% of GDP and is not diminishing towards the 60% threshold at a sufficiently rapid pace (by at least 1/20 per year on average over three years).[9] The preventive arm of the Pact now also includes an expenditure benchmark, according to which growth in general government expenditure must be lower than potential GDP growth unless the excess is matched by discretionary revenue measures; this should facilitate convergence towards the targeted structural balance.[10]

[1] The reference values for government deficit and debt are defined in Protocol No. 12 annexed to the Treaty on the European Union (TEU) and the Treaty on the Functioning of the European Union (TFEU). After the reform of the treaties in 2009, the coordination of fiscal policies in the EU is based on Articles 121, 126 and 136 of the TFEU.

[2] Among old EU Member States, particularly Italy, France, Germany, Portugal and Austria.

[3] The medium-term objective (MTO) is the targeted structural balance (calculated according to the methodology of the EU) that a country should reach in order to ensure fiscal sustainability.

[4] The revised pact also defined the fiscal effort required to attain the medium-term objective, and that as a reduction of the structural deficit by at least 0.5% of GDP per year (more in good times and less in bad times).

[5] The Fiscal Compact is part of the Treaty on Stability, Coordination and Governance of the Economic and Monetary Union (TSCG) signed in 2012 by all EU Member States except the United Kingdom, the Czech Republic and Croatia (the latter subsequently acceded to the EU. The Fiscal Compact is binding for all euro area countries, as well as for Denmark, Romania and Bulgaria, which have declared themselves to also be bound by the Fiscal Compact.

[6] Under the preventive arm of the Stability and Growth Pact, the lower limit of the annual structural balance is -1% of GDP, regardless of the level of the country's public debt.

[7] In compliance with the Common Principles on National Fiscal Correction Mechanisms (COM (2012) 342 final, 20 June 2012).

[8] The package of six legislative measures adopted in 2011 includes Council Directive 2011/85/EU and five regulations: Regulation (EU) No. 1173/2011, Regulation (EU) No. 1174/2011, Regulation (EU) No. 1175/2011, Regulation (EU) No. 1176/2011 and Regulation (EU) No. 1177/2011.

[9] If the excessive debt has not been sufficiently reduced in previous years, its dynamics over the next three years are also assessed (under the no-policy-change assumption). If they do not show a sufficient debt reduction, the corrective arm of the Pact enters into force. For countries that have already exited the excessive deficit programme (triggered before 8 November 2001) a three-year transition period for a gradual adjustment applies.

[10] If expenditure increases in line with potential GDP, the structural balance is constant, under certain assumptions; if it grows more rapidly, the structural balance deteriorates (and vice versa).

According to the expanded Stability and Growth Pact, which includes all legislative changes in recent years,[11] the estimate of the convergence to the medium-term financial objective thus also has to take into account, besides the fiscal effort, growth in expenditure relative to growth in potential GDP.

In recent years, a requirement has been introduced for euro area countries to submit their draft budgetary plans to the European Commission for inspection, fiscal surveillance in the EU has been enhanced and a more gradualist approach has been adopted for the sanction system. In line with the Two-Pack Regulations,[12] all euro area Member States are required to submit by October every year their draft budgetary plans[13] to the European Commission (EC) for the following year. The EC assesses the draft budgetary plans and thus monitors compliance with the stability programmes, which include medium-term budgetary objectives. In the event of serious non-compliance with EU rules, the EC may request a revised draft budgetary plan (a strengthening of the preventive arm). The Two-Pack Regulations also strengthened the surveillance procedures for countries subject to the excessive debt procedure, requiring that they submit economic partnership programmes that included a fiscal consolidation strategy. Instead of the previous *ad hoc* mechanisms, the Two-Pack introduced uniform rules to strengthen surveillance for euro area countries experiencing, or threatened with, serious difficulties with respect to their financial stability or fiscal sustainability, or those receiving financial assistance. With the Six-Pack, the sanction system[14] within the Stability and Growth Pact became more gradual. It can be applied at an earlier stage and is more automated in nature (decisions on sanctions taken by reversed qualified majority voting).

The new regulations also stipulate the minimum standards for the national budgetary frameworks of EU Member States. They refer to the following characteristics of the national budgetary frameworks.[15]

- A system of public accounting, which should comprehensively and consistently cover all sub-sectors of general government, ensure the regular public availability of fiscal data and be subject to internal control and independent audits;
- Macroeconomic and budgetary forecasts serving as the basis for fiscal planning, which should be realistic and based on the most up-to-date information (use of the most likely or a more prudent scenario) and should be prepared or confirmed by independent bodies;
- The definition of national numerical fiscal rules, which over a period of several years foster compliance with the reference values on deficit and debt and the achievement of medium-term budgetary objectives;
- The establishment of (at least in functional terms) autonomous bodies for the effective monitoring of compliance with the rules (see Chapter 1.3.1 for more on the requirements regarding the role of independent institutions in fiscal surveillance at the national level);
- Medium-term budgetary planning for at least three years.

At the beginning of 2015, the rules of the expanded Stability and Growth Pact were complemented by interpretative guidelines that, under certain conditions, allow temporary deviations. In an interpretative communication,[16] the EC explained that the preventive arm of the Pact allows for a temporary deviation from the medium-term budgetary objective or from the adjustment path towards it (up to 0.5% of GDP), if this is related to structural reforms or investment, and if certain other conditions are met. In the first case the government must implement major structural reform with verifiable positive budgetary effects, or submit a comprehensive and detailed structural reform plan that includes clearly defined measures and reasonable timelines for their adoption. The second case applies to countries with negative output growth, or a negative output gap greater than 1.5% of GDP, which have increased investment and where public investment is co-funded by the EU under the Cohesion Policy, by the European Fund for Strategic Investments (EFSI) or by other EU instruments. The deadline for correcting an excessive deficit may be extended for countries in the corrective arm of the Pact that have prepared a credible structural reform plan, but only if they have made the required fiscal effort. For countries in the corrective arm of the Pact, the EU also developed a new approach for assessing fiscal effort in isolation from the budgetary events that are beyond the control of governments.

EU rules, in accordance with which Member States pursue their national fiscal policies, have become very complex in recent years. With the reformed Stability and Growth Pact, the rules have become stricter but also more flexible. The Pact has thus come closer to a "one-size-fits-all" model, but it has also become less transparent, less user friendly, and more difficult to communicate to the general public. The current requirements of the preventive and corrective arms of the Stability and Growth Pact and the Fiscal Compact are summarised in Table 1. The elements of national fiscal frameworks and their features required by EU rules and the Fiscal Compact are shown in Figure 1.

[11] The reformed Stability and Growth Pact does not include the provisions of the Fiscal Compact, as the Fiscal Compact is an intergovernmental agreement (not EU law). Only those Fiscal Compact provisions that were included in the Two-Pack of EU regulations from 2013 are part of the EU legislation.

[12] The Two-Pack Regulations from 2012 comprise Regulation (EU) No. 472/2013 and Regulation (EU) No. 473/2013.

[13] The framework for the preparation of draft budgetary plans is specified in the Communications from the Commission COM (2013) 490 final, 27 June 2013, and COM (2014) 675 final, 28 October 2014.

[14] Sanctions may only be imposed on euro area countries.

[15] The standards were set by Directive 2011/85/EU, which is a component of the Six-Pack from 2011, and Regulation (EU) No. 473/2013, one of the Two-Pack Regulations from 2013.

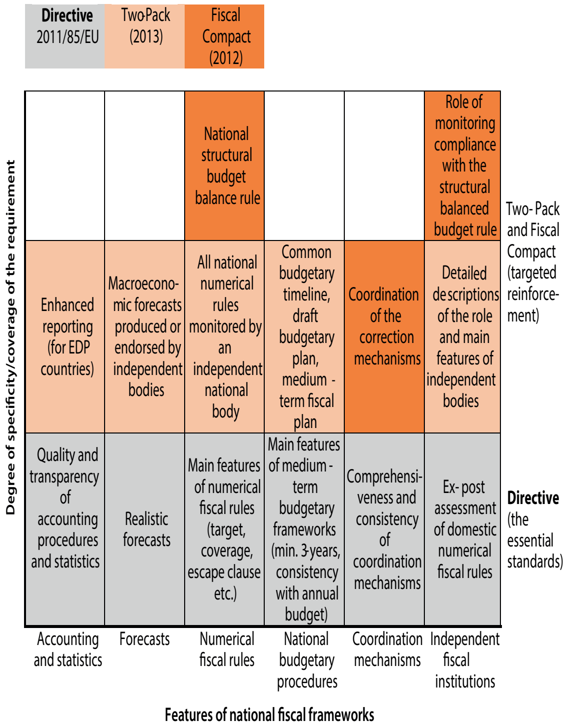
[16] Communication from the Commission COM (2015) 12 final, 13 January 2015

Table 1: **Main components of the Stability and Growth Pact and the Fiscal Compact**

Objective	Specification	Adjustment path and temporary deviations	Enforcement specification
STABILITY AND GROWTH PACT – PREVENTIVE ARM			
Requirement of a close to balance or in surplus position	**Country-specific medium-term objective** in structural terms: – For euro area Member States: the lower limit of the structural balance of -1% of GDP – Provide a safety margin with respect to the deficit limit of 3% of GDP – Allow room for budgetary manoeuvre – Ensure rapid progress towards sustainability (with regard the costs of ageing and public debt) In the event of deviations from the medium-term objective: – Rapid convergence to the objective; – Expenditure benchmark (expenditure excluding interest payments and some other expenditures, and net of discretionary measures on the revenue side, should grow ≤ medium-term potential GDP).	**Reduction of the structural deficit:** – By 0.5% of GDP per year as a benchmark (more in good times and less in bad times, according to the formula: exceptionally bad times = 0% ≤ very bad times ≤ 0.25% ≤ bad times ≤ 0.5% < good times)*; – By more than 0.5% of GDP per year if debt exceeds 60% of GDP or in the event of pronounced sustainability risks. **Growth in expenditure** is also taken into account. **Temporary deviations** permitted in the event of: – The implementation of major structural reforms with a verifiable impact on the public finances – An increase in investment if certain conditions are fulfilled – Unusual events outside the control of the Member State concerned which have a major impact on its financial position; – Severe economic downturn in the euro area or the EU as a whole.	Procedure for correcting significant deviations from the medium-term objective or the adjustment path (i.e. deviations by more than 0.5% of GDP in one year or more than 0.25% of GDP over two years). For euro area Member States: in the event of repeated non-compliance (an interest-bearing deposit of 0.2% of GDP).
STABILITY AND GROWTH PACT – CORRECTIVE ARM			
Correct major policy errors	**Upper limits:** – Deficit: 3% of GDP – Debt: 60% of GDP or diminishing sufficiently (average reduction of the gap by 5% per year over 3 years to 60%, taking into account the economic cycle and debt forecasts by the EC for the next two years).	**Reduction of the structural deficit:** by at least 0.5% of GDP. Supplemented by a bottom-up assessment of the budgetary effect of the adopted measures based on the no-policy-change scenario. **Possible extension** of deadline: – If effective action has been taken and in the case of unexpected adverse economic events with major unfavourable consequences for government finances; – In the event of a severe economic downturn in the euro area or in the EU as a whole provided that this does not endanger fiscal sustainability in the medium term; – In the event of the implementation of, or a credible plan for, structural reforms, and if the appropriate fiscal effort is made.	For euro area Member States: an early and gradual sanction system at the EU level (from a non-interest-bearing deposit of 0.2% of GDP to a fine in the same amount, plus a variable component in the event of repeated failure to take effective action).
FISCAL COMPACT			
Fostering fiscal discipline through national ownership of fiscal rules and procedures	**The balanced budget rule:** The lower limit for a country's structural balance to meet the medium-term objective is -0.5% of GDP (or -1.0% of GDP in the event of the debt-to-GDP ratio being significantly below 60%). In the event of deviation: rapid convergence towards the MTO. **Upper debt limit** (60% of GDP) or its sufficient reduction (1/20 per year on average**).	**Adjustment path:** the time frame to be proposed by the EC in its country-specific recommendations. Evaluation of progress in compliance with the SGP rules. Exceptions: as specified in the Stability and Growth Pact. No provisions regarding temporary deviations in the event of structural reforms and investment.	An automatically triggered correction mechanism at the national level. Surveillance carried out by a national independent fiscal institution.

Source: COM (2014) 905 final, 28 November 2014, p. 12, completed by IMAD.
Note: * The requirement depends on the level of public debt and the output gap, as specified in the Communication from the Commission COM (2015) 12 final, 13 January 2015. ** The Treaty refers to Council Regulation (EU) 1177/2011, according to which the debt-to-GDP ratio is deemed to be diminishing sufficiently if the deviation from the upper limit has decreased over the previous three years at an average rate of 1/20 per year. For those Member States that were in the excessive deficit procedure in December 2011, a transitional period applies (starting three years after the correction of the excessive deficit).

Figure 1: **Components of national fiscal frameworks – Overview of European requirements**



Source: Ciobanu (2014, p. 9).

1.2 Role of fiscal rules in stabilising the public finances

1.2.1 Numerical fiscal rules in the EU

All euro area countries have already transposed the balanced budget rule into their national laws. Most of them determined the fiscal rule by constitutional laws. Slovenia is one of the four countries that have defined the fiscal rule in their constitutions, even more strictly than required by the Fiscal Compact (see Chapter 1.4.2). According to the available data,[17] in eight euro area countries the rule is defined as a structural balance in % of GDP and in another eight euro area countries as a medium-term fiscal objective. In two, Estonia and the Netherlands, it is defined more loosely, as a balanced structural position. Slovenia is the only euro area country where the fiscal rule, enshrined in the constitution, has not yet been clearly specified, but the implementing act is in the parliamentary process (see Chapter 1.4.2). Fewer than half of euro area countries have also complemented the balanced budget rule with an expenditure rule and/ or a debt rule as defined in the Fiscal Compact.

[17] In mid-2015 the EC will prepare an official overview of the transfer of the Fiscal Compact into the national legislations of Member States with regard to the implementation of the fiscal rule.

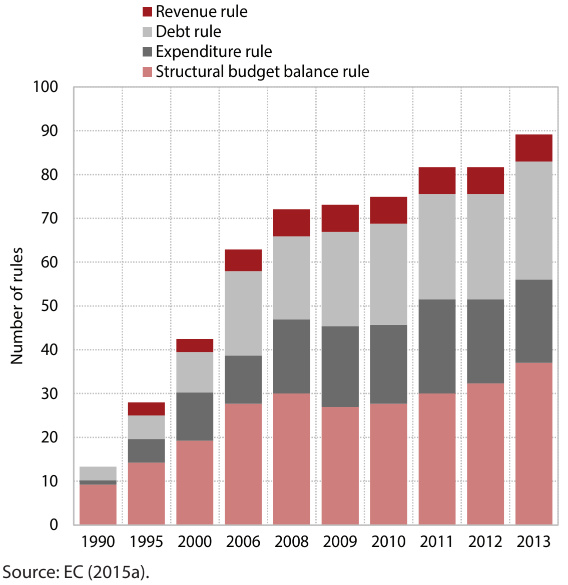
Table 2: **Fiscal rules according to the Fiscal Compact in euro area countries**

	Balanced budget rule transposed into national laws	**Fiscal rule definition (structural deficit)**	**Expenditure rule**	**Debt reduction rule (1/20 per year)**
Austria	✓	-0.35 % of GDP [1]	✓	✓
Belgium	✓	-0.5 % of GDP	✓	
Cyprus	✓	-0.5 % of GDP	✓	✓
Germany	✓	-0.5 % of GDP		
Estonia	✓	Balanced structural position [2]		
Spain	✓	-0.4 % of GDP	✓	✓
Finland	✓	Medium-term fiscal objective		
France	✓	Medium-term fiscal objective		
Greece	✓	-0.5 % of GDP		
Ireland	✓	Medium-term fiscal objective		✓
Italy	✓	Medium-term fiscal objective	✓	✓
Luxembourg	✓	Medium-term fiscal objective	✓	✓
Latvia	✓	-0.5 % of GDP	✓	✓
Lithuania	✓	Medium-term fiscal objective	✓	
Malta	✓	Medium-term fiscal objective		
Netherlands	✓	Balanced structural position [2]		
Portugal	✓	Medium-term fiscal objective		✓
Slovenia	✓	Implementing act under preparation		
Slovakia	✓	-0.5 % of GDP		

Notes: [1] Since 2017, -0.45% of GDP; [2] In Estonia and the Netherlands the fiscal rule is not precisely defined; according to the Fiscal Compact, a balanced structural position can be interpreted as a structural deficit of 0.5% of GDP.

EU Member States are required to also abide by other rules in addition to those of the Fiscal Compact. In the EU, most of the rules are related to a more broadly defined budget balance, followed by rules that limit the level of debt,[18] slightly fewer expenditure rules,[19] and far fewer rules related to revenues. In a number of EU Member States, debt rules set debt ceilings, which are most frequently expressed in relative terms as a percentage of GDP, whereas, particularly at the local government level, several countries also have rules that limit debt growth, usually in relation to revenues.[20] Many countries also have expenditure rules that determine real or nominal expenditure ceilings, whereas the expenditure rules in some countries limit real expenditure growth.

Figure 2: **Fiscal rules in the EU**



Source: EC (2015a).

1.2.2 The effectiveness of fiscal rules

Fiscal rules as numerical targets for budgetary aggregates are an important part of the institutional framework for the governance, coordination and surveillance of fiscal policies in the EU. They are mainly aimed at limiting the growth of public debt, which could destabilise the entire monetary union. This could be the result of a systematic and unlimited use of fiscal policy measures for mitigating economic shocks, which would otherwise be their role in an optimum currency area.

Various studies show that, in order to be effective, fiscal rules must satisfy a number of criteria. According to the Kopits-Symansky criteria (Kopits, 2011a), an ideal fiscal rule should be well defined, transparent, simple, flexible, adequate relative to the final goal, enforceable, consistent, and underpinned by structural reforms. According to Buiter (2013), the rules for the euro area should be simple, credible, impartial and consistent, also make sense in the long run, be neutral as regards the size of the public sector, differentiated (allowing for differences between Member States), and ensure the solvency of the state. The International Monetary Fund estimates that effective fiscal rules are those which, among other things, pursue three objectives: debt sustainability, economic stability, and containing the size of the government (IMF, 2009). All these studies emphasise that fiscal rules should be well defined, transparent, simple, enforceable, and conducive to the realisation of fiscal policy goals.

In an attempt to assess the effectiveness of fiscal rules, an index measuring their overall strength was introduced. The European Commission defined five criteria to assess the strength of fiscal rules in EU Member States, i.e. their suitability for meeting the targets: the statutory base of the rule; room for setting or revising its objectives; the body responsible for monitoring compliance with and enforcement of the rule; the enforcement mechanisms relating to the rule; and the media visibility of the rule. In terms of the index of fiscal rule strength, which indicates the potential effectiveness of the rules,[21] the highest ranking Member States are France, Germany, Spain, Ireland, Slovakia and Latvia, with the lowest ranking Member States being Slovenia and Malta..

1.2.3 Structural balance as the main fiscal rule

The structural balance is a better indicator of the fiscal position than the actual general government balance, but it also has its drawbacks. Its calculation is affected by estimates of potential GDP and the output gap, which tend to be very volatile owing to the way they are calculated. The volatility is, in addition to methodological changes, mainly attributable to the revisions of estimates of past economic growth and changes in forecasts due to altered conditions and prospects in the domestic and international environments. Expenditure ceilings defined by expenditure rules tied to potential GDP growth can also be volatile. Estimates of the structural balance are also affected by *ex-post* revisions of the actual general government balance and the definition of one-off factors. All this can radically change the estimate

[18] Alongside the Fiscal Compact rule regarding the reduction of debt (by 1/20), the majority of Member States have rules that determine debt ceilings, which are usually expressed as a percentage of GDP; particularly at the local level, several countries have rules that limit debt growth, most often in relation to revenue.

[19] Alongside the rules set in the Fiscal Compact, several countries also have expenditure rules which set the real or nominal expenditure ceilings, while some countries also have rules that limit real expenditure growth.

[20] Database of the European Commission on Fiscal Rules (EC, 2015a)

[21] Given the complexity and technical limitations in calculating the synthetic indices of the strength of individual fiscal rules (EC, 2015a), their values are indicative, in our estimation, and do not necessarily demonstrate the actual effectiveness of the rules.

of the fiscal position, not only for the current and coming years but also *ex post*, which can lead to the adoption of short-term interventionist measures that are not substantively justified or may even prove unnecessary at a later point of time. What is particularly problematic about the binding balanced budget provisions of the Fiscal Compact is that a violation of such a volatile rule may ultimately trigger sanctions.

The uncertainty attached to structural balance estimates tends to be higher in small EU Member States. The mean size of the revisions of output gap estimates in EU countries in the period between autumn T-1 and spring T+1 in 2003–2012 was as much as 1.3 percentage points of GDP (Simone et al., 2014). These are the revisions of the output gap estimates during the period between the final phase of the preparation of the budget for the forthcoming year and the phase when the first estimates of the outturn of this budget for the preceding year were already available. This may lead to a situation where, even if the budget was planned in compliance with the fiscal rule, its outturn can deviate from the plan only because of the revised estimate of the output gap. The revisions were largest during the crisis years of 2008 and 2009; outside this period they were relatively smaller (0.8% of GDP, on average). The uncertainty surrounding output gap estimates tends to be higher in small economies (Di Bella et al., 2015), including Slovenia (see Box 1).

Considering the volatility of estimates, the role of the structural balance as a principal indicator of the fiscal policy stance and the consolidation effort should be interpreted with caution and needs to be clearly defined in the implementing acts. Depending on the methodology for calculating the output gap, the estimates will also vary and differ between institutions in the future, which will impact the assessments of the country's structural balance. Fiscal policy should recognise this uncertainty and deal with it by systematic measures in order to prevent inappropriate or biased use of the fiscal rule. Fiscal rules based on uncertain output gap estimates should therefore be complemented by rules that regulate this uncertainty, for example, by means of a "control account" as in the German federal state of Hessen, where – if the cyclical component is not balanced over the course of the economic cycle – the ceiling of the cyclical/structural balance for the next period is corrected accordingly through a control account. An additional estimate of the general government balance, one not based on output gap estimates, is also welcome (i.e. a bottom-up assessment of the fiscal effects of individual measures).

As all fiscal rules have their strengths and weaknesses, a consistent combination of rules tends to be more effective that either rule alone, but this can reduce transparency and make monitoring even more difficult. The upgrade of the fiscal rules from the Maastricht Treaty by reforming the Stability and Growth Pact and, in particular, the Fiscal Compact represents a substantive improvement. The rules have become stricter, but also more flexible. The fiscal rule that is defined as a structural deficit meets the criteria for the effectiveness of fiscal rules to a greater extent than the general government deficit ceiling of 3% of GDP, which can be strongly

Table 3: **Strengths and weaknesses of fiscal rules in the EMU**

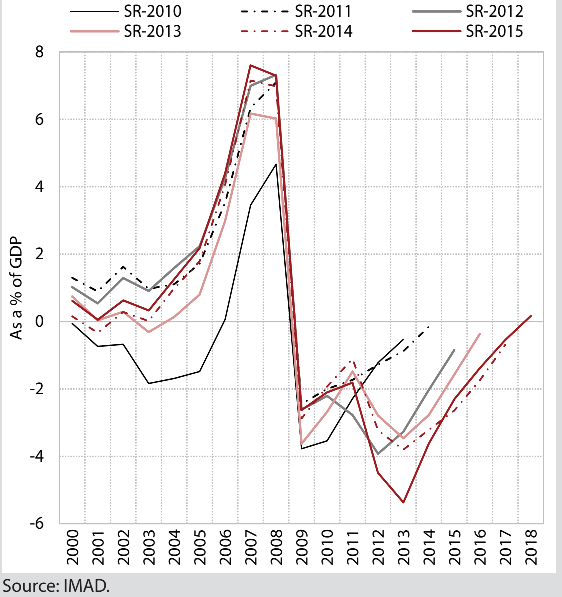
Rule	Strengths	Weaknesses
Budget balance rule	Clear operational guidance Closely linked to the final goal (debt sustainability) Easy to communicate and monitor	No economic stabilisation feature The deficit could be affected by developments outside the control of the government (e.g. a major economic downturn)
Structural budget balance rule	Relatively clear operational guidance Closely linked to the final goal (debt sustainability) Economic stabilisation function (accounts for the economic cycle) Allows to account for one-off and temporary factors	Correction for cycle is complicated, especially for countries undergoing structural reforms Need to pre-define one-off factors to avoid their discretionary use Complexity makes it more difficult to communicate and monitor Volatility of potential GDP calculations impacts transparency and requires caution in interpretation
Debt rule	Easy to communicate and monitor Directly linked to the final goal (debt sustainability)	No clear operational guidance in the short run Can be pro-cyclical May encourage creative accounting Debt could be affected by developments outside the control of the government
Expenditure rule	Clear operational guidance Allows for economic stabilisation Contains growth in government expenditure Relatively easy to communicate and monitor	Not directly linked to the final goal (debt sustainability) Could lead to unwanted changes in the distribution of spending and shifts to spending categories that are not covered by the rule

Source: Schaechter et al., 2012.
Note: The table includes only those rules that are included in the Fiscal Compact; among the deficiencies of the structural budget balance rule, the volatility of potential-GDP calculations is added on the basis of IMAD's estimate.

Box 1: **The variability of output gap estimates for Slovenia**

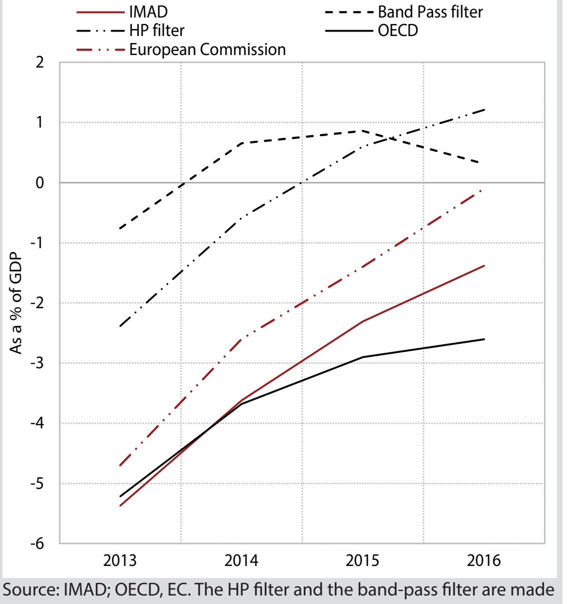
As a result of the methodological characteristics of the calculation, the output gap estimates for Slovenia have also been very volatile in the past years. The IMAD's estimate of the output gap[1] for 2013 from spring 2010 and 2011 indicated a significant decline in the output gap. Later on, the estimate of the output gap increased to more than 3% of GDP while, according to the most recent estimate, the output gap in 2013 totalled 5.4% of GDP (see Figure 3). The revisions of output gap estimates for other years were also not negligible. International institutions also revised their output gap estimates for Slovenia. The average revision[2] of the output gap estimates for 2009–2013 in OECD estimates[3] was thus 0.9%, in IMAD's estimates 1.1% and in EC estimates 1.6%.

Figure 3: **Changes to the IMAD's estimates of the output gap (according to the production function method) for Slovenia, as a % of GDP**



Source: IMAD.

Figure 4: **Estimates of the output gap for Slovenia, spring 2015, as a % of GDP**



Source: IMAD; OECD, EC. The HP filter and the band-pass filter are made using the Spring Forecast of Economic Trends by IMAD (2015a).

The current estimates of the output gap for Slovenia made by different institutions also differ significantly and indicate differences in the size of the output gap and the speed with which it is narrowing. In addition to IMAD, OECD and EC estimates, Figure 4 also shows estimates obtained by two univariate methods: the HP filter and the Band Pass filter. Both univariate methods indicate a smaller negative output gap in 2013. In 2015 and 2016 the output gap is already positive according to both methods. On the other hand, the calculations by the OECD, the EC and IMAD indicate a significant negative output gap in 2013 and its gradual decline in the following years. The decline is the steepest according to the EC estimate and the least steep according to the OECD estimate, while the IMAD's estimate is approximately between the two. The OECD and IMAD estimates for 2013 and 2014 are similar, but the OECD estimate for 2015 and 2016 shows a larger negative output gap. Amid a lower forecast for growth, this is a consequence of the OECD's higher estimate of growth in potential GDP. Compared with the EC estimate, the wider output gap according to IMAD is explained by a slightly higher estimate of potential GDP growth and a lower estimate by IMAD of the NAWRU for Slovenia.

Different output gap estimates imply different estimates of the structural balance of the country. The estimates of the structural balance based on univariate methods for calculating the output gap imply a significantly larger structural deficit in 2013–2013 than the estimates according to the methods by the EC, OECD and IMAD. These estimates also differ. IMAD and OECD estimates of the structural deficit in 2013 and 2014 are similar due to similar estimates of the output gap, while their estimates for 2015 and 2016 differ, which is, in addition to different estimates of the output gap, also a consequence of differences in the forecasts for fiscal aggregates. The structural deficit in 2013 and 2014 as estimated by the EC is higher than IMAD's estimate due to a smaller output gap, while the dynamics in the following years also reflect differences in the forecasts for fiscal aggregates.

[1] IMAD assesses potential GDP and the output gap using a structural method based on a production function approach in accordance with the methodology approved by Ecofin and used at the EU level since 2002.
[2] A comparison between the first estimates for the previous year (from the forecasts prepared by the institutions in the spring: IMAD in March, the European Commission in May and the OECD in June) and the latest estimates available.
[3] The OECD estimates for the 2010–2013 period.

Box 2: **The role of fiscal rules in achieving fiscal targets – the cases of Switzerland and Sweden**

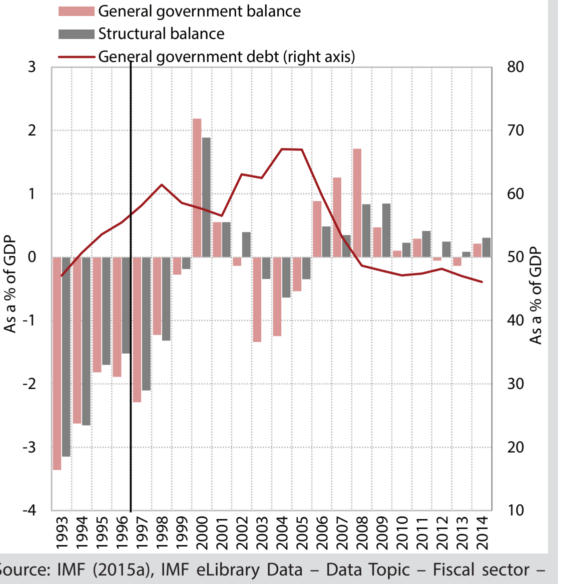
The box presents experiences regarding the achievement of fiscal goals based on fiscal rules in Switzerland and Sweden. Although some other countries have a longer tradition in implementing fiscal rules (for example, the Netherlands since 1961, Canada since 1992, the United Kingdom since 1997), these two countries stand out in terms of the pace of their fiscal improvement. Switzerland and Sweden were among the few countries where in the period of highly volatile economic activity (2005–2012) the debt-to-GDP ratio declined by more than 10 percentage points of GDP. However, the favourable fiscal developments in these countries are not due only to the fiscal rules. Among other things, Switzerland and Sweden can pursue an independent monetary policy, which, particularly in Sweden, took care of the competitiveness of the economy through a significant devaluation of the domestic currency after the onset of the crisis in the first half of the 1990s. Both countries also carried out structural reforms in the early years of the crisis and have favourable indicators of long-term fiscal sustainability.

The experiences of these two countries reveal that the introduction of fiscal rules must be supported by a broad-based consensus in society, that the effects of fiscal rules manifest over the longer term, and that any occurrence of short-term deviations needs to be properly evaluated. It has been proven that in order for a fiscal rule to be effective, it should be transparent, simple and thus verifiable. In this way, the governments of both countries therefore managed to gain broad support from the general public. In both Switzerland and Sweden a gradual, but pragmatic approach to assessing the implementation of the fiscal rule (e.g. the approach of the Swedish Fiscal Policy Council and the Swedish government after 2011) has proved to be a major factor in achieving the fiscal targets. Such approach should, to the greatest possible extent, take into account the long-term or at least the medium-term perspective of pursuing fiscal targets and thus avoid pro-cyclical fiscal policy actions. The introduction of fiscal rules also changed the budget preparation procedure, as the expenditure ceiling was set in advance. It also meant a transition from a short-term towards a medium-term timeframe for budget preparation. At the same time, the economic conditions over the past 15 years in both Switzerland and Sweden – with the exception of a few years during the crisis – have transpired to be more favourable than expected during the process of budget preparation. The consequent underestimation of revenue and the resulting lower level of expenditure planned have therefore made it easier for these countries to pursue and meet their fiscal targets.

Switzerland added the fiscal rule to its constitution in 2000. The fiscal rule, meant to contain debt ("debt-brake"), was approved with a large majority in a referendum in 2001 and started to be implemented in 2003. The Swiss fiscal rule is based on ensuring a structurally balanced budget by allowing the actual balance to fluctuate over the economic cycle at federal level.[1] The business cycle is determined by a modified HP filter.[2] The fiscal rule sets the nominal expenditure ceiling for the year ahead based on the forecasts for cyclically adjusted revenues. This means that if the general government budget is balanced, nominal public debt does not change over the business cycle or in the long term, and its share in GDP falls over time. If extraordinary events occur that increase the deficit, the deficit may be reduced gradually.

The introduction and adherence to the fiscal rule significantly contributed to the stabilisation of the Swiss fiscal position. Given its nature, the effectiveness of the fiscal rule in Switzerland is measured in terms of a decline in the debt-to-GDP ratio. Switzerland did not even have high public debt before the implementation of the fiscal rule, but it was increasing rapidly. Between 1990 and 1998, the total public debt as a share of GDP rose from around 35% to 54%, primarily owing to the rising public debt at federal level, which more than doubled in that period (to around 28% of GDP). As a result of the economic crisis in the second half of the 1990s, and consequent one-off government expenditures, the introduction of the fiscal rule did not

Figure 5: **Balance, structural balance and general government debt, Switzerland**



Source: IMF (2015a), IMF eLibrary Data – Data Topic – Fiscal sector – Government Finance Statistics.
Note: The vertical line denotes the year when the fiscal rule was introduced.

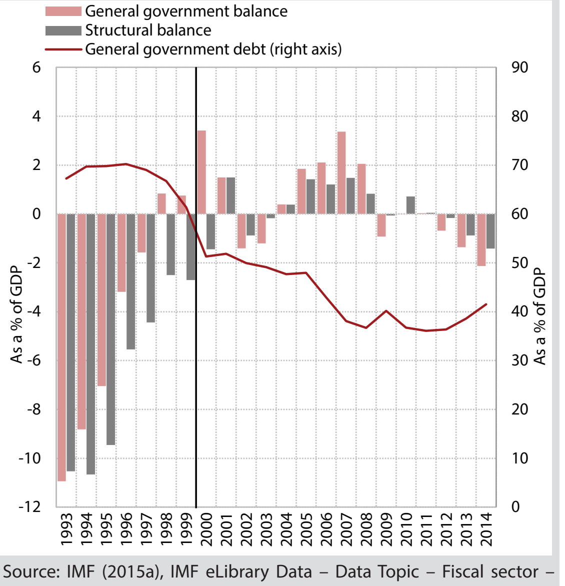
[1] At the same time, the majority of Switzerland's cantons also committed themselves to complying with the fiscal rules.
[2] The modification of the HP filter is related to the problem of its bias at the end of the estimated sample. This end-point problem has been dealt with by a modification of the weights within the filter, instead of only extending the GDP series by forecasts (Bruchez, 2003).

show in a decline in the share of total public debt immediately.[3] This decline became more notable only after 2005 and reached 45% of GDP in 2013 (federal debt: 22% of GDP). The decline in the share of public debt was otherwise also attributable to favourable economic activity, but the cyclically adjusted balance has been positive in the entire period since 2005 and the fiscal policy turned very counter-cyclical after the debt brake was introduced (e.g. Beljean and Geier, 2012; and Bundesrat, 2013).

The Swedish parliament adopted a legislative package in 1997 which included fiscal rules for various levels of the government. The rules were last changed in 2010, and the government has been required to use the expenditure rule ever since. The fiscal rule for the general government budget requires a surplus of 1% of GDP on average over the business cycle.[4] The surplus is to a large extent tied to another, expenditure, rule. This applies to the central government and the pension fund and determines nominal primary expenditure ceilings for both accounts for three years in advance. The third rule refers to local governments and requires that, if a local government falls into deficit, it recovers the budget balance within three years.

The effects of the introduction of the fiscal rule in Sweden were positive, although some negative deviations have been witnessed in recent years. The high level of general government debt, which exceeded 70% of GDP and was significantly affected by the consequences of the banking and financial crisis in the first half of 1990s, fell to around 40% of GDP by 2014. A survey of fiscal rules at all levels shows that they were generally complied with both before and during the global financial crisis, with the exception of the entire period since 2011, when the general government balance has been in deficit. This is a result of the deteriorated economic situation and higher levels of some social transfers owing to increased immigration costs and lower tax rates amongst other factors. The estimates (e.g. Sweden's Convergence Programme, 2015) of the – not yet fully specified[5] – rule on achieving a general government surplus over the business cycle indicate that during the last business cycle the fiscal position in Sweden deviated from fiscal rule targets. Despite a concurrent proposal of the government to raise the previously established expenditure ceilings (Sweden's Convergence Programme, 2015), the Swedish Fiscal Policy Council (Fiscal Policy Council, 2015) saw no need to modify the fiscal rules, but was nevertheless of the opinion that the fiscal policy approach of only a gradual reduction of the deficit over the next few years was inappropriate.

Figure 6: **Balance, structural balance and general government debt, Sweden**



Source: IMF (2015a), IMF eLibrary Data – Data Topic – Fiscal sector – Government Finance Statistics.
Note: The vertical line denotes the year when the fiscal rule was introduced.

[3] Public debt also fell slightly in nominal terms: from a maximum of around CHF 130 bn in 2005 to around CHF 115 bn in 2013.
[4] The original rule targeted a structural surplus of 2% of GDP, but this rule was changed in 2006 due to the new methodology, which transferred part of the pension system into the private sector.
[5] When the fiscal rules were introduced, the indicators of their effectiveness were not yet fully defined. They were formulated only gradually or have changed over time. Owing to their complexity, it was difficult to evaluate the fiscal rules, meaning that the structural surplus rule was subject to criticism and demands for change, both by the audit office and by the fiscal council. A typical example is the general government surplus target over the business cycle. As the "business cycle" is not defined in the legislation, the attainment of the "structural" surplus target is currently assessed by means of several equally important indicators. See, for example, Boije and Kanelainen (2012) or the Swedish Convergence Programme (2015).

affected by cyclical and one-off factors. The introduction of an expenditure rule, which facilitates more direct targeting by fiscal policy measures, is also appropriate. The introduction of an expenditure rule is also envisaged by the Fiscal Compact, but since the expenditure rule is defined in relation to trend GDP growth in the Fiscal Compact, it is also sensible to consider other options. In the Economic Survey of Slovenia 2015, the OECD recommended that Slovenia adopt a credible and transparent expenditure rule (to complement the balanced budget rule), which can be more directly targeted and is less uncertain than the cyclically adjusted balance. As a possibility of such rule, the OECD stated a multi-year nominal expenditure ceiling, putting forward Denmark, Finland, the Netherlands and Sweden as examples of how structural budget balance rules can be effectively combined with expenditure rules. According to the OECD (2015), such an expenditure rule, together with medium-term budgetary objectives based on the Fiscal Compact, could provide a good basis for a sustainable medium-term fiscal framework. In addition to the expenditure rule, it would also be sensible to introduce a rule providing for more stringent monitoring of debt sustainability, which is also the ultimate goal of fiscal policies. However, the proliferation of binding rules increases the complexity of the coordination mechanism, reduces the simplicity and transparency of fiscal rules and makes it difficult to monitor their implementation.

1.3 Fiscal policy surveillance in EU Member States

1.3.1 The role and tasks of independent fiscal institutions in the EU

The recent strengthening of the EU fiscal framework set the basic requirements for independent fiscal institutions, the main goal of which is to foster budgetary discipline, at the national level. Independent fiscal institutions are an important link between fiscal rules at the EU level and national rules and practice.[22] Some EU Member States have had independent fiscal institutions in place for decades (e.g. the Netherlands, Denmark and Belgium), but most have only had independent fiscal institutions established, or thoroughly reformed, in recent years. This was related to the economic and sovereign debt crisis, and the strengthening of the EU fiscal framework by stipulating the basic requirements for independent fiscal monitoring at the Member State level. The main goal of establishing independent fiscal institutions is to increase budgetary discipline, which can be achieved through different channels, such as: the direct impact of their (otherwise non-binding) public assessments and recommendations on fiscal policy, the preventive effect of the possibility of their interventions on the decisions of fiscal authorities, and an indirect impact on other monitoring institutions (court of auditors, other courts and the parliament) towards greater commitment and accountability.[23]

According to the EU legislation, independent fiscal institutions monitor compliance with fiscal rules and the functioning of the corrective mechanism, produce or endorse macroeconomic forecasts, and publicly release their assessments. Independent fiscal institutions, such as fiscal councils, are defined as non-partisan public bodies other than the central bank, government or parliament. They are financed primarily by public funds and are functionally independent from fiscal authorities.[24] Under EU legislation and the Fiscal Compact, the role and tasks of (at least functionally) independent fiscal institutions are:[25]

- To enhance the transparency of elements of the budgetary process;
- To effectively and promptly monitor (*ex ante* and *ex post*) compliance with the numerical fiscal rules, which promote compliance with the reference values of deficit and debt in the EU (3% of GDP and 60% of GDP, respectively) and adherence to the medium-term budgetary objectives of the government, based on reliable and independent analysis;
- To monitor compliance with the structurally balanced budget rule from the Fiscal Compact and the adjustment path towards meeting the medium-term fiscal objective of the Member State concerned;
- To release public assessments of compliance with all national fiscal rules;
- To monitor and support the credibility and transparency of the correction mechanism by providing public assessments: (i) over the occurrence of circumstances leading to the activation of the correction mechanism; (ii) of whether the budgetary correction is proceeding in accordance with national rules and plans; and (iii) over the occurrence of circumstances for triggering, extending or exiting escape clauses;
- To prepare or confirm the macroeconomic forecasts underlying the budgetary planning process.

The basic pillars of their effectiveness are an appropriate institutional model, clearly defined remits and accountability, independence from political interference, sufficient resources and effective communication with the public. In accordance with the common principles at EU level,[26] a high degree of functional autonomy and effectiveness should be ensured by:

- An appropriate statutory regime, a clearly defined mandate and the accountability of independent fiscal institutions;
- Nomination procedures based on experience and competence;
- Suitable access to the information required to carry out their mandate;
- Adequacy of resources;
- Freedom from interference – independent fiscal institutions shall not take instructions from budgetary or other authorities;
- Capacity to communicate with the public in a timely manner.

Furthermore, the design of these institutions should be consistent with the existing institutional setting and the country-specific administrative structure. Their effectiveness is to be further enhanced by introducing a "comply or explain" principle, according to which the government is obliged to comply with, or alternatively explain publicly, why it is not following the assessments and recommendations of independent fiscal institutions.

[22] At the EU level, fiscal councils interact formally and informally. The recently released report of the presidents of five European institutions titled Completing Europe's Economic and Monetary Union envisages the further strengthening of the current fiscal governance framework at the European level through the creation of a European fiscal board (Juncker et al., 2015). This would coordinate and complement the national fiscal institutions, *inter alia*, by providing an independent assessment of the fiscal situation in the EU.

[23] See EC (2014, pp. 54–56) and ECB (2014, pp. 96–99).

[24] Courts of auditors are included in this definition only if their activities extend beyond accounting control and cover any of the aforementioned tasks (EC, 2015b).

[25] Directive 2011/85/EU (Articles 2f, 5 and 6), Regulation (EU) No. 473/2013 (Article 5), The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (Chapter, III) and Communication from the Commission COM (2012) 342 final, 20 June 2012.

[26] Common principles on national fiscal correction mechanisms, Communication from the Commission COM (2012) 342 final, 20 June 2012.

Box 3: **General definitions of independent fiscal institutions and the principles of their operation**

According to Debrun et al. (2013, p. 8), a fiscal council is a permanent agency with a statutory or executive mandate to assess, publicly and independently from partisan influence, the government's fiscal policies, plans and performance against macroeconomic objectives related to long-term fiscal stability, short- and medium-term macroeconomic stability, and other official objectives. A fiscal council may also perform one or more of the following functions: (i) contribute to the use of unbiased macroeconomic and budgetary forecasts in budget preparation; (ii) identify sensible fiscal policy options and formulate recommendations; (iii) facilitate the implementation of fiscal policy rules; and (iv) cost new policy initiatives.

According to the OECD (2014, p. 1), independent fiscal institutions (referred to as fiscal councils or independent parliamentary budget offices) are publicly funded, independent bodies under the statutory authority of the executive or the legislature that provide non-partisan oversight and analysis of, and in some cases advice on, fiscal policy and performance. The core values of independent fiscal institutions are:
- independence,
- non-partisanship,
- transparency,
- accountability.

The quality of their work is crucially dependent on the high level of technical competence of their members.

The OECD Council (2014) formulated the principles of the functioning of independent fiscal institutions, which reflect the experience to date and good practices in a number of EU Member States. The principles, which refer to nine areas, are:
1. **National ownership of fiscal institutions**, which means broad consensus across the political spectrum, commitment and taking into account the local institutional framework;
2. **Independence and non-partisanship of fiscal institution members:** (i) to avoid even the perception of partisanship, their remit should not include any normative assessments of or proposals for policy measures; (ii) members should be selected on the basis of merit and technical competence, which should be clearly communicated to the public; (iii) their term should be independent of the electoral cycle; (iv) at least the head of the institution should be employed full-time, while for members employed on a part-time basis strict conflict-of-interest standards should apply; and (v) the leadership should have full freedom to hire and dismiss staff in accordance with applicable laws and through open competition;
3. The **mandate of the fiscal institution** should be clearly defined in legislation, including the general types of reports and analysis they are to produce. They should have the scope to produce reports and analysis at their own initiative, and the autonomy to determine their own work programme within the bounds of their mandate, with clear links to the budget process established within the mandate;
4. The **resources allocated to fiscal institutions** should be commensurate with their mandate. The appropriations should be treated in the same manner as the budgets of other independent bodies (such as audit offices);
5. **Accountability of the fiscal institution to the legislature should be clearly defined by law**, which can be achieved in several ways: by (i) submission of its reports to parliament in time to contribute to relevant legislative debate; (ii) appearance of its leadership or representatives before the budget committee (or equivalent); (iii) parliamentary scrutiny of the fiscal institution's budget; and (iv) a role for parliament's budget committee (or equivalent) in appointing and dismissing the fiscal institution's leadership.
6. **Full access to all relevant information in a timely manner**, including methodology and assumptions underlying the budget, which should be defined in legislation and, if necessary, reaffirmed through protocols or memoranda of understanding.
7. **Full transparency in work and operations of the fiscal institution**, meaning that its reports and analysis should be published and made freely available to all, the release dates of regular reports being formally established in advance;
8. **Effective communication channels with media, civil society, and other stakeholders** from the outset of its operation;
9. **External evaluation of its work**, which should be conducted by local or international experts.

The number, size, composition, remit and position of independent fiscal institutions differ across the EU. In some countries (e.g. in Austria, Belgium, the Netherlands and, partly, in Germany), the tasks of independent institutions, as defined in the EU fiscal framework, are dispersed among several institutions, of which only one (i.e. the fiscal council) is usually responsible for monitoring compliance with the numerical fiscal rules. In other countries, the majority of tasks are carried out by one fiscal council, which can also be assigned other tasks. The EU countries that have yet to establish a fiscal council are the Czech Republic, Poland and Slovenia (for more on the fiscal council in Slovenia see Chapter 1.4), while Greece, Malta and Bulgaria have recently adopted a legal basis for its establishment. The mandates of the existing fiscal institutions in some countries are not fully consistent with EU rules, particularly the Two-Pack from 2013. One of the possible classifications of fiscal institutions in the EU is shown in Table 4.

The legal provisions and established practices of some countries assign to fiscal councils a wider set of tasks than required at the EU level. In addition to performing tasks required by EU legislation, some fiscal councils (especially the larger ones) analyse their long-term fiscal sustainability, evaluate the costs of planned policy measures, assess the financial situation of state-owned enterprises, prepare fiscal forecasts, issue normative assessments and fiscal policy recommendations, and produce other economic analyses (EC, 2014a, p. 65). In order to ensure that these tasks are performed to a high standard, fiscal councils should be adequately staffed with highly qualified experts, whose effectiveness is also dependent on the credibility and reputation of the fiscal council among the general public.

1.3.2 Independent fiscal institutions in selected Member States

We have focused on the traditional and newly established fiscal institutions of six EU Member States. The following Member States have been analysed: (i) Austria, Belgium and the Netherlands where, as is the case in Slovenia, macroeconomic forecasts for budgetary planning are prepared by independent institutions; (ii) Slovakia and Latvia, two smaller post-socialist Member States; and (iii) Germany, the largest EU Member State. We have therefore covered not only independent and long-established fiscal institutions (in Austria, Belgium, the Netherlands and, to an extent, Germany) but also newly created fiscal councils (in Slovakia and Latvia). Alongside the fiscal councils monitoring compliance with the numerical fiscal rules, those countries with several fiscal institutions also have other independent fiscal institutions which carry out analytical and advisory tasks (e.g. the Austrian WIFO, the Belgian FPB, the Dutch CPB and the German Council of Economic Experts and the Joint Economic Forecast Project Team). The typical features of the independent fiscal institutions in the countries selected are summarised in Table 5; some countries (particularly Germany and the Netherlands) also have other advisory bodies in addition to these institutions (Appendix 1).

Table 4: **A tentative typology of independent fiscal institutions (IFIs)**

The forecasting-only institutions (well-established institutions, but only recently included in the fiscal framework)	**The assessing-only entities** (relatively new in fiscal assessment)
– Assigned forecasting tasks – Mandate for other non-conflicting technical tasks – Well-established institutions with a large number of staff – De facto autonomy within the government deriving from technical expertise For example: *the Dutch CPB, the Austrian WIFO, the Slovenian IMAD**	– Specialised in ex-post assessment of compliance with fiscal rules – Smaller staffing – Embedded in hosting entities – Benefiting from their resources and authority – Need for internal arrangements to ensure independent operation For example: *the Dutch Council of State, the Finnish Court of Auditors*
The Fiscal Councils (often established in recent years under the impact of the strengthening of the EU fiscal framework)	**The advanced fiscal councils** (often recently established in Member States with greater fiscal consolidation needs)
– Mandate excluding non-fiscal policy related issues, generally focussed on periodic fiscal policy and rule assessment (mandate significantly influenced by EU reforms) – Smaller teams of skilled personnel – Stand-alone bodies For example: *the Swedish Fiscal Policy Council, the Irish Fiscal Advisory Council*	– Broad and multi-faceted mandate encompassing forecasting and fiscal policy/rules assessment – Stand-alone institutions with a large number of staff For example: *the Portuguese Public Finance Council*

Source: Pench (2014, pp. 19–20).
Note: * Added by IMAD.

Table 5: **Characteristics and tasks of the main functionally independent fiscal institutions in selected EU Member States**

Member State	Fiscal councils[1] and other institutions	Source of funding	Number of members/total number of persons[2]	Appointment/ election	Monitoring compliance with numerical fiscal rules		Macro-economic forecasts[3]			"Comply or explain" principle[4]
					Fiscal rules	Correction mechanism	P	E	A	
Austria	Fiscal Council[1]	Central bank	15 members/ 21 persons	Government and non-governmental institutions	✓	✓				
	Austrian Institute of Economic Research WIFO	Private, market	Around 100 persons				✓			
Belgium	High Council of Finance[1]	Federal Public Service (FPS) Finance	3 members of the presidency, 24 other members/ at least 41 persons	The government or the minister and the king (on a proposal of reg. governments, ministers and the central bank)	✓	✓				✓[5]
	Federal Planning Bureau (FPB)	State budget	Around 90 persons	Commissioner: prime minister, minister of economic affairs and the king			✓			
Latvia	Fiscal Discipline Council[1]	State budget	6 members/ 9 persons	Parliament (simple majority)	✓	✓			✓	✓
Germany	Stability Council (with an independent advisory board)[1]	Federal and state budgets	Board: 9; members/ Council: more than 30 persons, depending on the area under consideration	Government, central bank and other institutions	✓	✓	✓			
	Joint Economic Forecast Project Team	Ministry of economic affairs	60 experts	Members are representatives of leading economic institutes			✓[6]			
Netherlands	Council of State – Advisory Division[1]	State budget	Members of the Division: 27/Council: over 600	Council: king (Division: N/A)	✓	✓				✓
	Central Planning Bureau (CPB)	Ministry of economic affairs	Close to 150 persons (around 120 full-time employees)	Director: government			✓			
Slovakia	Council for Budget Responsibility[1]	Central bank	3 members; 20 persons	Parliament (3/5 majority)	✓	✓				
	Financial Policy Institute	Ministry of finance	Macroeconomic Forecasting Committee: 10 members; Tax Revenue Forecasts Committee: 18 members	Ministry of finance, representatives of banks, the statistical office, academics, towns, employers and trade unions				✓		

Source: ECB (2014, p. 97), EC (2014, p. 62), Debrun and Kinda (2014, pp. 16–17), Burret and Schnellenbach (2013, p. 20), OECD (2012), completed by IMAD.
Notes: The fiscal frameworks and institutions in individual Member States are described in Appendix 1.
[1] A fiscal council in charge of monitoring compliance with numerical fiscal rules.
[2] Total number of members, including technical and other support staff (whether full- or part-time employees).
[3] P – Preparation, E – endorsement, A – non-binding assessment.
[4] Only for fiscal councils, i.e. independent fiscal institutions that issue assessments and recommendations regarding compliance with fiscal rules.
[5] The designation (✓) for Belgium means that the rule is observed in practice, although it is not included in the country's legislations.
[6] Only for the draft annual budget. The medium-term budgetary plan in the Stability Programme is based on federal government forecasts.
[7] The Advisory Division includes two consultants specialised in monitoring compliance with the fiscal rules of the EU, who perform their tasks with analytical support from the CPB.

The mandate of the fiscal councils in these countries goes beyond monitoring compliance with the numerical fiscal rules, with the exception of the Dutch council, whose tasks are complemented by the Netherlands Bureau for Economic Policy Analysis (CPB). In all the countries analysed, except the Netherlands, the fiscal councils are also in charge of fiscal and other economic analyses. In some countries, they are also responsible for assessing the quality and long-term sustainability of the public finances. In the event of deviations or potential deviations from the budgetary objectives, the councils usually formulate recommendations for fiscal policy measures. The Advisory Division of the Dutch Council of State, as a fiscal council, specialises in the *ex-ante* and *ex-post* surveillance of compliance with numerical rules and the functioning of correction mechanisms, in close cooperation with the Central Planning Bureau (CPB), which also performs other tasks arising from the EU fiscal framework. The reports and analyses of all fiscal councils are publicly available.

One of the main tasks of fiscal councils and other independent institutions is to prepare, endorse and assess the macroeconomic forecasts that serve as the basis for budgetary planning. In Austria, Belgium and the Netherlands, budgetary planning relies on forecasts of economic trends provided by independent institutions other than fiscal councils (the WIFO, FPB and CPB). In Latvia, Germany and Slovakia, the forecasts are prepared by the government or the ministry of finance. In Latvia, the fiscal council assesses the government forecasts, but the assessments are not binding. In Slovakia, the forecasts by the ministry are endorsed by the Macroeconomic Forecasting Committee and the Tax Revenue Committee, which operate within the ministry of finance as functionally independent project units (with external members). The German government compares its projections, which serve as the basis for the its medium-term budget plans, against an independent forecast prepared twice a year by leading research institutions; in the preparation of a multi-year tax revenue forecast, it is advised by the independent Working Party on Tax Revenue Forecasting, while its annual draft budgetary plan relies on the Joint Economic Forecast (JEF) prepared by leading research institutions.

Some countries also have other independent fiscal institutions with an analytical and advisory role. Alongside macroeconomic forecasts, the Austrian WIFO, the Belgian FPB and the Dutch CPB also produce analyses of public finances and a range of other areas. The CPB, which has a large number of staff, assesses the budgetary impacts of proposed measures and makes cost-benefit analyses of infrastructural projects. It also assesses the economic effects of the policy programmes of political parties before the elections, and the feasibility of measures included in the coalition agreement. In addition to the fiscal council and the CPB, the Netherlands also has other institutions involved in this capacity: the Advisory Group on Fiscal Policy, which gives non-binding recommendations to the government regarding fiscal targets and principles, the Working Groups on Spending Reviews and, if required, the Tax System Study Committee. Germany also has a network of fiscal institutions in place. Besides the above-mentioned institutions and groups, there are the Advisory Board to the Federal Ministry of Finance, which advises on fiscal policy matters, and the German Council of Economic Experts, which provides annual reports on the state of and prospects for the German economy and a range of other economic topics.

In some countries independent fiscal institutions have their own budgets; in several countries the fiscal councils are attached to another institution. In two of the six countries analysed, the fiscal councils have separate budgets; the Fiscal Discipline Council in Latvia is financed directly from the state budget, while the German Stability Council is funded from the federal and state budgets. The fiscal councils of Austria, Belgium and Slovakia operate as functionally independent units within the central bank or government offices, whereas the fiscal council in the Netherlands evolved within the Council of State.[27] The parent institutions provide fiscal councils with the resources required in order to operate and to provide professional and administrative support. The financing of other independent institutions also differs across countries: for example, the Austrian Institute of Economic Research (WIFO) is privately owned, the Belgium FPB is financed from the state budget, and the Dutch CPB operates within the ministry of economic affairs.

Most of the fiscal councils analysed are medium-sized; their members are appointed by the government and non-governmental institutions, or elected by the parliament. The size of independent fiscal institutions varies across countries. Latvia has the smallest fiscal council, which is comprised of nine persons: six members and three other members of staff working in the secretariat. The fiscal councils in Austria, Belgium, Germany and Slovakia consist of 20 to 50 persons including the members (who are often external consultants) and support staff. In the Dutch Advisory Division of the Council of State, there are currently two fiscal monitoring specialists, but they have strong analytical support from the CPB (with more than 120 employees) and administrative and technical support from the Council of State (over 600 employees). The Austrian WIFO and the Belgian FPB both have close to 100 employees, and both institutions, like the CPB, prepare macroeconomic forecasts and fiscal and other analyses. In Austria and Germany,[28] some fiscal council

[27] The Advisory Division of the Council of State has functioned as a fiscal council in the Netherlands since 2014 (see Appendix, 1). The CPB is otherwise often referred to as the Dutch Fiscal Council. It performs a number of tasks assigned to independent fiscal institutions by the EU fiscal framework, but is not responsible for monitoring compliance with the numerical fiscal rules of the EU referred to in the national legislation.

[28] For Germany, the independent Advisory Board to the

members are appointed by the government and the rest by local authorities and non-governmental institutions (the central bank, independent institutions, the economic chamber or trade unions). The Belgian fiscal council is chaired by the minister of finance, who appoints two deputy chairs, while other fiscal council members are nominated by the king on the proposal of the central bank, ministers and regional governments. In Latvia and Slovakia, the number of council members is smaller. They are elected by their respective parliaments – in Latvia by a simple majority upon the proposal of members of the parliament, and a joint proposal of the governor of the central bank and the minister of finance, and in Slovakia by a qualified majority (3/5)[29] upon the proposal of the government, the central bank and the president of the state.

The fiscal council members are often external consultants supported by permanent expert teams. The members of the fiscal councils in Austria, Belgium, Latvia and Germany are external experts who are employed in other institutions. In Slovakia, fiscal council members are consultants, who can be full-time employees (in 2015, two of the three members were full-time consultants) or work part-time. Fiscal council members are assisted by a secretary (or a secretariat) and an expert team, or, in the small fiscal council in Latvia, two experts in addition to the secretary.

In none of the six countries (or any other euro area country) are the recommendations of the fiscal council binding for the government. Fiscal councils can nevertheless be important institutions, as they can make the fiscal situation and developments more transparent, raise awareness of economic policy-makers, shape public opinion, and thereby indirectly impact fiscal policy. Their effectiveness could be augmented by introducing a "comply or explain" clause in the national legislation (in line with the Fiscal Compact). This clause has already been adopted by Latvia and the Netherlands, while the governments in the other four countries studied are not obliged to respond to the recommendations of their fiscal councils. In Belgium the government nevertheless tends to refer to them in its reports, while in Germany they are discussed in parliament.

1.3.3 Challenges to establishing fiscal surveillance in EU Member States

The key tasks of independent fiscal institutions and the principles of their independence and effectiveness are defined in EU legislation, while the organisational structure and a detailed specification of tasks remain the responsibility of Member States. Given the diversity and short history of fiscal councils in a number of EU Member States, it is still too early to draw general conclusions about their effectiveness, but it is possible to highlight some elements and solutions that have proved to be high risk from the perspective of the effectiveness of fiscal surveillance thus far.

Fiscal councils that are not sufficiently embedded into the existing institutional framework and lack political and public support can be susceptible to pressures on their independence and effectiveness. As seen from experiences to date, one of the conditions for the proper functioning of fiscal councils is their integration into the existing institutional set-up and their acceptance by the political establishment and the general public. If this is not achieved, fiscal councils may be subject to pressures which can compromise their independence and effectiveness. A frequently cited example of a fiscal council that was not accepted by the government is the fiscal council in Hungary, where in 2011 the government weakened the fiscal council established by the previous government[30] by reducing its funding and staff, narrowing its mandate and restricting access to information (Kopits, 2011, p. 5; Hageman, 2011, p. 86).

The politically motivated appointment of members, insufficient staffing and uncertain funding represent further risks to the independent and effective operation of a fiscal council. In most EU countries at least some fiscal council members are appointed by the government or elected in the parliament (ECB, 2014, p. 97). In the first case, in particular, it is difficult to justify their independence from the executive authority, while in the second case their impartiality could come into question if they may be elected with (only) a simple majority of votes. The effectiveness of the council otherwise relies on its functional independence and autonomy in operation. This is more likely if: (i) the council consists of non-partisan and highly qualified experts nominated according to a transparent procedure; (ii) the council has access to current data and information; and (iii) the council has a secure budget with regard to the responsibilities conferred. The fiscal council in Hungary, for example, thus faced cuts in funding that coincided with the critical assessment of fiscal policy, and the stability of fiscal council financing was also put to the test in Sweden (Kopits, 2011, p. 5; Debrun and Takahashi, 2011, p. 48).

Stability Council has been taken into account, which assesses compliance with the numerical fiscal rules (and not the entire Stability Council).

[29] On the first occasion, a 3/5 majority is required for each member; thereafter, only the vote on the head of the fiscal council requires such majority.

[30] The fiscal council in Hungary commenced operations in 2009. It consisted of three members elected by the parliament for nine years upon the proposal of the president of the state, the governor of the central bank and the president of the audit office. After hearings in the relevant parliamentary committee, they had to be elected by a simple majority in the parliament. In 2010 the new government cut funding for the fiscal council and narrowed its remit, which was purportedly related to the critical assessments of the medium-term budgetary framework of the country and the new government's scepticism about the institutions inherited from the previous government (Kopits, 2011, p. 12).

Attaching the fiscal council to another public institution can have a number of advantages, but can also raise doubts as to its autonomy. An established public institution can provide the fiscal council with the administrative and professional support it requires. It also has connections with other domestic and international institutions, as well as a reputation, which an independent fiscal council would otherwise have to build. Another advantage can be access to up-to-date information and closer participation in the process of budget preparation and execution, which makes it easier for the fiscal council to perform its tasks. However, if the parent institution is not the central bank, the audit office or an independent office but a ministry or an office directly subordinate to the government and tied to its term of office,[31] the connection with the executive authority can be too close and may raise doubts as to the autonomy of the council's work.

Small and independent fiscal councils face staffing and financial limitations, and also have more restricted access to information. Newly established councils, which tend to be smaller and have separate budgets, often have narrower remits than larger institutions. They do not have enough staff and lack the resources to perform more technically demanding tasks such as evaluating the budgetary impact of fiscal policy measures or forecasting fiscal revenue. Their access to relevant information may also be more restricted. Furthermore, their work often takes the form of periodical meetings, as their members are often external experts employed elsewhere and therefore less embedded in the council's area of work. The absence of a permanent analytical team can also seriously inhibit the scope and thoroughness of analyses performed.

Remits and levels of accountability which are unclear and not defined in sufficient detail also pose a risk to the effectiveness of the fiscal council. In addition to the clearly specified remits in accordance with the regulations at the EU level, a clear specification of accountability is also necessary. Both are important guidelines for the operation of the council's members. According to the recommendations of the OECD Council (2014, p. 3), fiscal councils should be accountable to their respective parliaments, for example, in the form of submitting and presenting reports.

Some fiscal councils have yet to establish effective communication channels with the public and still lack the credibility required. This is more frequently the case in recently established institutions than in traditional independent fiscal institutions (Debrun et al., 2013, p. 18). Independent fiscal institutions – monitoring, analytical and advisory – should bring transparency to the fiscal situation and developments, highlight the budgetary consequences of fiscal policy measures, and encourage public debate on risks and other topical issues, thereby indirectly contributing to sustainable and responsible fiscal policy over the long term. In order for fiscal councils to be effective, it is vital that they strive to develop effective channels of communication with the public and media, forge a reputation with the public and strengthen their credibility. This is where the existing independent fiscal institutions with a longer tradition (such as the Austrian WIFO, the Belgian High Council of Finance, the German Council of Economic Experts and the Dutch CPB) have an advantage over their newly established counterparts.

The "comply or explain" principle, which can increase the effectiveness of the council's recommendations, has been introduced in only a few Member States. In addition to analyses and assessments of the fiscal situation and trends (regarding their compliance with numerical rules), some fiscal councils also perform and publish normative assessments and recommendations. Although their recommendations are not binding for the governments, they can have a significant influence on public opinion and, indirectly, fiscal policy as a result. The obligation of the government to react to the recommendations (according to the "comply or explain" principle) is another step towards budget responsibility, but has been introduced – or is being introduced – in only half of the EU's Member States (ECB, 2014, p. 97).

1.4 Challenges to establishing an institutional framework for fiscal policy surveillance in Slovenia

1.4.1 The current institutional framework

The first fiscal council in Slovenia was established in 2009, a few months after the requisite legal basis had been adopted. The legal basis for the establishment of the fiscal council was put in place in June 2009, when the National Assembly adopted amendments to the Public Finances Act (ZJF-E). The legislation defined the fiscal council as a consultative body for the independent assessment of fiscal policy and the implementation of structural reforms. The fiscal council was established in November 2009 as a consultative body within the framework of the Secretariat-General of the Government of the Republic of Slovenia. In accordance with the law, it comprised seven members, each of whom was appointed by the government for a five-year term at the proposal of the minister of finance. Save for the reimbursement of meeting attendance fees and costs, they performed their duties for no payment, but were permitted to take payment for providing their analyses and in-depth opinions. Administrative support was provided by the Secretariat-General, while for analytical work and additional opinions the fiscal council was allowed to sign contracts with its members and other experts.

[31] For example, the Secretariat-General of the Government of the Republic of Slovenia, the tenure of which is directly tied to the tenure of the government.

The Court of Audit highlighted several shortcomings in the operations of the first Slovenian fiscal council. In its report titled Efficiency of the Preparation of Budgets of the Republic of Slovenia for the Years 2010 and 2011 (RS RS, 2012), the Court of Audit of the Republic of Slovenia assessed that the remit of the fiscal council had been disproportionate to the scope of its expert support, which made it difficult for the fiscal council to carry out analysis independently and perform its tasks prescribed by the law. Furthermore, its independence was compromised given that it was financed from the government services budget. Therefore, the Court of Audit took the view that there was a risk that the fiscal council was not completely independent in its assessment of the budgetary performance and that there could be doubt as to the impartiality of its assessments. Another key Court of Audit finding was that the remit of the fiscal council was weak since its role was primarily advisory in nature, and it provided assessments of past trends or previously adopted decisions. One of the shortcomings identified was that the verification of compliance with the expenditure rule in place at the time was not among the fiscal council's many assignments. Based on these findings the Court of Audit assessed that the fiscal council would perform its surveillance role more credibly and independently as an independent budget user, or at least as an expert body within the framework of the National Assembly, and that *ex-ante* assessments of fiscal policies and public presentations of opinions would significantly contribute to a more sustainable fiscal policy.

Having provided fairly general assessments of the fiscal, structural and development policies in its annual reports, all without the support of a secretariat, the fiscal council ceased operation in mid-2012. The fiscal council, which met periodically, released three annual reports in 2010–2012, in which it provided: (i) *ex-post* assessments of economic forecasts, budgets, multiannual budgetary frameworks and government borrowing and guarantees; and (ii) general assessments of fiscal policy (including the institutional framework), competitiveness policy and other structural policies. The fiscal council ceased operation in 2012, when four of its seven members resigned. The reasons stated for their resignations included lack of government support and its unresponsiveness[32], as well as discord among the members, which was also reflected in the final report, whose appendix included analyses and opinions by the individual members that give the impression of separate (rather than common) opinions and estimates. The weaknesses of the fiscal council – aside from those singled out by the Court of Audit – include its poor integration into the existing institutional set-up, the appointment of (all) its members by the government, the periodic nature of its activities, the absence of a permanent working group to provide expert support in the form of analysis and evaluations[33] to the council members, and the overgeneralised, sectorally dispersed analyses and estimates, which were largely normative and ineffective. The EC (2012, p. 160) also assessed that the fiscal council had not built a strong reputation in the course of its work.

Many tasks of independent fiscal institutions in Slovenia are performed by IMAD. IMAD is an independent government office engaged in the fields of economic and social policy, development strategy and policy, national accounts and other tools for analysis and forecasting, as well as international cooperation and economic integration.[34] In accordance with the Decree on the Documents of Development Planning (Article 15)[35], IMAD prepares economic trend forecasts twice a year, which serve as a basis for annual and medium-term budgetary planning. It prepares monthly and annual reviews of fiscal trends, and analyses of the stability and quality of the public finances, the regular publication[36] of which contributes to better transparency in this area. It participates in fiscal and other working groups, and prepares ad hoc analyses at the request of the government or upon the proposal of individual ministries. With regard to these tasks, IMAD is an independent fiscal institution under EU law (EC, 2015b; EC, 2014a, p. 63; Debrun et al, 2013, p. 13). It is also a member of the EU Network of Independent Fiscal Institutions (EUNIFI), which was founded in 2013. The network is a forum for communication and cooperation between independent fiscal institutions of Member States and European Commission services. It deals with the international exchange of experience concerning the establishment and work of fiscal institutions, debates on the challenges they face, and provides information on methodological issues and other topics regarding fiscal surveillance.

The OECD and the IMF have put forward several proposals regarding the configuration of the fiscal rule and the fiscal council in their analyses for Slovenia. In their formulation the OECD and IMF proposals took account of the actual situation in Slovenia and best practice in this field. The key proposals are as follows:

[32] After he resigned, the chairman of the fiscal council made the following statement: "After my conversation with the Minister of Finance, I realised that I did not have support and that it would not be possible to improve the work of the fiscal council in the direction desired. In addition to this, the new government has embarked on a fiscal policy that I could not accept as a matter of principle. This is why I offered the government my resignation. The government did not respond to my resignation, whereupon several other members of the fiscal council also resigned. The fiscal council is no longer in operation" (TFL Glasnik, 2012).

[33] In its reports the fiscal council also drew attention to the insufficient expert capacity to conduct a comprehensive analysis of fiscal policy, as well as a lack of staff and financial support (Fiscal Council 2010, p. 8; Fiscal Council 2011, p. 119).

[34] Decision determining the organisation and responsibilities of the Institute of Macroeconomic Analysis and Development (Official Gazette RS, No. 12/01).

[35] Decree on development planning documents and procedures for the preparation of the national budget and budgets of self-governing local communities (Official Gazette RS, No. 54/2010).

[36] In the following periodicals: Economic Mirror, Development Report and Economic Issues.

- In its Economic Survey of Slovenia 2015, the Organisation for Economic Cooperation and Development *(OECD)* recommended that Slovenia adopt a fiscal rule with a credible and transparent expenditure rule (see chapter 1.2) and establish an effective fiscal council charged with assessing the compliance of budgetary projections with the fiscal rule and the rationale for the use of escape provisions (OECD, 2015). In the Economic Survey of Slovenia 2013, the OECD further recommended that IMAD assume the duties of the fiscal council given that it was already preparing macroeconomic projections and regular assessments of budgetary performance, and had the appropriate technical know-how.
- The *International Monetary Fund (IMF)* explicitly refers to the role of the fiscal council in its proposal for the budgeting procedure in the report titled *Enhancing the Framework for Fiscal Governance in Slovenia* (MF, 2014). The IMF proposed that the fiscal council in Slovenia publicly present its opinions on the macroeconomic basis for its budgeting and, subsequently, on its budget planning documents (Budget Memorandum, Stability Programme, National Reform Programme), and the compliance of the budget to the fiscal rule. It recommended that the government respond and set out its reasoning for the budgetary projections prior to submitting the documents to the National Assembly or the European Commission.

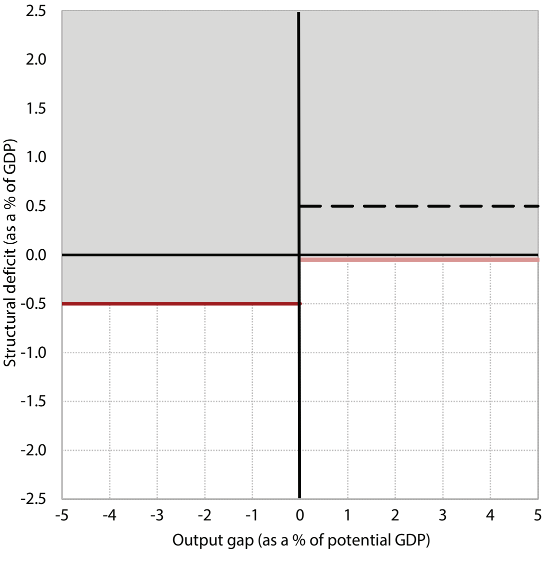
1.4.2 Proposal for a new institutional framework

The National Assembly of the Republic of Slovenia adopted an amendment to Article 148 of the Constitution of the Republic of Slovenia in May 2013. The amendment stipulates that budget revenue and expenditure must either be balanced in the medium term, without borrowing, or revenue must exceed expenditure. Temporary deviation from this principle may only be permitted in exceptional circumstances. The amended article of the constitution stipulates that a fiscal rule will be implemented via an implementing act which must be adopted by the National Assembly with a two-thirds majority. This implementing act must determine the principles and time frame for the execution of the medium-term fiscal balance, the criteria for determining exceptional circumstances, and the course of action to be taken when exceptional circumstances arise.

Under the constitutional amendments, the government prepared a draft implementing act for the fiscal rule which is currently in the parliamentary process. The draft act has been in the parliamentary process since December 2014[37] and has been heavily amended.[38] The current version comprises three main sections, which deal with: (i) the execution of the medium-term balance of national budgets (the fiscal rule); (ii) the fiscal council; and (iii) the elimination of deviations and exceptional circumstances, which also determines the course of action to be taken for the elimination of deviations from the medium-term objective. For the purposes of budget planning and implementation, including surveillance, the adoption of the act must be followed up by amendments to the Public Finances Act, and the National Assembly Rules of Procedure will need to be amended appropriately in order to accommodate the changed jurisdiction of the National Assembly in the budgetary planning process.

In the draft act the fiscal rule is defined asymmetrically, depending on the phase of the business cycle. Medium-term structural balance is ensured by limiting the planned scope of general government expenditure, taking into account the projected revenue and bringing expenditure into compliance with the targeted structural balance. The draft act stipulates that when the economy is in a recession, i.e. when GDP is below potential GDP, the structural deficit at the annual level may be at the maximum level permitted by the TSCG, which is currently set at 0.5% of GDP. If the economy expands, i.e. when GDP is above potential GDP, the annual structural balance must be at least balanced, or in surplus, and at a level which ensures the achievement of the medium-

Figure 7: **Permitted structural balance areas in the proposed fiscal rule for Slovenia**



Source: IMAD assessments based on the amended draft Fiscal Rule Act (2015).
Notes: The shaded area shows permitted values of the structural balance. The red lines indicate the lower limits of the structural balance when the output gap is negative (-0.5% of GDP) or positive (0.0% of GDP), respectively. The dotted line indicates the hypothetically required structural surplus (0.5% of GDP) when the output gap is positive, which ensures the achievement of the medium-term objective in the event that the structural balance amounts to -0.5% of GDP on average in the period when the output gap is negative.

[37] Draft Fiscal Rule Act (2014).
[38] Amended draft Fiscal Rule Act (2015). All subsequent references to the act in chapter 1.4.2 refer to this document.

term objective.[39] Surpluses generated in individual years by individual institutional units within the general government sector are accumulated on a separate account and may only be used to pay down debt; in the absence of debt, the surpluses may be used to finance deficits when the business cycle is unfavourable, for financing purposes when exceptional circumstances arise, or for the financing of investments in subsequent years. The targeted balance of the general government and the maximum general government expenditure have to be determined by the National Assembly each year for at least three years in advance.

Despite the fiscal council being among the EU's smallest in terms of the number of members, according to the draft act, its remit however will be extensive. The draft act stipulates that the fiscal council is an independent and autonomous state body. It will have three members nominated by the government and elected by the National Assembly by a two-thirds majority. The chairman of the fiscal council will be employed for at least 50% of full working time, while the remaining two members will have contracts for no more than 50% of full working time. The members will be appointed for a five-year term and limited to two consecutive terms, their tenure exceeding the terms of individual governments. A secretariat with up to four public employees is to offer expert support to the fiscal council, whereas administrative and technical support will be provided by the Court of Audit. The fiscal council will have the option to conclude cooperation agreements with institutional units of the general government sector which will determine the tasks that the individual units perform for the fiscal council within its remit. Under the draft act, the fiscal council gives assessments and recommendations concerning the compliance of fiscal policy with the fiscal rules as well as past and envisaged fiscal trends. The government must provide written position regarding these assessments and the National Assembly may leverage the fiscal council assessments to request the government to change legislation or take additional measures. The fiscal council's funding will be provided from the national budget at the proposal of the fiscal council, which shall have sole discretion as to how it spends the allocated funds.

[39] Slovenia has a structural deficit which is still quite far removed from the medium-term fiscal objective – structural balance. For the period of convergence with the medium-term objective, the act therefore stipulates that achievement of medium-term balance shall be deemed to be on track if the dynamics of convergence are in accordance with the dynamics determined pursuant to the Stability and Growth Pact.

Table 6: **Compliance of draft act with EU legislation and fiscal compact, recommendations by international institutions, and best practices**

Fiscal rule	Demands of EU legislation and fiscal compact	Applicable to Slovenia / draft act
The fiscal rule takes into account a medium-term horizon when determining the balance of the budget	x	+
Clear definition of circumstances allowing a deviation from the fiscal rule	x	+
Surveillance of fiscal rule implementation not assigned to several institutions	x	+
The fiscal rule is clearly defined		+/?
The fiscal rule act enjoys the broad support of political parties and the public		?

Fiscal council	Demands of EU legislation and fiscal compact	Applicable to Slovenia / draft act
The fiscal council must be an independent and professionally autonomous body	x	?
The remit of the fiscal council includes oversight of compliance with the fiscal rule	x	+
The fiscal council proposes additional measures in the event of non-compliance with the fiscal rule	x	+
Presence of a corrective mechanism with elements of automatism	x	+
The fiscal council assesses justification of exceptional circumstances for deviation from the rule		+
The remit and operation of the fiscal council are clearly defined		+
The fiscal council gives opinions on budgetary planning documents		+
The fiscal council may not veto the draft budget		+
Fiscal institution's funding should be proportionate to its remit		+
At least the chair of the fiscal council must be employed full time, and all other members undergo a mandatory check of conflict of interest		? / +
The composition of the fiscal council ensures it is fully operational		-
The fiscal council gives public opinions on the macroeconomic framework for budgetary planning		-
Independent evaluation of the work of the fiscal council by domestic or foreign experts		-

Source: IMAD assessments based on the amended draft Fiscal Rule Act (2015).
Note: the "x" indicates that the demand derives from EU legislation. The +/- indicates that the recommendation or best practice is either present/or not present in Slovenia. The "?" indicates uncertainty as to whether the recommendation or best practice has been implemented.

The draft act also determines the mechanism for the course of action to be taken in the event of deviations from the medium-term balance, and defines the exceptional circumstances in which such deviation is permitted. In rectifying deviations from the medium-term balance, the government must prepare measures to eliminate such deviations at the recommendation or request of the fiscal council. The draft act lists two circumstances in which deviation from the medium-term balance is permitted: a period of serious economic downturn, or unusual and uncontrollable events that have significant consequences on the financial position of the general government sector, as defined by the Stability and Growth Pact. The fiscal council provides an opinion on the existence of such circumstances, either at its own discretion or at the request of the government. The government decides whether such circumstances actually occurred, whereas the scope of deviation permitted from the medium-term balance is decided by the National Assembly based on a preliminary opinion by the fiscal council and at the proposal of the government.

The fiscal rule as defined in the draft act complies with the demands of EU legislation and the fiscal compact, but there is significant uncertainty due to the differentiation between two stages of the business cycle. The draft act stipulates that the stage of the business cycle which serves as the basis for how fiscal policy is oriented is identified using potential output calculated using EC methodology. Experience shows that, when using this methodology, average changes in output gap estimates for individual years may amount to as much as a percentage point, which can alter the assessment of the stage of the business cycle and hence the required fiscal policy position. Since the fiscal rule is very sensitive to changes in the assessment of the business cycle (more in Chapter 1.2.3, see Box 1 for Slovenia), there is a risk of the ex-post non-compliance at marginal values of the structural balance in individual years. This could lead to demands for more substantial adjustments to fiscal policy in order to ensure a structural balance over the medium term. Consequently, the volatility of fiscal policy could increase in the short term, especially when the output gap estimate is close to balance, i.e. when the economy is transitioning from one phase of the business cycle to the other. The point of transition from recession to expansion could be particularly critical when the demand is to tighten fiscal policy. The scope of the required fiscal policy adjustment also depends on its position when GDP is below potential.

There are several other ambiguities in how the fiscal rule is defined. For example, the draft act does not define the length of the medium-term period, i.e. the period during a normal business cycle in which the structural balance must be achieved; the duration thereof is therefore also subject to shortcomings in assessments of potential output. Moreover, the mathematical formula of the fiscal rule contains the parameter of elasticity of the general government sector balance to the output gap, which can be arbitrarily assessed depending, for example, on the level of aggregation (e.g. Bornhorst et al., 2011). The provision on the precautionary principle in planning and assessing revenue and expenditure is also unclear. The provision requires taking into account downside risks to macroeconomic stability and hence to the planned budget revenue and expenditure, but does not include a detailed description of how such risks should be factored into the planning of revenue and expenditure since both are just point estimates. In our view, the possibility of spending surpluses to finance investments in the absence of debt is inappropriate since surpluses should be earmarked exclusively for provisions for deficit financing during periods of slow economic growth.

Although the draft act largely complies with the demands of EU legislation and the fiscal compact, it nevertheless has some shortcomings. In terms of the fulfilment of the demands and principles of EU law, we believe an insufficient level of independence and the relatively small size of the fiscal council to be the main challenges regarding the implementation of the new legislation. Compared to the draft act of December 2014, under which members of the fiscal council would be nominated by the President of the Republic of Slovenia, the Bank of Slovenia and the government, and confirmed by the National Assembly by an ordinary majority, the latest draft determines they will be nominated only by the government. Despite the required two-thirds majority in the National Assembly, this could cast doubt over the independence of the institution, particularly during the initial years of its existence. In light of the fiscal council's proposed composition, the fact that its three members are only employed part-time, and that the fiscal council will therefore be among the smallest in the EU, it is questionable whether it can successfully perform all the tasks prescribed by the draft act. Nevertheless, the draft act partially resolves this dilemma by requiring all the institutional units of the general government sector to provide the fiscal council with all the information and analyses it requires to perform its tasks.

The legislative solution currently proposed poses several challenges regarding the future effectiveness of the implementation of the fiscal rule and the operation of the fiscal council. Given the aforementioned methodological shortcomings and the ambiguous definition of medium-term balance, it would be useful to adopt a pragmatic approach in determining the structural balance; however, this should not be entirely discretionary. Sweden, for example, comes close to this: in order to determine the structural balance in a business cycle stage, its fiscal council uses several equivalent indicators (see Box 2, footnote 30). The fiscal council should prepare transparent analyses and reports in order to deal with the remaining uncertainties present in the draft act. It is also necessary to precisely define how the surpluses may be used; aside from using reserves to finance deficits during periods when the business cycle is unfavourable, these funds could act pro-cyclically when the business cycle is favourable. Owing to possible concerns regarding its independence stemming from the procedure for appointing its members, the fiscal council will have to build up its credibility gradually. It will be able to do so only by producing transparent, consistent and objective assessments of the implementation of fiscal rules and analyses of fiscal trends, and speaking with one voice in public. Its credibility will also be affected by the conduct of the government, which will need to be proactive and respond to the fiscal council's initiatives to the maximum extent possible, even if they are non-binding. Moreover, the credibility of the fiscal council will be strengthened through raised awareness of the relevance of its activities and with the support of the general public and the political establishment. Given that the proposed fiscal council is relatively small and the draft act stipulates it will be supported by other institutional units of the general government sector, it will also have to ensure and verify the compliance of the data, analysis and information provided by the various institutions.

Best practices from abroad show that broad support for the fiscal rule and the fiscal council is desirable. This would reduce the possibility of diverging interpretations of the legally defined fiscal rule and address doubts as to the independence of the fiscal council. Only by being employed together effectively can the fiscal rule and the fiscal council contribute to achieving medium-term fiscal balance. The debate concerning changes to the implementing act, which governs the fiscal council and, in particular, the fiscal rule, was not framed broadly enough and did not include the expert public to a sufficient extent, as negotiations were mostly conducted only at the level of political parties. The adoption of such legislation would require additional simulations and analyses, and there is a lack of explanations regarding their operation and implementation in practice, which is not a good starting point for their general acceptance.

2 Assessment of the medium-term consolidation plan for Slovenia

2.1 Overview of the state of the public finances and consolidation starting points for the coming years

Against the backdrop of the effect of automatic stabilisers and the recapitalisations of banks and several state-owned companies, the structural deficiencies in Slovenia's public finances led to a substantial deterioration in the public finance situation during the course of the crisis. While enjoying brisk economic growth, Slovenia had pursued an unsustainable fiscal policy, which was reflected in its relatively high structural deficit, which increased fiscal exposure when the economic crisis broke out. The severe economic downturn in 2009 and the effect of the automatic stabilisers severely disrupted the balance of the public finances in 2009 (–5.9% of GDP). Additionally, stimulus measures equivalent to about 2% of GDP were adopted to mitigate the effects of the crisis in the first years after its outbreak. Until 2011 the deficit remained at a high level (of around 6%), and consolidation did not begin until 2012, when the deficit dropped significantly for the first time since the beginning of the crisis. In recent years, expenditure growth has also been driven by the recapitalisation of state-owned companies and banks, the absorption of the debt of certain companies, which totalled about 13% of GDP in 2010–2014, plus several one-off factors. Given the severe decline in economic activity during the crisis period, this deterioration in the fiscal position resulted in a significant increase in public debt, from 21.6% of GDP in 2008 to 80.9% of GDP by 2014.

Fiscal policy has thus far tackled the consolidation challenges largely through stop-gap measures, which are mostly non-systemic in nature. These were adopted in extraordinary circumstances and lacked a long-term vision, with many put in place only until the economic situation improved. The temporary as opposed to systemic nature of these measures is evident in their adoption for only a limited period (until the end of 2015), or until economic growth exceeded 2% or 2.5%, depending on the measure in question. Such temporary measures were adopted in the following areas: pensions (indexation of pensions and the amount of the annual allowance), social transfers (indexation), family benefits, allowances, social security, public sector hires, wages and other compensations in the public sector, per capita transfers for the financing of municipalities, value added tax rates, and the top income tax bracket. In recent years, consolidation has also been affected by restrained expenditure on goods and services, the effects of which were largely achieved with a linear approach rather

Table 7: **General government revenue, expenditure and balance (ESA-2010), Slovenia, as a % of GDP**

	2008	2009	2010	2011	2012	2013	2014
Revenue	42.5	42.3	43.7	43.3	44.6	45.0	45.0
Expenditure	43.9	48.2	49.3	50.0	48.6	59.9	49.8
General government deficit	**–1.4**	**–5.9**	**–5.6**	**–6.6**	**–4.0**	**–14.9**	**–4.9**
General government deficit excluding one-off factors	–1.4	–5.9	–5.4	–5.5	–3.8	–4.2	–3.2
Primary balance excluding one-off factors*	–0.3	–4.6	–3.8	–3.6	–1.8	–1.7	0.0
Consolidated general government debt	**21.6**	**34.5**	**38.2**	**46.5**	**53.7**	**70.3**	**80.9**
- Central government	21.4	36.2	36.7	44.8	52.1	68.8	79.3
- Local government	0.9	1.4	1.7	1.9	2.0	2.0	2.1
- Social security funds	0.0	0.0	0.1	0.1	0.1	0.0	0.0
- Consolidated debt among sub-sectors	–0.7	–0.5	–0.4	–0.4	–0.5	–0.5	–0.5

Source: Si-Stat data portal – Economy – National Accounts – Basic aggregates of the general government, May 2015.
Note: * One-off factors include government expenditure on the recapitalisation of banks and non-financial companies, assumption of the debt of certain companies, the net effect of the payments for the third of four instalments for the elimination of wage disparities in the public sector, compensation for persons erased from the permanent residence register, and pay-outs to depositors of Ljubljanska Banka in Croatia and Bosnia and Herzegovina (interest not yet included).

than being based on systemic reviews and measures. Consolidation was furthermore buttressed with a reduction in subsidies, which were however replaced with other support instruments (state aids; see IMAD 2015b). The majority of the permanent measures were adopted to support increased revenue,[40] and activities to improve the efficiency of recovering tax liabilities were also stepped up.

The effects of these measures, coupled with the rebound in economic growth and the significantly reduced expenditure on bank recapitalisation, reduced the general government deficit in 2014. The deficit dropped from 14.9% of GDP in 2013 to 4.9% of GDP last year as expenditure on bank recapitalisation plunged from 10.1% of GDP in 2013 to 0.9% of GDP in 2014. Other one-off items of expenditure, which included pay-outs to depositors of Ljubljanska Banka in Croatia and Bosnia and Herzegovina, reached 0.7% of GDP. Excluding one-off factors, the deficit amounted to 3.2% of GDP – the lowest level since 2008. One-off factors excluded, revenue growth (3.4%)[41] outpaced expenditure growth (1.3%). In the tax segment, tax revenue from production and exports recorded the largest increase, mainly due to the impact of higher VAT revenue following the increase of VAT rates in mid-2013. After five years of contraction, income and property taxes rose, a result of higher corporate income tax revenue. Improved labour market conditions coupled with an expansion of the contributions base restored the growth of revenue from social contributions, which had declined over the previous two years. Among non-tax and non-contributions revenue, revenue from EU cohesion funds increased the most in 2014. Due to measures adopted in recent years, the majority of which are due to expire this year, subsidies, compensation of employees, and expenditure on social benefits (except pensions) declined last year. The decrease in expenditure on social benefits was also driven by the improved labour market conditions. General government expenditure on goods and services rose slightly in 2014, following two years of decline. Interest expenditure stood out yet again among the expenditure categories that rose in 2014, with the increase significantly higher than for the year before. Pension expenditure also increased again. A significant turnaround, already detected in 2013 and exerting a positive effect on economic activity, was the expansion of government investment, which rose significantly in 2014 as the drawing of EU funds accelerated.

At 4.9% of GDP, the general government deficit was above the 4.1% of GDP projected in the SP2014, but, one-off factors apart, it did not deviate from the planned 3.2% of GDP. The difference between the actual and the planned deficit stems largely from the inclusion of the one-off pay-outs to Ljubljanska Banka depositors in Croatia and in Bosnia and Herzegovina (0.7% of GDP), which was not planned in the SP2014, whereas expenditure on bank recapitalisation was on target as a share of GDP (0.9% of GDP), although slightly higher than planned in nominal terms. One-off expenditure excluded, the deficit was nominally EUR 67 m higher than planned in 2014 and on target as a share of GDP (3.2% of GDP). Nevertheless, there were significant deviations at the level of revenue and expenditure, and their sub-categories. Revenue and expenditure were 1.3% and 3.1% respectively higher than planned in the

[40] Excise duty hikes, increase of contribution rates and expansion of the contribution base for health insurance for some categories of insured, introduction of a tax on financial services, increase of environmental tax on CO2 emissions etc.

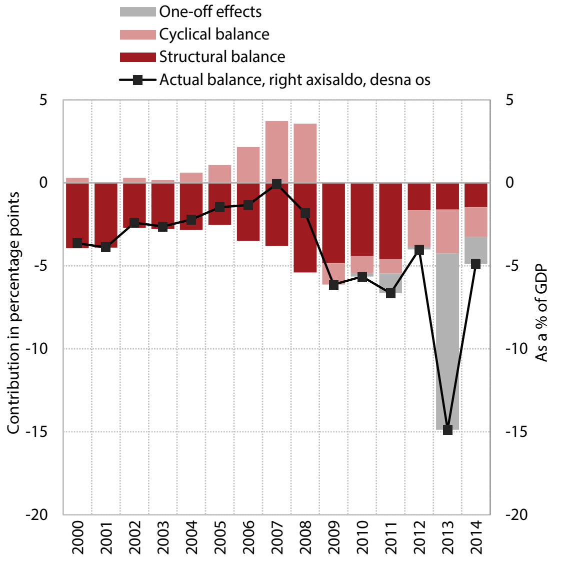
[41] Revenue growth in 2014 excluding one-off factors in 2013 (i.e. revenue in 2013 from income tax and social contributions associated with the payment of the third of four instalments for the elimination of wage disparities in the public sector).

SP2014. The expenditure and revenue gap is partially attributed to economic trends that were more favourable than expected (higher social contributions, lower social benefits). But the outturn shows that the intermediate consumption expenditure and compensation of employees in particular, were budgeted too low. Income tax revenue, on the other hand, was budgeted too high. However, due to numerous changes including the methodological transition to ESA-2010, the neutralisation of EU flows, the inclusion of new units in the general government sector with the publication of the data for 2014, and unplanned differences in the accounting of some revenues (the sale of the radio spectrum), some revenue and expenditure levels and growth rates are not comparable in the SP2014 and the SP2015.[42]

Contrary to EU Council Recommendations, the structural deficit did not reduce in 2014; however, the bottom-up assessment of discretionary measures for 2014 shows the fiscal effort was largely realised. Assessments of the structural deficit vary due to differences in output gap forecasts as well as the definition of one-off factors by the institutions calculating the deficit (see chapter 1.2.3). Nevertheless, the assessments by domestic and international institutions (MF, IMAD, EC and OECD) reveal that the structural deficit, having narrowed considerably in 2012, remained roughly level after that or even slightly increased in 2014. In accordance with the June 2013 recommendation of the EU council within the framework of the excessive deficit procedure, the structural deficit should have decreased by 0.5% of GDP in 2014. On the other hand, the bottom-up assessment of the adopted fiscal measures, which is not derived from output gap estimates and is used to supplement the assessment of the fiscal effort performed, indicates that the fiscal effort was largely implemented (the EC estimates it as being 1.2% of GDP compared to the 1.5% of GDP requirement from the EDP recommendation).

[42] In autumn 2014 the Statistical Office began releasing data in accordance with the ESA-2010 methodology, which was also used in the preparation of projections of aggregates of the general government in the Stability Programme 2015. Preliminary releases of general government aggregates and their projections in the SP2014 were based on ESA-1995. The main changes involve the nominal level of taxes on production and imports, revenue from marketable production and other non-marketable production and gross capital formation, which is higher in the realisation for 2014 and in the projections of the SP2015 than according to the SP2014 due to the transition to ESA-2010. As regards the neutralisation of EU flows, the release of the data for 2014 as well as for the period 2004–2013 involved changes to certain revenues: the reduction of revenue from current transfers (structural funds) and the increase of capital transfers (cohesion funds). On the expenditure side, the associated changes were more difficult to identify. These changes also reduced the comparability of the "other revenue" category, which includes revenue from EU funds in the SP2014 relative to the SP2015.

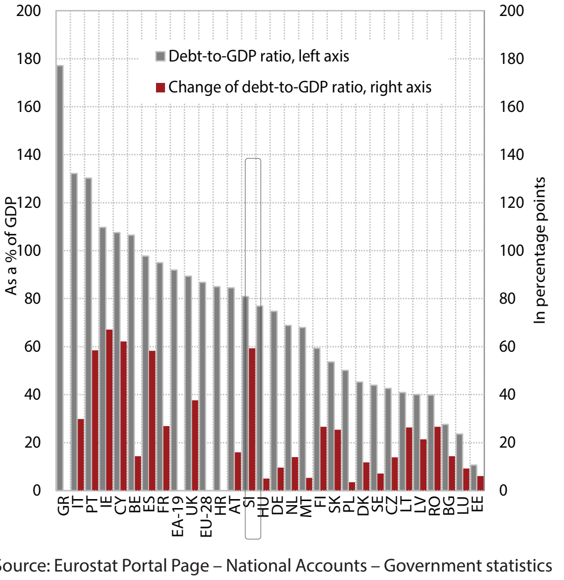
Figure 8: **Actual and structural balance of public finances (IMAD calculations), Slovenia**



Source: Si-Stat data portal – Economy – National Accounts – Basic aggregates of the general government, May 2015; MF for one-off factors, IMAD for the calculation of structural balance.
Note: One-off factors include government expenditure on the recapitalisation of banks and non-financial companies, assumption of the debt of certain companies, the net effect of the payments for the third of four instalments of the elimination of wage disparities in the public sector, compensation for persons erased from the permanent residence register, and pay-outs to Ljubljanska Banka depositors in Croatia and Bosnia and Herzegovina (interest not yet included).

General government debt rose significantly in 2014, the sixth consecutive yearly increase. Slovenia therefore numbers among the EU countries whose debt increased the most during the crisis, but is mid-ranked

Figure 9: **Debt-to-GDP ratio in 2014 and change in the period 2008–2014**



Source: Eurostat Portal Page – National Accounts – Government statistics – Government deficit and debt.
Note: comparable data for Greece and Croatia are not available for this period.

Box 4: **Macroeconomic assumptions of the medium-term consolidation plan in the SP2015**

The macroeconomic scenario of the Stability Programme 2015 assumes a continuation of the recovery of economic activity. After two years of decline, GDP rose by 2.6% in 2014 on the back of accelerated growth in exports and the first increase in domestic consumption since the start of the crisis in 2008. The Spring Forecast 2015 (IMAD, 2015a), which constitutes the macroeconomic framework of the fiscal consolidation plan in the SP2015, assumes that the recovery will continue in the period 2015–2019. This scenario assumes that sustainable reduction of the deficit and stabilisation of the banking system will help create stable conditions for government financing and, indirectly, private sector financing. This will have a positive effect on overall economic activity, which will accelerate at an average annual pace of 2.2% in real terms in the SP2015 period. Given the gradual recovery among principal trading partners, exports will remain the driving force of economic activity. The recovery of domestic consumption is also expected to continue. Coupled with improved household confidence, the recovery on the labour market will buoy private consumption growth. Private investment will also gradually strengthen on the back of better business results, in particular in the export segment, the continued deleveraging, and the projected improvement of access to financing sources. The macroeconomic scenario is similar to projections made by the other domestic and international institutions (EC, OECD, IMF and BS), which expect a continuation of the recovery this year and beyond. For the entire period, the forecast growth outpaces the assumptions in the Spring Forecast 2014, which formed the basis for last year's Stability Programme.[1]

Table 8: **Macroeconomic assumptions in the consolidation of public finances in SP2014 and SP2015**

	2013	2014	2015	2016	2017	2018	2019
GDP in EUR m (SP2014), ESA-1995*	35,275	35,634	36,255	37,219	38,414	39,662	
GDP in EUR m (SP2015), ESA-2010*	36,144	37,246	38,558	39,474	40,701	42,164	43,734
Nominal GDP growth, in % (SP2014)		1.0	1.7	2.7	3.2	3.2	
Nominal GDP growth, in % (SP2015)		3.1	3.5	2.4	3.1	3.6	3.7
Real GDP growth, in % (SP2014)		0.5	0.7	1.3	1.7	1.7	
Real GDP growth, in % (SP2015)		2.6	2.4	2.0	2.1	2.2	2.2

Source: SORS; Spring Forecast of Economic Trends 2014, IMAD (2014a), Spring Forecast of Economic Trends 2015, IMAD (2015a).
Note: *Due to the transition from ESA-1995 to ESA-2010, which led to an increase in nominal GDP levels, the projections of nominal GDP in SP2014 and SP2015 are not comparable. GDP growth rates provide better comparability.

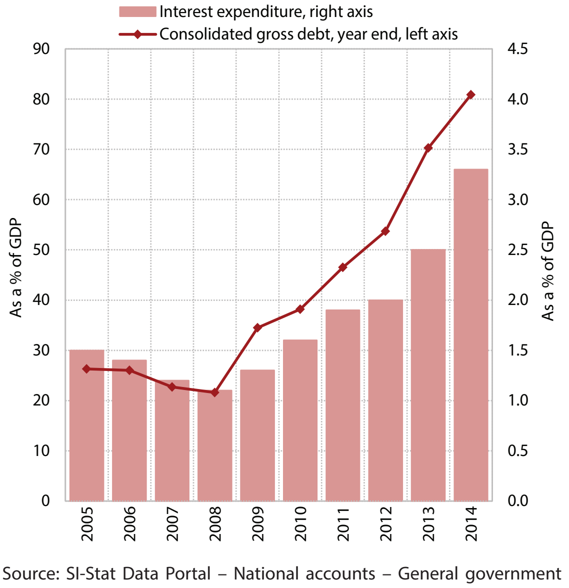
Owing to challenges concerning the ongoing elimination of macroeconomic imbalances, the economic recovery remains fragile over the medium term, which requires caution in the planning of fiscal policy measures. Aggravated by accumulated structural weaknesses, the decline of economic activity in Slovenia was more pronounced than in the EU on average. Since the start of the crisis, GDP at purchasing power standards dropped from 89% to 82% of the EU average, which equals the development level recorded in 2002. The progress made in reforms (pension system and labour market) in recent years, the start of the stabilisation of the banking system, the restructuring and privatisation of companies, and the improved situation in the euro area all helped to significantly improve the borrowing conditions on international financial markets. However, macroeconomic balances, which had deteriorated since the start of the crisis, remain unchanged in many areas or are only slowly improving. The general government deficit remains relatively high, whereas public debt has surged along with interest payments. On the other hand, deleveraging of the private sector has led to a surplus of savings over investments. The banking system, which is undergoing intensive restructuring, is yet to provide sufficient financial sources to allow companies to accelerate growth. The overall situation has started to gradually improve, but there are many challenges in ensuring more sustainable economic growth, fiscal consolidation, and improving the stability of the entire financial system. Consequently, the economic recovery remains fragile over the medium term.

[1] The nominal GDP levels in the SP2014 and SP2015 are not comparable because the transition from ESA-1995 to ESA-2010 increased nominal GDP. Growth rates are therefore more appropriate for the comparison of GDP projections.

among EU countries in terms of its debt-to-GDP ratio in 2014. Since 2008, the debt-to-GDP ratio increased by almost 60 percentage points. In a relatively short time, the pace of the debt increase and the resulting rise in interest payments created strong pressure for further adjustments to other expenditure components against the backdrop of the fiscal effort required to reduce the deficit.

The general government debt widened by EUR 4.7 bn in 2014 to 80.9% of GDP. Debt thus rose by 10.6% of GDP in 2014, which was solely attributable to a nominal debt increase. Deficit financing accounted for just under half of the nominal debt increase, 4.9% of GDP, of which 0.9% of GDP was attributed to bank recapitalisation. The debt increase was strongly affected by the pre-financing of projected requirements, which totalled about EUR 3 bn, whereby cash and deposits rose by about EUR 2.2 bn or 5.8% of GDP. The borrowing was largely underpinned by the issue of long-term instruments, which extended the maturity profile.[43] Whereas loans from domestic banks were slightly lower, loans taken abroad rose marginally. In the short-term borrowing segment there was a significant shift compared to 2013, when the borrowing conditions were exceptionally tight, from treasury bills with the shortest maturity (3 and 6 months) towards 12-month treasury bills. The improvement in borrowing terms was also reflected in the price of borrowing, as the weighted average interest rate on newly issued debt expressed in euros dropped from 4.6% in 2013 to 2.7% in 2014. Nevertheless, the implicit interest on debt remained almost unchanged at 4.8%.

Figure 10: **Gross general government debt and interest expenditure, Slovenia**



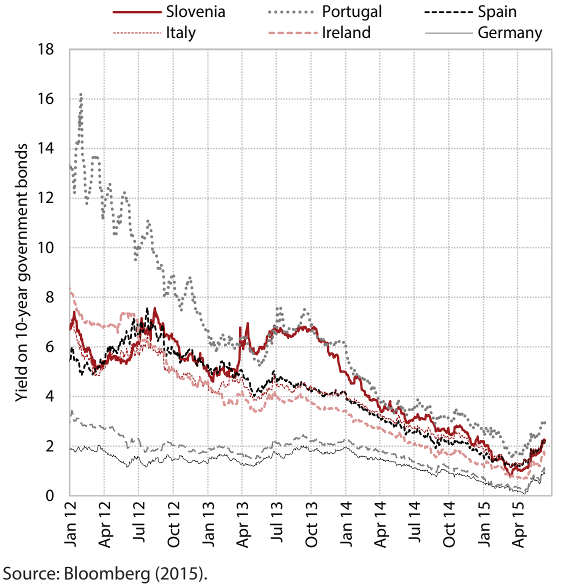
Source: SI-Stat Data Portal – National accounts – General government accounts – Main aggregates of the general government, May 2015.

[43] The issues included one three-year euro bond, two seven-year euro bonds, a five-year US dollar bond, a ten-year US dollar bond, and an 18-month treasury bill.

The conditions for government borrowing in 2014 were substantially better than in 2013. The yield on 10-year Slovenian bonds, which had dropped below 5% after the late-2013 bank recapitalisation, narrowed to 2% by the end of 2014. This improvement was driven primarily by government and Bank of Slovenia measures related to the restructuring of the banking system, and the overall improvement of economic conditions in the euro area and Slovenia. In the aftermath of the announcement and launch of the ECB purchases of euro area government bonds (quantitative easing), the yield on Slovenian bonds dropped to its lowest level on record in the first quarter of 2015 (about 1%), but began to rebound in mid-March and achieved levels recorded immediately before the ECB announcement in mid-January. In 2014 none of the three main ratings agencies changed Slovenia's credit rating, but they upgraded the outlook from negative to stable. In early 2015, Moody's restored Slovenia's rating to investment-grade.

In 2014 the debt increase was faster than that which was projected in the SP2014, a consequence of one-off factors and government pre-financing for the settlement of future liabilities. Debt actually increased by EUR 4.7 bn compared to the EUR 3.5 bn projected in the SP2014, but the debt-to-GDP ratio did not deviate from the projected path (80.9% of GDP). This difference stems from the higher-than-expected deficit due to the pay-outs to depositors of Ljubljanska Banka, and higher pre-financing of future liabilities due to the improved conditions on the international financial markets[44].

Figure 11: **Yield on 10-year euro-denominated government bonds**



Source: Bloomberg (2015).

[44] To a lesser extent, the higher-than-planned nominal debt is the result of the inclusion of new units into the general government sector with the transition to ESA-2010.

2.2 Assessment of Stability Programme 2015 measures and compliance with fiscal objectives

2.2.1 Medium-term consolidation plan in SP2015

The promotion of economic growth and fiscal consolidation are the main objectives of government economic policy in the coming years. In its efforts to achieve these goals, the priority areas of government action include the promotion of investments, structural reforms and fiscal responsibility. The goal of fiscal policy is consolidation in line with the Stability and Growth Pact commitments and in accordance with the recommendations in the excessive deficit procedure, which Slovenia has been subject to since 2009 (see Box 5). The short-term objective is to reduce the general government deficit to below 3% of GDP in 2015; over the medium term the goal is structural balance in 2020 and the stabilisation of public debt. Economic policy goals also include action in several other areas of macroeconomic imbalances where measures are ongoing, including the completion of banking sector stabilisation, the launch of a corporate restructuring task force and the completion of the State Asset Management Strategy and strategies for the banking and insurance sectors.

The operationalisation of the objectives and guidelines of the broader economic and fiscal policies presented hereinafter is described in the Stability Programme 2015 and the National Reform Programme 2015.[45] The SP2015 underlines that the conditions for promoting economic growth will be created by improving competitiveness factors and increasing productivity and employment. A key lever for the achievement of fiscal targets, according to the SP2015, is the strengthening of the fiscal framework and responsibility through the adoption of the Fiscal Rule Act, which will operationalise the constitutional requirement regarding the balancing of the general government budget in the medium term, and the reform of the Public Finances Act to more precisely define budget planning responsibilities in accordance with EU requirements. The fiscal targets defined in the SP2015 will also be achieved by substituting the effects of short-term austerity measures with the effects of long-term structural measures, either by transforming certain short-term measures into systemic measures, or by replacing the remaining short-term measures with other, systemic measures. Those short-term measures which cannot be transformed into systemic ones are to be replaced with other measures with comparable financial effects (Stability Programme 2015, pp. 4 and 21).

[45] The Stability Programme is the government's medium-term blueprint of measures to achieve fiscal policy objectives. Along with the National Reform Programme, the document constitutes the basis for the preparation and implementation of the economic policy measures required to achieve the country's economic and fiscal objectives.

2.2.1.1 Policy mix for narrowing the general government deficit

The SP2015 assumes a reduction of the general government deficit below 3% of GDP in 2015 and a gradual narrowing thereafter. The projected deficit reduction in 2015, to 2.9% of GDP, will allow Slovenia to exit the excessive deficit procedure, which it has been subject to since 2009. In the period 2015–2019 deficit reduction is planned to amount to 0.5 percentage points annually, bringing the deficit down to 0.9% of GDP by the end of the programme horizon in 2019. The general government balance, excluding interest (the primary balance), is projected to be in surplus for the entire programme horizon, with the 2019 figure at 1.4% of GDP.

Tabela 9: **Comparison of planned general government revenue, expenditure and balance in the SP2014 and SP2015**

As a % of GDP	SP 2014					Realisation	SP 2015				
	2014	2015	2016	2017	2018	2014	2015	2016	2017	2018	2019
Revenue	46.4	45.5	44.6	43.8	43.4	45.0	44.7	43.1	42.5	42.0	41.5
Expenditure	50.5	47.9	46.1	44.5	43.1	49.8	47.6	45.3	44.3	43.4	42.4
General government balance	-4.1	-2.4	-1.5	-0.7	0.3	-4.9	-2.9	-2.3	-1.8	-1.4	-0.9
Primary general government balance	-0.7	0.9	1.8	2.4	3.3	-1.6	0.2	0.7	0.9	1.1	1.4
Bank recapitalisation expenditure	0.9	-	-	-	-	0.9	-	-	-	-	-
Other one-off expenditure – pay out to depositors*	-	-	-	-	-	0.7	-	-	-	-	-
General government balance excluding bank recapitalisation expenditure	-3.2	-2.4	-1.5	-0.7	0.3	-3.9	-2.9	-2.3	-1.8	-1.4	-0.9
General government balance excluding bank recapitalisation and other one-off expenditure*	-3.2	-2.4	-1.5	-0.7	0.3	-3.2	-2.9	-2.3	-1.8	-1.4	-0.9

Source: SORS, Stability Programme – Amendments 2014, Stability Programme – Amendments 2015.
Note: *Other one-off items of expenditure in 2014 include pay-outs to depositors of Ljubljanska Banka in Croatia and Bosnia and Herzegovina (excluding interest payments, which have not been included since they cannot yet be irrevocably evaluated). In the SP2014 this expenditure was not foreseen.

Box 5: **Excessive deficit procedure and surveillance in Slovenia within the framework of enhanced coordination of fiscal policies in the EU**

Slovenia remains subject to the excessive deficit procedure in 2015. In December 2009, the EU Council, acting on the recommendation of the European Commission, launched an excessive deficit procedure against Slovenia and set 2013 as the deadline for correcting the excessive deficit. Due to significantly altered macroeconomic circumstances relative to 2009, which slowed the pace of fiscal improvement, the EU Council issued new recommendations[1] in June 2013 and extended the deadline for the correction of the excessive deficit by 2015. In accordance with the enhanced mechanism for the surveillance of public finances in the euro area, Slovenia prepared a Draft Budgetary Plan for 2015, which it submitted to the EC in October 2014.

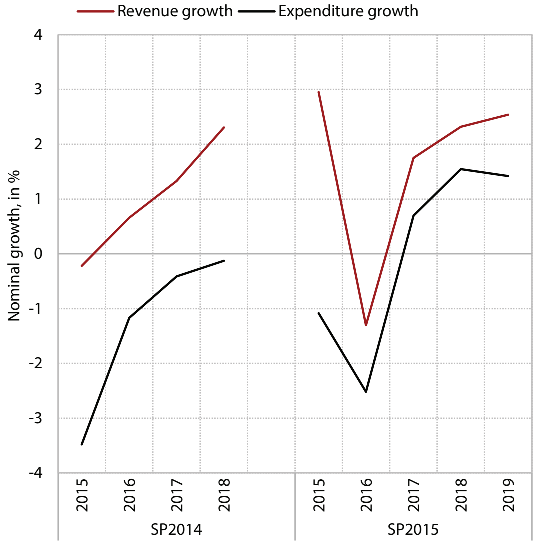
After its examination of the budget documents for 2015, the EC urged Slovenia in November 2014 to take additional measures to ensure a sufficient structural effort[2] and long-term fiscal sustainability. In November 2014 the EC[3] assessed that the Draft Budgetary Plan for 2015 was broadly compliant with the provisions of the Stability and Growth Pact in that it envisaged that the budget deficit would be brought below the reference value of 3% of GDP in 2015. It nevertheless commented that the reduction did not constitute a sufficient fiscal effort. In its autumn forecast, the EC assessed that the structural deficit would be reduced by 0.3% of GDP, which is less than the required adjustment of 0.5% of GDP. An analysis of discretionary measures using the bottom-up approach, which supplements the assessment of the fiscal effort based on changes of the structural deficit, showed measures amounting to 2.1% of GDP in 2015, which is more than the 1.5% of GDP determined in the EU Council recommendations of June 2013. The EC nevertheless requested that Slovenia adopt measures within the budgetary process for 2015 in order to ensure better compliance with Stability and Growth Pact rules. The EC also urged Slovenia to (i) accelerate the adoption of fiscal reforms, particularly in the centralisation of public procurement, (ii) undertake a comprehensive review of health care expenditure, (iii) carry out fiscal measures regarding population ageing, and (iv) adopt a fiscal rule.

After reaching the conclusion that Slovenia would correct the excessive deficit but not make sufficient fiscal effort this year and in the coming years, the EC proposed additional recommendations to the EU Council in May 2015. In its opinion on the SP2015,[4] in which it also took into consideration its spring forecast[5], the EC forecast that Slovenia would exit the excessive deficit procedure with a deficit of 2.9% of GDP, but that the improvement relative to the reference value (3.0% of GDP) would be modest. At the same time the EC said that the fiscal effort, taking into account the adopted and the proposed but insufficiently defined measures, would be insufficient, as the structural deficit is to be reduced by only 0.1% of GDP, whereas the adjusted structural deficit is to actually increase by 0.1% of GDP, well below the required reduction of 0.5% of GDP. On the other hand, the EC's bottom-up assessment shows that the fiscal effort in 2015 would amount to 1.4% of GDP, slightly below the recommended 1.5% of GDP. As of 2016 Slovenia is expected to be subject to the preventive arm of the Stability and Growth Pact. Nevertheless, even in this framework, the assumed fiscal effort is expected to fall short as the EC's spring forecast suggests the structural deficit will increase by 0.5% of GDP in 2016, which the EC believes represents a significant departure from the required structural adjustment. The EC estimates that expenditure growth[6] will similarly significantly exceed the reference values, which are based on the assessment of medium-term growth of potential output, an issue that the government also highlights in the SP2015. In the event of a failure to achieve the requisite structural adjustment and of excessive expenditure growth, in-depth surveillance can be initiated even in a country subject to the preventive arm of the Stability and Growth Pact. On the recommendations of the European Commission, the EU Council urged[7] Slovenia to ensure a lasting correction to the excessive deficit and achieve a fiscal effort of 0.6% of GDP. By the end of 2015 it should also adopt health care and long-term care reforms, and continue with long-term pension system reform. It also recommends that Slovenia adopt the Fiscal Rule Act and amend its Public Finances Act.[8]

[1] COUNCIL RECOMMENDATION with a view to bringing an end to the situation of excessive government deficit in Slovenia, Council of the European Union, 18 June 2013.
[2] The European Commission assesses the fiscal effort with two indicators: (i) the structural deficit, which it calculates itself and compares to the figure reported by Member States in Stability Programmes, with both figures being calculated with the output gap estimate; and (ii) a bottom-up assessment in which the Commission evaluates the feasibility of the estimates of individual discretionary measures on the revenue and expenditure side that the Member States provide in their Stability Programmes. The target values of both indicators are determined by the European Commission for each country, pursuant to the provisions of the Stability and Growth Pact and the Fiscal Compact.
[3] COMMISSION OPINION of 28 November 2014 on the draft budgetary plan of Slovenia, C(2014) 8813 final.
[4] EC (2015e).
[5] The EC Spring Forecast for 2015 (EC, 2015c) projects a deficit of 2.9% of GDP for 2015 and 2.8% of GDP in 2016, which exceeds the recommended targets in the excessive deficit procedure (2.5% of GDP in 2015). The structural balance (calculated based on the output gap) is to improve by 0.1 percentage points in 2015 and deteriorate by 0.5 percentage points in 2016, which is not in compliance with the requested improvement of 0.5 percentage points in both years.
[6] Growth of primary expenditure excluding expenditure entirely dependent on revenue from the EU budget and cyclical expenditure for compensation of employees; it excludes discretionary revenue-side measures.
[7] COUNCIL RECOMMENDATION on the 2015 National Reform Programme of Slovenia and delivering a Council Opinion on the 2015 Stability Programme of Slovenia, Council of the European union, COM(2015) 273 final, Brussels, 13.5.2015.
[8] Detailed recommendations, including recommendations on a comprehensive review of health care and education expenditure, that would facilitate the transition from discretionary to systemic measures are also included in the document drafted by the EC as part of the Macroeconomic Imbalances Procedure (Commission Staff Working Document, SWD(2015) 43 final/2. Country Report Slovenia 2015. {COM(2015) 85 final}. Brussels, 18 March 2015).

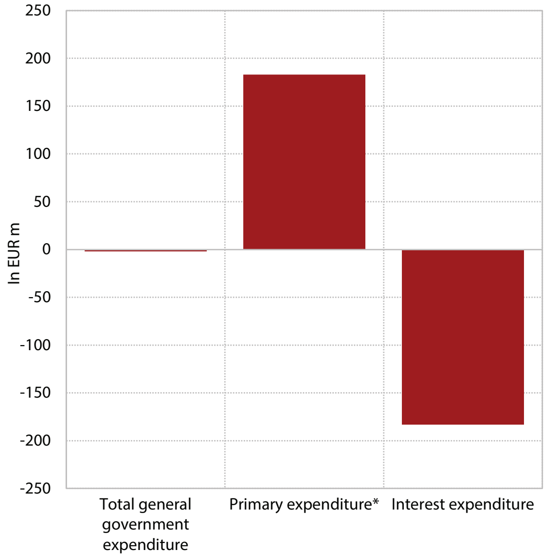
The SP2015 brings a turnaround in the expenditure-side consolidation strategy compared to last year's plan. The policy mix for deficit reduction in the SP2015 is based on revenue growth and the medium-term preservation of expenditure at the 2014 level. The SP2014 involved a similar plan, but there was a turnaround in this year's SP in the expenditure-side policy mix. Equalisation of the expenditure level in 2019 with that of 2014 is underpinned by an expected decrease in interest expenditure, which fully offsets the increase in primary expenditure in the period (see chapters 2.2.1.4 and 2.2.1.5). This approach to consolidation (reducing expenditure on interest to free up funds for other purposes) became possible after the strong decline in the yield on Slovenian securities and constitutes the most significant departure from last year's medium-term consolidation plan in the SP2014. The consolidation strategy in the SP2014 was the opposite: it involved decreasing primary expenditure (mostly compensation of employees, intermediate consumption and subsidies), which fully offset the predicted increase in interest expenditure by 2018. The government has put this year's approach to deficit reduction in the context of the broader economic policy objective of promoting growth, but this approach is subject to risk. Much like in the SP2014, the measures are vague and still retain an excessive austerity bent instead of transitioning to a more permanent and systemic adjustment to the altered macroeconomic and demographic circumstances (see chapters 2.2.1.2–2.2.1.5). The interest rate assumptions underpinning the interest expenditure projections over the programme horizon are also subject to risk (see chapters 2.2.1.4 and 2.2.1.5).

Figure 12: **Planned change in government revenue and expenditure in SP2014 and SP2015**



Source: Stability Programme – Amendments 2014, Stability Programme – Amendments 2015.

Figure 13: **Expenditure-side consolidation in the SP2015 (change of expenditure in 2014–2019)**



Source: SORS, Stability Programme – Amendments 2015.

Note: *Overall general government expenditure and primary expenditure in the baseline year of 2014 include one-off factors.

According to the SP2015, short-term austerity measures will be transformed into systemic measures or replaced with new measures. Transformation of short-term austerity measures into systemic measures can only be suitable for a minor share of the measures. For example, in circumstances of predominantly export-led economic growth, which is reflected in the gradual recovery of tax revenue, and against the backdrop of the reduction of certain tax rates during the crisis, it may be appropriate to make short-term VAT hikes permanent, which is planned in the SP2015. However, using this principle may be less appropriate for numerous other measures, especially on the expenditure side, as keeping such measures in place for several years has already started producing certain unfavourable effects. Examples of measures which have significantly contributed to deficit-reduction in the short term but cannot provide for a permanent balance of the structural fiscal position in the medium and long term include: the linear policy of restricting wages and recruitment in the public sector; the linear reduction of expenditure on goods and services; the containment of expenditure growth in health care by regulating medicine prices and delaying investments; limiting the growth of pension expenditure largely based on holding back indexation; and resolving the problems associated with the fragmented system of local government by limiting per capita transfers to municipalities, among others.

The SP2015 merely indicates, but does not elaborate on, the planned new systemic measures required to achieve the target deficit. The SP2015 emphasises that reforms of certain systems and structural changes will be undertaken in individual areas. It announces, for example, reforms to the system of health care and long-term care, the strategy for public administration development, and changes to the system of public procurement. However, since these systemic changes are mostly still in development and lack specified and finalised measures, their financial impact cannot be evaluated. It is therefore unclear as to what extent they support the individual expenditure projections presented in the SP2015, or to what extent these projections are still based on extensions of existing short-term measures or their transformation into systemic or permanent measures. The bulk of the expenditure contained until 2015 with stop-gap measures will start growing in 2016, which indicates a discrepancy with the SP2015 guideline that short-term measures will be transformed into systemic measures or replaced by other measures with comparable financial effects. The SP2015 states that the planned expenditure policy in individual areas supports the objective of promoting domestic expenditure growth and providing for appropriate socio-economic conditions for individuals. However, we estimate that, over the medium term, this expenditure policy does not support a reduction to the structural deficit in accordance with EC recommendations. In the framework of the preventive arm of the Stability and Growth Pact, whose rules will apply to Slovenia as of the projected exit date from the excessive deficit procedure in 2016, inappropriate structural adjustment may trigger in-depth surveillance procedures (see Box 5 and chapter 2.5.1.2).

We believe that, in order for fiscal policy to be oriented towards more permanent adjustment and depart from the current austerity policy, it should focus primarily on the gradual rectification of structural and long-term problems in the following areas:

(i) Reform of social protection systems and their adjustment to demographic trends (pensions, health care, long-term care).

(ii) Systemic streamlining of selected expenditure based on an in-depth review of expenditure, and a programming approach to budgetary planning that would allow for a more substantive debate on the earmarking of limited public funds to priority areas.

(iii) Management of assets aimed at achieving higher returns and consequent mitigation of risks that led to the spike in public debt in the latest crisis.

(iv) Active debt management with a view to reducing the debt and interest burden, including privatisation revenue.

2.2.1.2 Structural deficit projections

The structural deficit projections in the SP2015 assume a balanced budget by 2020; however, according to current estimates, the fiscal effort is not sufficient to achieve the target set by the European Commission. The structural deficit projections are subject to risks stemming from the estimates of potential output. Based on MF projections of the output gap, the SP2015 projects a fiscal easing of 0.1 percentage points in 2015 followed by an increase in the fiscal effort of 0.6 percentage points in 2016 (see Tables 10 and 11). This will not suffice to fulfil the recommendation by the EC that the fiscal effort amounts to 0.5 percentage points in 2015. Moreover, the

Table 10: **Comparison of estimates of potential output, output gap and structural balance**

Potential output growth	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
MF – SP2015				0.7	1.4	1.6	1.9	2.1	1.7
EC – spring 2015	0.0	-0.2	-0.3	0.6	0.8	0.9			
IMAD – spring 2015	0.3	0.1	-0.1	0.8	1.0	1.1	1.3	1.4	1.7
Output gap estimates	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
MF – SP2015				-2.3	-1.4	-1.0	-0.8	-0.7	-0.3
EC – spring 2015	-1.6	-4.0	-4.7	-2.7	-1.2	-0.1			
IMAD – spring 2015	-1.8	-4.5	-5.4	-3.6	-2.3	-1.4	-0.5	0.2	0.7
Structural balance	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
MF – SP2015				-2.1	-2.2	-1.6	-1.3	-1.0	-0.8
EC – spring 2015	-4.9	-2.1	-2.2	-2.5	-2.4	-2.9			
IMAD – spring 2015*	-4.6	-1.6	-1.6	-1.5	-1.8	-1.6	-1.5	-1.5	-1.3

Source: MF – Stability Programme – Amendments 2015, European Commission – forecasts, May 2015, IMAD – Spring Forecast, April 2015.
Note: * Estimate of structural balance on the basis of general government balance projections by the MF – SP2015 and estimates of output gap by IMAD based on the Spring Forecast 2015. The calculation of the structural balance takes into account one-off factors including government expenditure on the restructuring of banks and non-financial companies, assumption of the debt of certain companies, the net effect of the payment of the third of four instalments for the elimination of wage disparities in the public sector, the assessment of compensation to persons erased from the permanent residence register, and the assessment of pay-outs to savers of Ljubljanska Banka in Croatia and Bosnia and Herzegovina (excluding interest).

planned fiscal effort in 2016, when Slovenia is to exit the excessive deficit procedure, would constitute one of the biggest decreases in the structural deficit thus far.[46] The SP2015 assumes a balanced budget in structural terms in 2020, whereby the structural effort in 2017–2019 is 0.3 percentage points each year and as much as 0.8 percentage points in 2020, even though the SP2015 does not indicate specific measures that would contribute to such a restrictive fiscal policy. Such reduction of the structural deficit in the period 2017–2019 would yet again breach Stability and Growth Pact rules.

On the other hand, the supplementary assessment of the fiscal effort, which is not based on the output gap estimate, shows compliance with the EC's demands in 2015, which indicates that caution is required in interpreting the fiscal effort. This assessment is based on all adopted discretionary measures – the so-called bottom-up assessment of the fiscal effects of individual measures. The government's Draft Budgetary Plan, which was submitted for EC evaluation in October 2014, suggests the discretionary measures will amount to 2.7% of GDP in 2015. However, several previously announced measures are not included[47] in the SP2015, while some new measures are present in the document.[48] Taking into account these changes, we estimate that the proposed measures constitute a fiscal effort which complies with EC requirements regarding the adoption of discretionary measures worth 1.5% of GDP (see Box 5).

In IMAD's opinion there are two more factors aside from the insufficiently specified measures that drive the deviation from the recommended fiscal effort. Both revenue-side and expenditure-side projections in the SP2015 ought to be better specified and, in particular, structural in nature. One of the factors that restrict the fiscal effort is the relatively slow recovery of the estimated potential output. GDP growth in 2014 and 2015 is largely based on exports and less on domestic expenditure and private investment which would increase capital, strengthen total factor productivity, and consequently enhance the output potential of the economy. The second factor holding back the fiscal effort is the structure of economic growth and the resulting "unfavourable" expansion of the tax base. The existing structure contributes to revenue less than would be the case if the contribution of domestic consumption to economic growth were more balanced.[49] The current fiscal policy stance can therefore be assessed as a slightly expansionary fiscal policy in conditions where the business cycle is still relatively weak (negative output gap). This means that fiscal policy supports economic activity in 2015, a year in which the projected domestic demand and, in particular, private sector investment remain modest and public investments can still be financed with funds from the previous (2007–2013) EU financial perspectives.[50]

2.2.1.3 Revenue projections

Despite certain discretionary measures, the SP2015 projects only modest growth of overall general government revenue on average. Revenue is projected to rise by 3.0% in 2015, decline in 2016, and to slightly

[46] This provision requires that a country subject to the preventive arm of the Pact achieves a fiscal effort of 0.5 percentage points of GDP in times of normal economic conditions, i.e. when the output gap is between -1.5% and 1.5% and debt does not exceed 60% of GDP. See Box 5 for the EC's assessment of the fiscal effort in 2015 and 2016.

[47] The reduction to employee compensation is significantly lower than planned in the Draft Budgetary Plan for 2015; subsidies, which were planned to decrease through a transition to refundable funds, are projected to grow in the SP2015, while social benefits are similarly projected to grow instead of decline.

[48] The draft budgetary plan for 2015 does not yet include pension and health insurance contributions levied on student work.

[49] The changed structure of economic growth can significantly affect the assessment of the structural balance. According to the EC (EC, 2010), the discrepancy can range from 1.5% of GDP (developed countries) to 4% of GDP (new EU members) owing to the changed contribution of domestic consumption. The IMF also arrived at an effect similar to the lower boundary of the EC estimate using a panel of developed and emerging economies (Dobrescu and Salman, 2011). The ECB assessments (Bouthevillain et al., 2001) are lower, as the maximum effect of the structure of economic growth on the structural balance is about 0.8% of GDP. However, it is necessary to take into account that the EC and the IMF were able to factor into their analyses rapid changes in the structure of economic growth before and during the last crisis.

[50] On the important condition that public investments are designed to have the maximum multiplier effect and are predominantly targeted towards increasing long-term economic potential.

Table 11: **Comparison of output gap-based projections of the structural balance in the SP2014 and SP2015**

	2015	2016	2017	2018	2019
	SP 2014				
Structural balance, as a % of GDP	-1.5	-1.0	-0.7	-0.1	
– change in percentage points	0.5	0.5	0.3	0.6	
	SP 2015				
Structural balance, as a % of GDP	-2.2	-1.6	-1.3	-1.0	-0.8
– change in percentage points	-0.1	0.6	0.3	0.3	0.3

Source: Stability Programme – Amendments 2014, Stability Programme – Amendments 2015.

Table 12: **Projections of general government revenue in the SP2015**

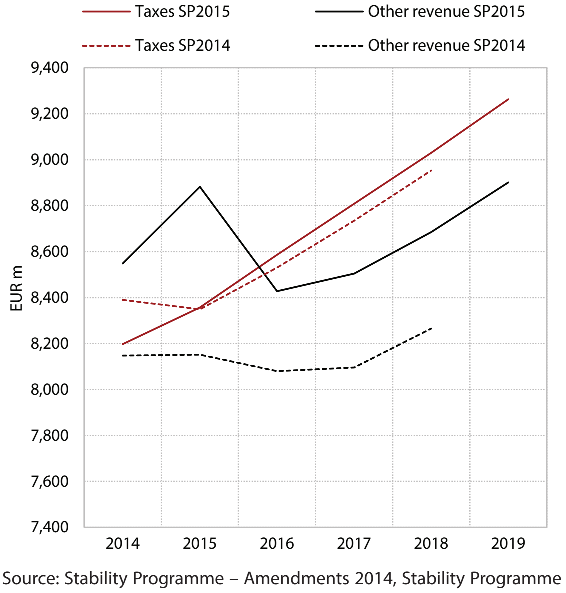
	Share of overall revenue in 2014, in %	Nominal growth, in %				
		2015	2016	2017	2018	2019
TOTAL GENERAL GOVERNMENT REVENUE	100.0	3.0	-1.3	1.8	2.3	2.5
Taxes on production and imports	33.3	1.9	2.3	2.5	2.3	2.3
Current taxes on income, property	15.6	2.1	3.7	2.8	3.0	3.2
Taxes on capital	0.1	-29.5	1.5	1.6	1.7	1.7
Social contributions	32.8	2.8	3.8	2.9	3.1	3.1
Property income	2.7	-14.5	-42.1	2.9	-6.3	-3.0
Other revenue	15.5	9.4	-17.7	-4.4	0.5	1.4

Source: Stability Programme – Amendments 2015.

exceed the 2015 level in 2017. In 2015 all groups of revenue[51] as well as social security contributions are to increase. The increase in both groups of revenue in 2015 reflects not only the macroeconomic circumstances, which in IMAD's opinion contribute roughly three-fifths to the tax revenue growth, but also the adopted and planned fiscal policy measures. The increase of taxes on production and imports outpaces the anticipated expansion of the tax base, particularly in 2016. This is largely owing to the effects of additional tax collection measures planned by the government. Key among these measures is the rollout of certified cash registers, due to be launched as of 2016, for which the government has already prepared the legal basis. In the first year of their introduction revenue is to increase by EUR 50 to 100 m.[52] Based on the general orientation of the consolidation plan in the SP2015 to convert temporary measures into permanent ones, we assume that taxes will remain at 2015 levels until the end of the programme horizon. The SP2015 states that the higher VAT rates introduced in 2013 will remain in place. This means that, according to the SP2015, additional VAT revenue of about EUR 300 m will be secured annually. As of 2015 the rates of tax on financial services and insurance transactions rose after the expiry of the tax on total bank assets, as did the environmental tax on CO_2 emissions.[53] In 2015 and 2016 the increase in revenue from social contributions outpaces the growth of the gross wage bill, which we assess is the result of new social contributions on student work.

The fluctuation of overall general government revenue over the programme horizon is mostly a result of the dynamics of the drawing of EU funds. The fluctuations with the strongest impact on overall revenue are evident in the "other revenue" component (see Table 12);[54] inflows from EU funds account for a substantial portion of this revenue group. This component accounts for just over half the projected increase of overall general government revenue in 2015. This type of inflow has risen significantly in the last two years, with high growth still projected in 2015, the last year in which funds from the 2007–2013 financial perspectives can be drawn. Similarly, the decline in overall revenue in 2016, despite higher tax revenue and social contributions, is largely based on the strong contraction of other revenue. In the last two years the level of the drawing of EU funds was exceptionally high, but this will be reduced in the coming years because eligible funding in the new financial perspectives is significantly lower than in the expiring perspectives and the drawing dynamics at the onset of a new period are typically slower. Major fluctuations also appear in the "property income" group, which includes

Figure 14: **Projections of tax and other general government revenue in the SP2014 and SP2015**



Source: Stability Programme – Amendments 2014, Stability Programme – Amendments 2015.

Note: Other revenue: social contributions, property income, other revenue (EU funds and other various transfers and capital revenue).

[51] Taxes on capital are an exception, but they account for a small portion of overall tax revenue (about 0.1%).

[52] Estimate from the Draft Act on the Verification of Invoices (2015).

[53] The rates of tax on financial services and insurance transactions rose from 6.5% to 8.5%, while the environmental tax on CO_2 emissions rose by 20%.

[54] There are also significant fluctuations in the "property income" category, which includes interest revenue, corporate profits and rental income. However, the fluctuations in this revenue category are not treated separately since it represents about one sixth the size of the "other revenue" category.

interest and property revenue (both account for around 95% of total property income). We assume that the fluctuations to this component are partially attributable to lower interest rates, although the strong decline in 2016 could also reflect a shortfall of dividend payments due to the sale of certain state-owned companies.

Except in certain cases, the planned revenue trend is in accordance with the tax-base projections. We estimate that the projection of the component "other revenue", which is characterised by the biggest fluctuations, is subject to the greatest uncertainty given that it is determined to a large extent by revenue from EU funds, in particular in 2015 and 2016. Aside from the customary uncertainty about macroeconomic trends, the risks also stem from certain not entirely specified revenue-side measures. The proceeds from the introduction of certified cash registers remain uncertain. The assumption on social contributions in 2016 is also subject to risk since it is probably based on the projection of a significant expansion of student work given that revenue growth in this segment outpaces the expansion of the tax base. The Government drafted in May this year a Comprehensive Plan of Tax Projects and established a Steering Committee to monitor and steer its implementation. A successful completion of these projects, including changes in the taxation of real estate, represents an opportunity to increase revenue over the horizon of the SP2015.

2.2.1.4 Expenditure projections

Given the predicted absence of one-off expenditure and the growth of practically all other expenditure, the overall level of expenditure will contract in 2015 and 2016 and expand thereafter. The decline of overall expenditure in 2015 is the consequence of the absence of one-off items that affected expenditure in 2014 (bank recapitalisation and pay-outs to depositors of Ljubljanska Banka); in 2016 it is largely associated with a decline in investments and partially of subsidies owing to the contraction of inflows of EU funds in the transition to the new financial perspectives. In the period 2017–2019 overall general government expenditure is projected to expand on the back of broad-based expenditure rises (see Table 13).

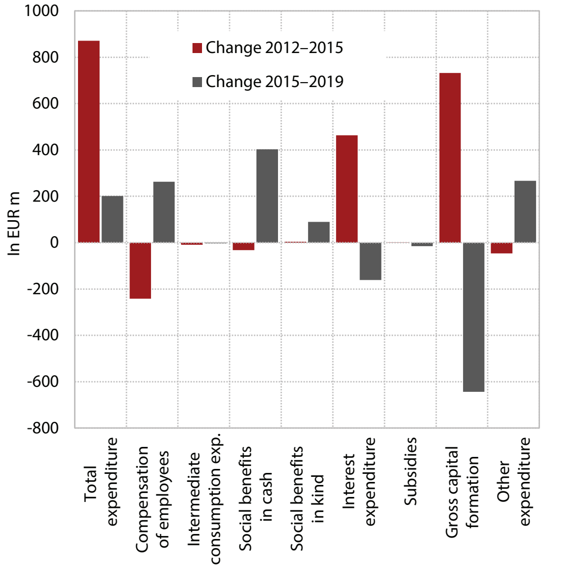
2016 marks a turnaround in the expenditure-side consolidation of public finances relative to 2012–2015, in that a large part of the savings from this period is cancelled out. Expenditure projections in the SP2015 show that all expenditure contained with temporary measures until 2015 starts to expand in 2016 and exceeds the 2014 level by the end of the programme horizon. Their increase is offset with lower interest expenditure and, in the segment of primary expenditure, with the contraction of investments and subsidies. The decline in investments and subsidies, which is particularly pronounced in 2016, is to a large degree associated with lower revenue from EU funds. However, we estimate that this is partially also a reduction of two categories of relatively flexible expenditure which, in the absence of other measures, contributes to consolidation in 2016. The projections of expanding expenditure indicate an imbalance between the stated goals of the SP2015 with respect to the replacement of short-term measures with systemic measures or measures with comparable financial effects. The expansion of individual expenditure components in the period 2015–2019 thus largely cancels out the savings achieved in the period 2012–2015 (see Figure 15). Even though the SP2015 explains such expenditure policy with the pursuit of the promotion of domestic consumption and the securing of appropriate socioeconomic conditions for individuals, in the medium term such an expenditure policy does not ensure a reduction of the structural deficit in accordance with EC recommendations (see chapter 2.2.1.2).

Table 13: **Projections of general government expenditure in the SP2015**

	Share of overall expenditure, 2014, in %	Nominal growth, in %				
		2015	2016	2017	2018	2019
TOTAL GENERAL GOVERNMENT EXPENDITURE	100.0	-1.1	-2.5	0.7	1.5	1.4
Primary expenditure (includes one-off items in 2014)*	93.5	-1.0	-2.5	1.3	1.8	1.5
Compensation of employees	23.2	-0.2	1.4	1.5	1.5	1.6
Intermediate consumption expenditure	13.4	-0.3	1.7	-6.5	3.7	1.3
Total social benefits	37.0	0.7	2.1	1.6	1.6	1.6
- Social benefits in cash	33.1	0.2	1.9	1.5	1.5	1.5
- Social benefits in kind	3.9	4.8	3.7	2.4	2.5	2.8
Interest expenditure	6.5	-1.8	-2.4	-8.2	-3.0	-0.5
Subsidies	1.7	3.9	-29.7	26.5	3.9	3.3
Gross capital formation	10.2	14.7	-29.8	-3.1	2.5	1.0
Other expenditure (includes one-off items in 2014)	7.9	-34.2	6.7	18.7	-0.6	1.4

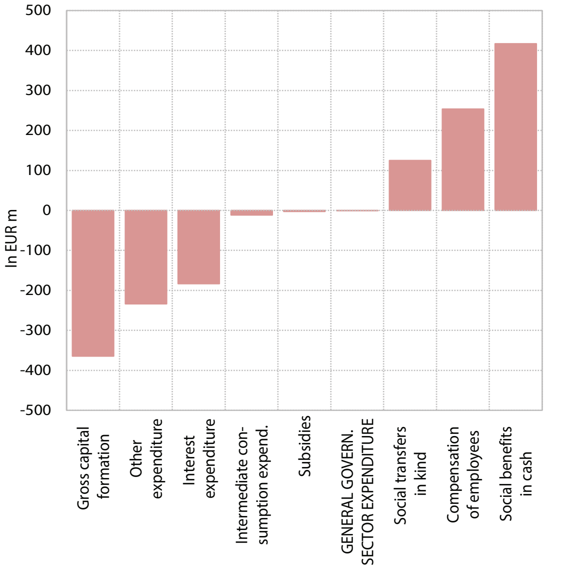
Source: Stability Programme – Amendments 2015.
Note:* One-off items in 2014 include bank recapitalisation costs, and pay-outs to savers of Ljubljanska Banka in Croatia and Bosnia and Herzegovina (excluding interest).

Figure 15: **Changes of individual expenditure categories in 2012–2015 and 2015–2019**



Source: SI-Stat Data Portal – National accounts – General government accounts – Main aggregates of the general government, May 2015. Stability Programme – Amendments 2015.

Figure 16: **Changes of individual expenditure categories in the SP2015, 2014–2019**



Source: Stability Programme – Amendments 2015.

The increase of primary expenditure in 2014–2019 is to be offset with lower interest expenditure, but there are significant risks. The strong increase of interest expenditure since the start of the crisis (from 2.9% to 6.5% of overall general government expenditure) is increasingly crowding out other expenditure components. The opportunity to cushion this trend as envisaged by the SP2015 has become feasible recently as the price of Slovenia's borrowing plunged. However, such approach is associated with risks on both sides. We estimate that the planned level of certain categories of primary expenditure through 2019 is somewhat conservative given the insufficiently defined measures to achieve the projections in the individual years. The projected contraction of interest expenditure throughout the entire consolidation period is likewise subject to risks. Despite the relatively high level of debt in this period, this projection is in our opinion supported only by the assumption that the currently very low yields will persist.[55] Given the potential for fluctuations on financial markets that are not necessarily associated with conditions in Slovenia, this is a relatively optimistic assumption (see chapter 2.5.1.5).

Insufficient specification of measures is the main downside risk in the projections of primary expenditure. The SP2015 backs up its projections of compensation of employees with the effects of the Strategy of the Development of the Public Administration (Public Administration 2020, April 2015), which was adopted in April 2015. The strategy represents the basis for measures aimed at optimising the public administration, for the implementation of activities regarding the elimination of anomalies in the valuation of jobs in the public sector, and for the preparation of systemic measures to improve the public sector salary system. The implementing measures have not yet been determined,[56] rendering it impossible to determine whether they will result in growth of compensation of employees as planned in the SP2015. The fact is that the assumed growth rate corresponds to the pay-out of only a part of the wage elements (promotions) [57] and is yet to be agreed with the social partners for the period 2016–2019.[58] In order to achieve the projections, the savings brought by the Strategy of the Development of the Public Administration would have to be relatively high. Reduction of subsidies also partially contributes to consolidation in 2016, but in the SP2015 it is not backed up by measures; a portion of the decrease can be attributed to the reduced drawing of EU funds during the transition to the new financial

[55] The SP2015 states that the weighted average interest on issued debt is expected to be below 2% over the medium term.

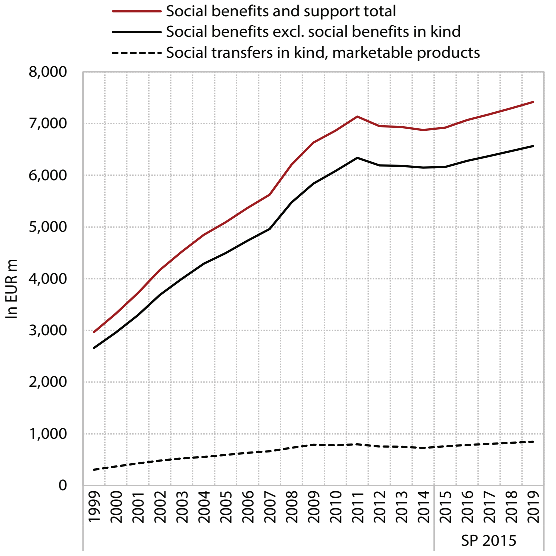
[56] Under government decree, Action Plans for 2015 and 2016 are to be adopted at the end of June 2015 assuming the underlying strategy is adopted.

[57] We estimate that the projections in the SP2015 correspond to the payment of promotions – or less than that, in particular in 2016 – as the estimated effect of promotions that year has changed since the signing of the last wage agreement. At the same time, realisation of the projected compensation of employees in the SP2015 is only possible assuming the hiring policy in the public sector remains restrictive.

[58] On 18 June 2015 the Government adopted as a basis for negotiations the document entitled Starting Points for Negotiations with Representative Public Sector Trade Unions on Improvements to the Wage System in the Public Sector, Elimination of Anomalies, and the Wage Policy in the Period 2016–2019.

perspective.[59] The planned consolidation in 2017, which is based on a substantial decrease of intermediate consumption expenditure (by 0.3% of GDP) is likewise uncertain. To buttress the containment of this expenditure the government already implemented in 2015 certain measures as part of a reform of public procurement (e-auctions), which are expected to be expanded to more categories of expenditure in the future, and it is planning new measures.[60] These are measures that undoubtedly support the streamlining of intermediate consumption expenditure, but the projected substantial saving in 2017 indicate that the projection of this expenditure category has been partially adjusted to the planned dynamics of other expenditure, one of the purposes being to achieve the target deficit that year. There are also certain risks associated with the projections in the category "other expenditure", which fluctuate significantly over the programming period. We estimate that this expenditure will be reduced in 2015 after a spike in 2014 that was the consequence of one-off factors (recapitalisations, pay-outs to depositors of Ljubljanska Banka excluding interest). As of 2016 this expenditure generally rises, with the SP2015 not providing the underlying reasons. It is therefore not possible to assess whether these projections already include pay-outs of interest to depositors of Ljubljanska Banka or whether that represents an additional risk

Figure 17: **Expenditure on social benefits, current trends and projections in the SP2015**



Source: SORS – SI-Stat Data Portal – National accounts – General government accounts – Main aggregates of the general government, April 2015, Stability Programme – Amendments 2015.

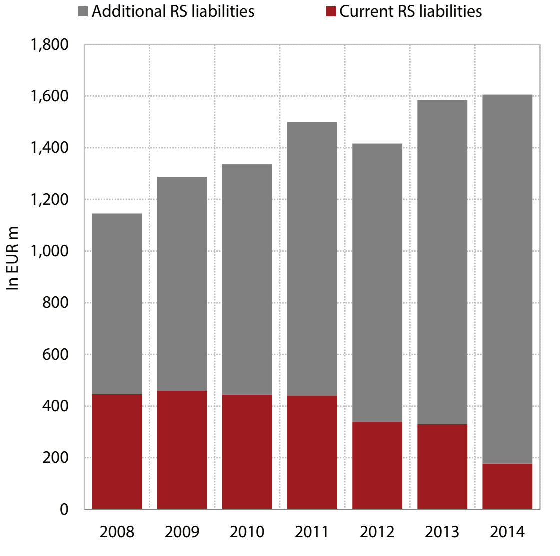
[59] The SP2014 projected a substantial (29%) reduction in subsidies already in 2015, which was to be achieved by changing the subsidy system to transition from grants to refundable funds (loans, guarantees, equity stakes, venture capital). This will not be realised, as the SP2015 projects a slight increase in investments in 2015.

[60] The plan involves a centralisation of the management of state-owned real estate with the objective of reducing running costs and the costs of investment and current maintenance, and a centralisation of the government IT system.

regarding expenditure growth in the coming years.[61] For the most part of the programme horizon the pension indexation policy and the currently limited annual allowance for all pensioners, which substantially determine projections of expenditure on social benefits and transfers, are unspecified as well. There is a risk that this expenditure will therefore rise faster than projected in the SP2015.

In the recent years pension expenditure has been increasingly financed with transfers from the national budget to the ZPIZ. As ZPIZ revenue has declined, transfers from the national budget have grown substantially in recent years to reach EUR 1.6 bn in 2014, 33.1% of total pension insurance revenue. Budgetary transfers to the ZPIZ thus covered as much as 59% of the increase in pension expenditure in 2007–2014. This trend has been putting an increasingly unsustainable pressure on other budget expenditure. The SP2015 states that measures would be adopted ensuring that budgetary transfers to the ZPIZ do not increase in 2016 relative to the 2015 figure; in the subsequent years the transfers are to be reduced in accordance with the already adopted

Figure 18: **Budgetary transfers to the ZPIZ**



Source: MF (2015) Bulletin of Government Finance – Balance sheet of the Pension and Disability Insurance Institute.

Note: Current RS liabilities involve the settlement of the liabilities of compulsory insurance arising from the recognition or assessment of pension and disability insurance rights under special conditions or due to default in the payment of contributions (Article 161 of the ZPIZ-2). Funds for the settlement of the shortfall of ZPIZ revenue from contributions and other sources over expenditure account for about 95% of the additional liabilities (Article 162), the remainder includes other funds for current expenditure, funds for employer contributions for parental benefits and employer contributions for unemployment benefits.

[61] The Government adopted the Draft Act on the Method of Execution of the European Court of Human Rights Judgement in Case no. 60642/08, which governs payouts to the savers of Ljubljanska Banka in Croatia and Bosnia and Herzegovina, on 28.5.2015. The bill is currently on the National Assembly agenda. The financial consequences of the act are estimated at EUR 385 m including estimated interest.

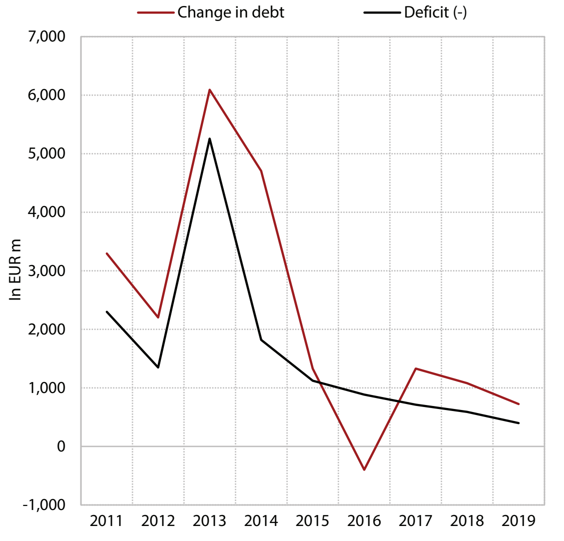
pension reform. There are no plans in the SP2015 of new interventions in the pension system, whose necessity has been highlighted with increasing urgency by domestic and foreign institutions (see chapter 2.2.2).[62] In the event that measures to reduce transfers to the ZPIZ are not adopted, the pressure on other budget expenditure will increase further.

Additional measures that could buttress the planned expenditure-side consolidation in the coming years could emerge from the ongoing review of education and social policy expenditure. Aside from a review of health care expenditure that along with the Resolution on a National Health Care Programme for the Period 2016–2026 is to represent the basis for systemic changes in health care that the government plans to make a structural reform priority[63], the SP2015 also states that reviews of education and social policy expenditure are ongoing. These two reviews are likewise expected to inform improvements in systems which have seen mostly stop-gap measures in recent years; the gradual relaxation of temporary measures, which have not been replaced by permanent measures with similar financial effects, is creating renewed pressure on expenditure growth. The measures arising from these reviews could to a certain extent support the required fiscal effort in the coming years.

2.2.1.5 Projections of consolidated general government debt

SP2015 projections indicate that total general government debt will grow throughout the programming period in nominal terms and decline only slightly as a share of GDP. In 2015 it will reach EUR 31.4 bn or 81.6% of GDP, by 2019 it is projected to be at EUR 34.2 bn or 78.2% of GDP. The projected increase of nominal debt in 2015 is slightly higher than the projected deficit. This probably reflects the government's intention to pre-finance future liabilities this year, when the price of new borrowing is exceptionally low. Over the entire period debt is to decline in nominal terms only in 2016, although a deficit is planned for that year as well[64]. After 2016 the annual increase of nominal debt exceeds the planned deficit by about a factor of two. This may also be associated with the provision of budgetary liquidity reserves, with the cumulative sum of the difference totalling about EUR 1.4 bn in 2017–2019.

Figure 19: **Inter-year change of consolidated general government debt and deficit, Slovenia**



Source: SORS – SI-Stat Data Portal – National accounts – General government accounts – Main aggregates of the general government, April 2015, Stability Programme – Amendments 2015.

Compared to the SP2014, the dynamics of debt-to-GDP reduction planned in the SP2015 are significantly slowed down. At the end of the programme horizon, which was 2018 in the SP2014, general government debt stood at 70.4% of GDP and was reduced by 10.5 percentage points over four years from 2014. In the SP2015, however, debt stands at 78.2% of GDP in 2019 and is only reduced by 3.4 percentage points over four years from 2015, despite a primary surplus throughout the horizon.

Table 14: **Comparison of general government debt and interest expenditure in the SP2014 and SP2015, as a % of GDP**

	SP – Amendments 2014 (April 2014)					2014 realisation	SP – Amendments 2015 (May 2015)				
	2014	2015	2016	2017	2018		2015	2016	2017	2018	2019
General government debt	80.9	81.1	76.0	72.5	70.4	80.9	81.6	78.7	79.6	79.4	78.2
Interest	3.4	3.3	3.3	3.1	3.0	3.3	3.1	2.9	2.6	2.5	2.4

Source: Stability Programme – Amendments 2014, Stability Programme – Amendments 2015.

[62] A white paper on a reform of the system of pension and disability insurance is being drafted and a government task force is expected to finalise it by the end of this year.
[63] The Draft resolution was put to public debate in mid-June 2015 and the Government expects it will be adopted no later than on 15.12.2015 (Normative Programme of the Government of the RS for 2015, June 2015).

[64] According to Ministry of Finance data (Bulletin of Government Finance), the maturity of liabilities is relatively evenly spread over the next ten years, with an average annual principal refinancing liability of EUR 2.2 bn (just under 5% of GDP). The biggest outlier with regard to debt maturity is 2016, when EUR 3.5 bn in principal falls due (8.8% of GDP), of which about 60% is domestic debt. Alternatively, the decline of debt that year can be explained with proceeds from the sale of state assets. The difference between the deficit and the debt contraction in 2016 amounts to about EUR 1.3 bn.

Coupled with the slower pace of deficit reduction, the slowdown of the debt-to-GDP reduction probably reflects changes of the current and assumed financing conditions. Firstly, due to the exceptionally low cost of borrowing at least at the outset of the programme period, substantial pre-financing of future liabilities is planned. Secondly, the assumption of the maintenance of the currently low interest rates is built into the projections. This would create some buffer for the preservation of debt at a relatively high level without an increase of the burden of interest expenditure. Despite debt remaining at a higher level, the SP2015 reduces the planned interest expenditure to 2.4% of GDP in 2019 (compared to 3.0% of GDP in 2018 under the SP2014). Furthermore, the implicit interest rate on debt is reduced from 3.9% in 2015 to 3.1% in 2019, whereas the SP2014 assumed it would stay at a level close to 4.1% at the start of the programme horizon and indeed increase to 4.2% by the end of the period. Despite such assumptions of interest rates in the SP2015, it should be pointed out that the snowball effect[65] does not become favourable until 2018 due to the assumed slow growth in nominal GDP. And thirdly, it is possible that the altered debt dynamics compared to the SP2014 also reflect lower proceeds from privatisation that could reduce debt[66].

We estimate that the preservation of debt at a high level on the assumption of a more permanent period of low interest rates constitutes a significant fiscal risk. The high level of debt, which increased by a factor of more than four since 2008, reduces to a significant extent Slovenia's resilience to additional external and domestic shocks. Given the still uncertain and fast-changing circumstances on the financial markets, yields and hence the cost of new borrowing could increase partially as a result of the high level of debt[67]. The pressure on yields, and pressure to take additional consolidation measures, could also escalate in the event the market participants do not perceive the planned consolidation measures as credible. It is also necessary to take into consideration the possibility of the calling of guarantees extended by the Republic of Slovenia, which has so far not occurred to a substantial extent. At the end of 2014 guarantees totalled EUR 8.3 bn or 22.3% of GDP, up 9.9 percentage points compared to the end of 2008.

[65] Snowball effect: an increase of debt despite a balanced primary position. This occurs when the implicit rates on public debt are higher than nominal GDP growth. In the SP2014 the snowball effect was unfavourable throughout the entire programming period.
[66] The Public Finances Act stipulates that privatisation proceeds be used exclusively to pay down public debt.
[67] Since almost 98% of the overall debt is fixed-rate, the effect of growing interest rates on the deficit and the overall debt position is fairly small.

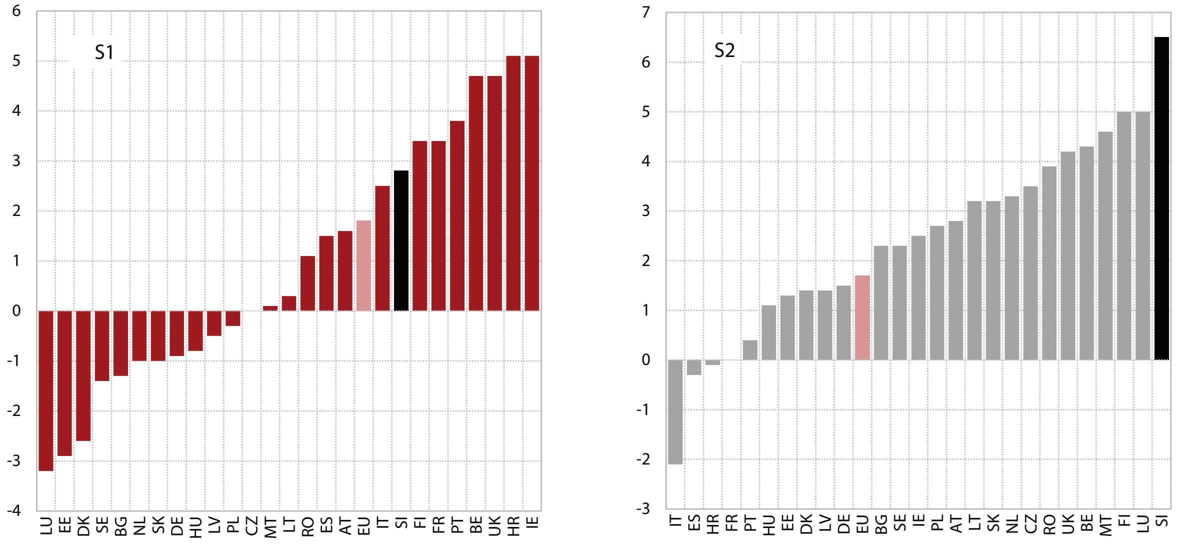
2.2.2 Long-term sustainability of public finances

The ageing of the population and the attendant adjustment of the systems of pension insurance, health care and long-term care pose a series of challenges for Slovenia. According to the latest Eurostat projections from March 2014, the number of persons aged over 65 is projected to more than double relative to the working-age population (20–64) by 2060.[68] The number of the oldest persons (over 85), which was rising fast in the last 13 years,[69] will continue to increase (their share will grow from 2% to 7% of the population). The projections suggest that the share of the elderly will already grow rapidly in the period 2020–2030. Assuming the preservation of the current arrangement of social protection systems, this will step up pressure on age-related general government expenditure, as the demand for pensions, health services and long-term care will increase whereas the share of the working-age population will contract, creating problems in securing revenue. Absent an adjustment of these systems in the next few years, it will be impossible to achieve the medium-term balancing of public finances. Many domestic and international institutions have been highlighting the urgency of change, and securing long-term sustainability of public finances[70] has been made a principal objective of EU economic policies.

The latest EC calculations show that Slovenia is the only EU country with a high risk regarding the long-term sustainability of public finances, and it is in the group of countries with a high medium-term risk. Based on long-term projections of age-related expenditure,[71] the EC also calculated new values of the S1 and S2 indicators,[72] and the contributions of

[68] At the beginning of 2013 there were 26.9 people over 65 dependent on 100 working-age people; by 2060 the figure will rise to 58.3 (EUROPOP2010: 63.4).
[69] By the beginning of 2016 their number in Slovenia had increased by 60% on 2000 figures.
[70] The notion of sustainability of public finances refers to a country's ability to sustain the existing tax policy and the provision of public services in the future without increasing the debt-to-GDP ratio (EC, 2014b).
[71] The coordination of the projection, which the European Commission releases every three years, is conducted by the AWG – Working Group on Ageing and Sustainability at the Economic Policy Committee, on which the IMAD is also a member. The latest projections were made this year.
[72] The basic indicators for monitoring fiscal sustainability (sustainability gap indicators) which are used in the framework of EU budgetary surveillance are:
S1 – indicator of medium-term fiscal sustainability, which shows the effort (expressed as the primary balance) required for a Member State to reduce public debt to 60% of GDP as determined by the Maastricht Treaty by 2030. The calculation factors in the growth of age-related expenditure (pensions, health care and long-term care) until 2030 (from the Ageing Report, EC, 2015d). S1 values above 2.5 represent high risk.
S2 – indicator of long-term fiscal sustainability, which shows the permanent improvement in the structural balance required to

Figure 20: **Indicators of medium-term and long-term fiscal sustainability – S1 and S2, Slovenia and EU countries**



Source: Stability and Convergence Programmes, 2015.

individual age-related areas (pensions, health care and long-term care) to sustainability in the medium and long term. Slovenia is one of eight countries facing a high risk to the sustainability of public finances over the medium term (S1) [73] as well as the only country with a high risk in the long term (S2).[74] In addition to the adjustment of the baseline budgetary position and the adjustment required for the debt reduction, the sustainability gap is fuelled in the medium term (S1) by health expenditure and in the long-term (S2) by the growth of pension expenditure. The latter stems to a large extent from the failure to adjust the effective retirement age to changes in life expectancy in the current pension legislation, which is extending the number of years of retirement. In recent years many EU countries have already built such adjustments into their pension systems. It was due to the high values of S1 and S2 that Slovenia received yet again in 2015 Special Community Recommendations to continue the long-term reform of its pension system and adopt a health care and long-term care reform by the end of 2015.[75]

By 2060 Slovenia is projected to record the biggest increase in age-related general government expenditure in the entire EU. New long-term projections by the European Commission show that total age-related expenditure in the EU will average 27% of GDP in 2060, 1.4 percentage points more than in 2013 (pension expenditure is actually projected to decrease slightly by 2060 compared to the present level).[76] In Slovenia the increase is expected to be significantly more pronounced assuming an unchanged policy of age-related expenditure: it is projected to rise by as much as 6.8 percentage points, from 24.7% of GDP to 31.5% of GDP. The projections indicate an acceleration of expenditure growth in particular after 2022, which would crowd out other expenditure to an even larger extend than at the present.

The effect of ageing on general government expenditure is particularly strong with regard to pensions. Pensions account for the bulk of age-related expenditure[77], a consequence of the demographic situation in Slovenia – until 2060 the number of the elderly and age dependency will increase significantly – and the insufficient adjustment of pension legislation, which still does not restrain early retirement[78] to a sufficient degree. The latter is also a reason why the employment rate of older people is the lowest in the EU. The shortcomings of the new legislation of 2012, which did not cut into the system deeply enough, will therefore outweigh its positive effects about 10 years after the implementation of the reform. In the subsequent years the pressure on public finances will escalate, as the support ratio will start to grow at a constant rate as a consequence of the increasing number of pensioners and decreasing number of workers. This trend has already started, not least due to the ageing of the population (see Figure 21)[79].

prevent an increase of the debt-to-GDP ratio in the long-term compared to the reference year. S2 values above 6.0 represent high risk.

[73] The required fiscal effort is 2.8% of GDP.

[74] The required fiscal effort is 6.5% of GDP.

[75] Council Recommendation on Slovenia's 2015 national reform programme and a Council Opinion on Slovenia's stability programme for 2015, EC (COM 2015) 273 final, 13 May 2015.

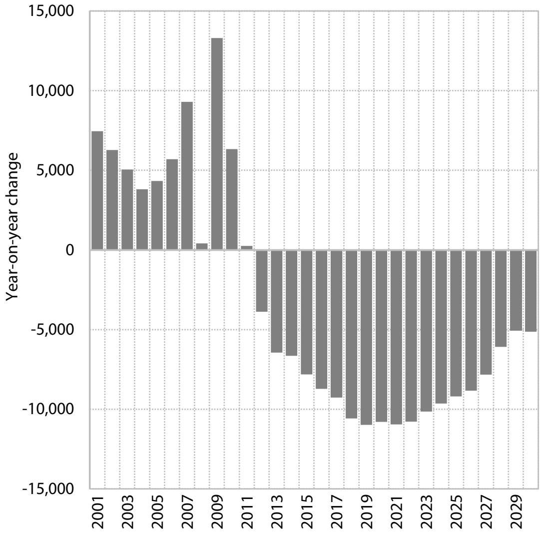
[76] Ageing Report (EC, 2015d).

[77] Pensions in Slovenia are to reach the highest share in the EU in the period 2047–2060 (2060: 15.3% of GDP) and expenditure on pensions as a share of GDP is to increase at the fastest pace in the period 2013–2060 (by 3.5 percentage points).

[78] Relatively small disincentives for earlier retirement, retirement age not linked to increasing life expectancy.

[79] See Spring Forecast of Economic Trends 2015 (IMAD, 2015a), Box 4: Impact of demographic change on the labour market, p. 18.

Figure 21: **Change in size of working-age population (20–64), annual**



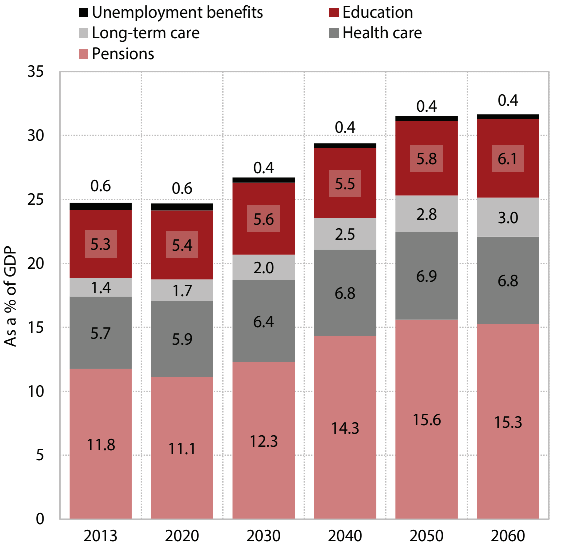
Source: SORS, Eurostat (EUROPOP 2013).

Projections of the growth of other public expenditure related to demographic change (health care, long-term care and education) exceed the EU average and similarly significantly contribute to risks to long-term fiscal sustainability. In health care and long-term care, expenditure growth in Slovenia is projected to be high and exceeds the EU average,[80] mostly owing to unfavourable demographic trends; Slovenia also stands out in long-term care as a result of the relatively high estimated share of the population needing assistance from another person in performing activities of daily living. The deviation from the EU average is even greater in the projected public expenditure on education.[81] Once again the principal reason is demographic projections showing that, under the assumed birth-rate trend (higher number of births in certain periods) and the preservation of the same participation rate in education, the total number of persons in education will rise further.

[80] Assuming the policies remain unchanged, and factoring in mostly just population ageing (baseline scenario), public expenditure on health care as a share of GDP would increase by 1.2 percentage points (EU: 0.9 percentage points); in the risk scenario, the increase would be 1.9 percentage points (EU: 1.6 percentage points). Growth of public expenditure on long-term care is projected to be even steeper: 1.5 percentage points under the baseline scenario (EU: 1.1 percentage points) and as much as 2.7 percentage points under the risk scenario (EU: 2.5 percentage points).

[81] This expenditure is projected to increase by 0.8 percentage points by 2060 (EU: 0.0 percentage points).

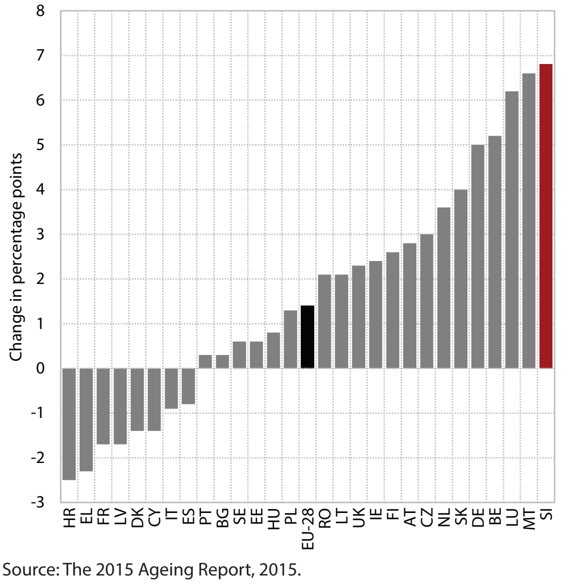
Figure 22: **Long-term projections of public expenditure associated with demographic trends (baseline scenario), Slovenia, as a % of GDP**



Source: The 2015 Ageing Report, 2015.

Note: The baseline scenario takes into account mostly age-related expenditure growth; other non-demographic factors have a minimum impact, although they can be dominant in health care and long-term care. Public expenditure on health care is based on the system of health accounts (SHA) but excludes expenditure on long-term care (HC.3). In AWG projections, public expenditure on long-term care according to SHA methodology (0.98% of GDP in 2012) is taken into account, plus selected cash receipts under the ESSPROS methodology (disability allowance), amounting to 0.5% of GDP.

Figure 23: **Change of public expenditure related to demographic trends, 2013–2060 (baseline scenario), EU-27, as a percentage points of GDP**



Source: The 2015 Ageing Report, 2015.

Government strategic documents adopted in 2015 (SP and NRP) do not address the challenges to the sustainability of the pension system. In terms of expenditure on pensions as a share of GDP, Slovenia's pension system will cease to be sustainable in less than ten years – and it is already being propped up to a significant degree with transfers from the national budget. In 2015 the transfer was the equivalent of 33.1% of all pension insurance revenue; in the period 2007–2014 it covered almost 60% of the increase in pension expenditure. Such trends demand immediate change. This year's SP and NRP list possible area of actions in very general terms[82] but do not provide a timeline for their implementation (a white paper on the reform of the system of pension and disability insurance is to be finalised by the end of this year).

Numerous domestic and foreign institutions[83] have recently been emphasising the urgent need for changes to be made to the pension system in Slovenia. In their proposals, some of which are can be implemented relatively quickly, they are much more specific than government strategic documents. The proposed measures refer mostly to:

(i) Increasing the effective retirement age (tying the retirement age to changes in life expectancy, rewarding those who choose to remain in service more generously, reducing incentives for early retirement),

(ii) Increasing the weight of inflation in the indexation of pensions,

(iii) Eliminating the annual allowance over a certain threshold pension and building the bonus into pensions below that threshold,

(iv) Calculating pensionable earnings based on all contribution years,

(v) Increasing the role of private pension savings,

(vi) Eliminating the special tax credit over a certain pension threshold.

With regard to health care and long-term care, government strategic documents provide some general guidelines on planned systemic changes, with detailed legislative proposals due to be finalised in the first half of 2016. The documents available suggest that expenditure cuts are not planned as part of the planned systemic changes, with the efficiency, quality and accessibility of both systems to instead be the focus in order to prevent a rapid growth of such expenditure in the future. In the past year headway has been made among the stakeholders in understanding that the systems of health care and long-term care are substantively and financially tightly interlinked, making it impossible to carry out separate reforms. By the end of 2015, a Resolution on the National Health Care Plan for 2016–2026 is to be adopted, and activities are ongoing on a comprehensive analysis of the health system[84] with special emphasis on a review of expenditure at all levels (including long-term care), an assessment of the financing of existing systems, and proposals for change. The new legislative framework is to be prepared by the end of May 2016.[85]

In order to secure the long-term fiscal sustainability of the health care and long-term care systems, the specific reform proposals should achieve the following:

(i) Redefine the relationships between public and private financing of selected services, medicines and materials, and the basket of rights in both systems. This should involve reallocation of the available public financing sources only to those rights that are demonstrably cost-effective, and the financing of additional long-term care services.

(ii) Carry out changes in financing sources, in particular with the diversification of public sources, and extend the burden to the inactive population. The fact is that the current system of compulsory health insurance, which is funded mostly with contributions on labour, is not sustainable in the long term given the rapid decline of the active working population.

(iii) Increase the efficiency of use of public sources. The majority of the measures improving the efficiency of the health system are structural and demand a certain implementation time, in particular if they are also designed to promote healthier lifestyles. The key guidelines include: strengthening the primary level and the gatekeeper system[86] to prevent unnecessary use of more expensive specialist outpatient services and hospital treatment; regulating the prices of medicines and medical devices; increasing investment in prevention and health promotion; increasing excise on tobacco, alcohol, and food/beverages with high amounts of added sugar in order to reduce the burden of chronic disease; investing in e-health; introducing the health technology assessment (HTA) method as the basis for introducing and financing new treatment procedures and medicines.

[82] The SP2015 states: "Study of potential disincentives and existing incentives to prolonging working life of the elderly"; "management of age-related expenditure."; "Measures will be adopted concerning the financing of pension and disability insurance which will ensure that the amount of transfer from the state budget in ZPIZ in 2016 does not increase with consideration of realisation compared to 2015; in the future, a gradual reduction of this transfer in accordance with the adopted pension reform will be ensured."

[83] See, for example, IMAD (2014b; 2015b), IMF (2015b), OECD (2015), COUNCIL RECOMMENDATION on the 2015 National Reform Programme of Slovenia and the delivery of a Council Opinion on the 2015 Stability Programme of Slovenia, EC COM(2015) 273 final, 13.5.2015.

[84] Ministry of Health, TOR for Analysis of the Health System in Slovenia, 2015.

[85] Normative Programme of the Government for 2015 (June 2015).

[86] At the primary level, general practitioners act as gatekeepers, which means they reduce the scope of more expensive specialist outpatient treatment.

3 Fiscal policy challenges

The main objective of fiscal policy is fiscal consolidation, which will eliminate the structural imbalances accumulated. Slovenia joined the list of EU countries which adopted measures during the crisis to mitigate the rise in the general government deficit and for its gradual reduction with a delay of several years. In 2012 Slovenia adopted a package of austerity measures that mainly affected earnings in the public administration, social benefits, material costs and public investment. These measures, which were comparable to those implemented in other EU Member States, reduced the general government deficit and restored investors' confidence in Slovenia's economy at a time of high uncertainty when Slovenia had difficulties in accessing finance on foreign markets. However, the extension of these measures, which were mainly savings-oriented, into the years that followed has revealed their weaknesses, such as their negative impact on economic activity and the way they undermine other policies, for example, the wage policy in the public sector. An even greater flaw in this approach is that it does not offer permanent solutions for establishing fiscal sustainability, which is to be achieved by eliminating problems at their source.

In order to ensure fiscal sustainability, Slovenia will therefore need to deal with the consequences of population ageing and the accumulated public debt. The SP 2015 outlines medium-term consolidation, but does not sufficiently address the challenges to fiscal policy. Although Slovenia has one of the fastest ageing populations in the EU, its social protection systems have yet to be adapted to the changing situation. On the one hand, this causes difficulties in ensuring social protection for the population while, on the other, it exerts additional pressure on the public finances. As the gap between contributions paid and pensions received widens, despite the reform of 2013, the transfer from the budget to the pension fund is rising – in 2014 this figure was as high as EUR 1.6 bn. This highlights the pressing need for more radical pension reform that would ensure more sustainable financing of the pension system. The increase in public debt to over EUR 30 bn, which reflects the high general government deficits in the past few years and the extensive recapitalisations of banks and enterprises, is also a sign of inefficient management in state-owned enterprises. A change in management practices, or indeed privatisation, would therefore improve the efficiency of these enterprises and reduce the likelihood of further recapitalisations with public funds.

With regard to other categories of expenditure, a more sustainable fiscal situation could be achieved through a more selective approach to expenditure reduction instead of the implementation of linear cuts. The consolidation process is also hindered by the manner in which the budget is drawn up. In circumstances where deliberations on the preparation of the budget and its structure are mainly focused on individual categories of expenditure (such as earnings, material costs, etc.) for budget users, it is difficult to conduct rationalisation on the basis of the tasks they perform. Shifting attention to individual projects would ensure a more transparent approach to budgeting and a more transparent way of managing budgetary funds. It would also enable their rationalisation on the basis of predetermined priorities, and the implementation of policies that are least harmful to the recovery or strengthen the long-term potential of the economy.

Stronger institutional monitoring focused on the enforcement of long-term professional decisions would significantly contribute to the effectiveness of consolidation. The vast majority of EU Member States have established an institutional framework for conducting a more sustainable fiscal policy by means of independent fiscal councils which monitor fiscal policy compliance according to predetermined rules. Slovenia has yet to establish a formal system of independent fiscal policy monitoring. The fiscal rule has already been incorporated into the constitution but has not yet been defined at the operational level. These issues should therefore be dealt with as soon as possible. The experience of countries with a long tradition of effective fiscal policy monitoring has demonstrated the importance of fiscal councils' independence and the expert knowledge of their staff. The effectiveness of the monitoring process is also ensured by taking into account the characteristics of the existing institutional framework rather than simply transplanting EU rules into the domestic environment.

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4 Appendix to the 1st Chapter: Fiscal framework and surveillance in selected EU Member States

4.1 Austria

Austria has reformed its fiscal framework over the past five years. It has introduced public accounting on an accrual basis, binding medium-term budgetary planning (for a four-year period) with coordination between the federal, state and municipal levels, and a new system of numerical fiscal rules. This system relates to: (i) expenditure growth, which should not exceed the medium-term rate of potential GDP growth; (ii) the structural deficit, which must be below 0.35% of GDP at the federal level and below 0.1% of GDP at the level of states and municipalities; (iii) the upper limit on actual debt (60% of GDP with the envisaged correction rule); and (iv) the upper limit on potential liabilities.

Austria has reinforced fiscal surveillance and advisory support to both the government and the parliament. Since 2013, the function of independent fiscal institution as required by the Two-Pack Regulations of the EU from 2013 and the Fiscal Compact has been carried out by the **Fiscal Advisory Council** (Fiskalrat), which was transformed from the former Government Debt Committee (Staatsschuldenausschus) founded in 1970. It consists of 15 members appointed for a six-year period, who serve as independent experts on an honorary basis. The office of the Fiscal Advisory Council employs five economists, a researcher/statistician and an administrator (the researcher/statistician and administrator are employed on a part-time basis). The members of staff are provided by the central bank, which also finances the office. The Council monitors the compliance of the budgets with national and EU rules, produces analyses of the sustainability and the quality of the public finances and other studies, makes recommendations to the ministry of finance and shapes public opinion on fiscal matters. In parallel with the Council, Austria also has the **Parliamentary Budget Office** (Budgetdienst), which was established in 2012 and provides direct professional support to the members of parliament and the Parliamentary Budget Committee.

Budgetary planning is based on the forecasts of economic trends prepared by an independent economic institute, **WIFO** (Österreichisches Institut für Wirtschaftsforschung Wien), founded in 1927. Its forecasts are also used by the Fiscal Council in formulating fiscal policy recommendations. The WIFO also conducts fiscal and other economic research.

4.2 Belgium

Belgium transposed the fiscal principles and rules of EU legislation into its legal order during the period between the end of 2013 and the first half of 2014. It improved the transparency of the budget planning and execution process, established medium-term budget planning at all government levels and reinforced the coordination mechanism between different government levels in order to achieve the structural budget balance of the general government. It has also strengthened budget control and the role of *ex-post* evaluations of budgetary plans.

The role of **independent fiscal institution** was assigned to the High Council of Finance (Hoge Raad van Financiën/Conseil supérieur des Finances), which took over most of the advisory and control tasks imposed by the Fiscal Compact and the Two-Pack Regulations from 2013, and the National Accounts Institute (Instituut voor de Nationale Rekeningen/L'Institut des Comptes nationaux), which is responsible for preparation and *ex-post* evaluations of macroeconomic projections used in the budgetary planning.

Established in 1936 and then reformed several times, the **High Council of Finance** is part of the Federal Public Service Finance (Federale Overheidsdienst Financiën/ Service Public Fédéral Finances) under the authority of the federal government and does not have a separate budget line. It is divided into two permanent sections (the Public Sector Borrowing Requirements Section and the Taxation and Social Security Contributions Section) and a study group on ageing, all of which are fairly autonomous in their operations. In addition to the chair and two deputy chairs, the Council is made up of 24 section members, who are supported by 12 economic experts and 2 secretariat administrators. The funding for its operation and professional staff is provided by the Federal Public Service Finance, whereas the chairs, deputy chairs and section members come from other (federal, regional and community) institutions. The Council's task is to analyse and evaluate fiscal developments and prospects, give advice in setting the budgetary targets for different levels of government, analyse draft budgets, monitor compliance with the stability programme targets (according to the fiscal rules) and determine whether exceptional circumstances exist that permit deviation from the rules. In the event of substantial deviations from the budgetary targets, the Council issues recommendations regarding the extent and the timeframe for correction measures and monitors their implementation. It also prepares analyses and expresses opinions related to taxation, the costs of population ageing and other fiscal matters. The government is not obliged to respond to the recommendations of the Council, although it usually refers to them in its reports.

In practice, **macroeconomic forecasts** on behalf of the National Account Institute are produced by the Federal Planning Bureau (Federaal Planbureau/Bureau fédéral du Plan, FPB). Founded in 1959, the Federal Planning Bureau is an independent public agency with its own budget and 90–100 employees. Its main tasks include the preparation of short- and medium-term forecasts of economic trends, population projections, analyses of the socio-economic impacts of (proposed) measures and other studies (on socio-economic and environmental policy issues, transport policy and sustainable development).

4.3 The Netherlands

The Netherlands has a well-developed and long-established budgetary framework, which was reformed and adjusted to EU rules with the Sustainable Public Finance Act in 2013. The act does not explicitly define the numerical budgetary rule but instead refers to the legislation of the EU. In budgetary planning – which is based on an independent economic forecast – revenues are strictly separated from expenditures so that the windfalls on the revenue side cannot be used to increase expenditure. In a budget memorandum, the government sets a multi-year fiscal framework, which determines the ceiling for real expenditure growth during the government term. Some of the formalised budget policy principles had already been part of general policy practice before the reform.

The tasks of an **independent fiscal institution** that arise from EU legislation are split between two institutions: the CPB (Centraal Planbureau) and the Council of State (Raad van State). The majority of tasks are the responsibility of the CPB, whereas the Council of State is in charge of monitoring compliance with the numerical fiscal rules.

Founded in 1945, the CPB operates within the ministry of economic affairs, which provides funding for its activities. Its director is appointed by the minister for a seven-year period; there is an informal understanding that a well-respected and non-partisan economist should be nominated for this position. Despite its financial dependency, the CPB is independent from the government in its operations, and its institutional set-up allows for its regular participation in the budget preparation process and the preparation of socio-economic policy measures. The CPB has a broad mandate including the preparation of: (i) the forecasts of economic trends used for drafting the budget; (ii) short- and medium-term fiscal analyses; (iii) analyses of the long-term sustainability of public finances (every 4–5 years); (iv) estimates of the financial and broader economic impacts of legislative proposals and cost-benefit analyses of infrastructural projects (upon request of the government); and (v) studies on other matters (as required). The CPB also keeps the public abreast of fiscal developments and prospects. Furthermore, it is also involved in the election cycle: it publishes an overview of the economic situation and a medium-term economic forecast, which serve as a baseline for the preparation of the political parties' manifestos; before the elections, it analyses the financial and broader socio-economic effects of the political parties' programmes, whereas after the elections, it often evaluates, and subsequently monitors, the measures included and commitments made in the coalition agreement.

According to the constitution, the **Council of State** has two separate tasks: (i) its advisory division provides independent advice on legislation and governance to the government and the parliament; (ii) its jurisdiction division is the country's highest administrative court. In the fiscal framework, the Council of State has a monitoring function. Since 2014, its Advisory Division, in close cooperation with the CPB, has assessed fiscal policy compliance with EU rules, supervised the correction mechanism process and the implementation of action plans, and formulated recommendations. The estimates of compliance with the fiscal rules and the assessments of corrective measures are released publicly. If the government does not comply with the recommendations, it is obliged to explain its reasons.

A special role in Dutch fiscal policy is played by the **Advisory Group on Fiscal Policy**, a traditional consultative body which gives unbinding recommendations to the government regarding the implementation of fiscal principles and targets. In 2009, the **working groups on spending reviews** and the **Tax System Study Committee** were also established, which are activated on the initiative of the ministry of finance.

4.4 Germany

A number of elements of Germany's fiscal framework were established 60 years ago and then reformed and completed after the onset of the economic crisis. In 2009, Germany replaced the ineffective golden rule on borrowing with constitutional restrictions on structural budget deficits at the federal level (0.35% of GDP) and the level of federal states (0% of GDP), which should ensure compliance with EU fiscal rules. In 2013, it included into its national legislation (by way of an ordinary law) a ceiling for the structural deficit of the general government in line with the Fiscal Compact (0.5% of GDP), and authorised the Stability Council to monitor compliance with this rule. The fiscal restrictions for the federal level and the adjustment mechanism to be triggered in the event of deviations are relatively strict, whereas the states have more room for loosening budgetary discipline. Germany's fiscal framework also includes a legislative provision on balanced budgets for municipalities.

Since 2010 the role of fiscal council has been performed by the **Stability Council** (Stabilitätsrat). The Stability Council monitors compliance with constitutional budget rules at the federal level and the state level through a set of fiscal indicators and – if risks are identified – agrees on a budget rehabilitation programme with the relevant authorities. Twice a year, the Council also assesses compliance with the structural budget balance rule for the general government (for the current and the following four years). In this function, it is supported by the **independent Advisory Board of the Stability Council** (Beirat), which was established in 2013. In the event of risks (deviations), the Council formulates recommendations for correcting the excessive deficit, which are then discussed in the federal and state parliaments. It cannot impose sanctions for violations of the fiscal rules, with the exception of the withdrawal of the consolidation grants that are received by five federal states. The members of the Stability Council are the federal minister of finance, the federal minister for economic affairs and the ministers of finance of the states (16), which are assisted in their work by a secretariat. The Council also has a working group, which includes representatives of the federal ministries of finance and economic affairs and the ministries of finance of the states. Its actual composition at meetings depends on the matter discussed. The costs of the Council's operation are evenly distributed between the federal level and the states. Since 2013, the Stability Council has been assisted by an Advisory Board, an independent body of nine experts appointed for a five-year period (three representatives from independent economic institutions, four representatives from federal authorities and the states, and two representatives from municipalities and social security funds). The Advisory Board expresses its opinion regarding compliance with the fiscal rule for the general government and, in the event of deviations, makes recommendations for corrective measures, which are then released publicly.

Germany otherwise has a wide network of (functionally) **independent fiscal institutions**, some of which have a 60-year history. The Advisory Board to the Federal Ministry of Finance, which consists of 25 economists and lawyers (mostly academics), advises the Ministry on fiscal policy matters; its analyses and proposals are made available to the public. The German Council of Economic Experts provides annual reports on the state of and prospects for the German economy and a range of other topics. Furthermore, the Working Party on Tax Revenue Forecasting, an independent advisory body that includes experts from a number of institutions, prepares multi-year tax revenue forecasts based on government forecasts of economic trends. Twice a year, the Joint Economic Forecast Project Team, a group of researchers from leading economic institutes, prepares its forecast of domestic and international economic trends; this joint forecast serves as the basis for the annual draft budgetary plan, while in medium-term budgetary plans, it is also used as a benchmark to measure the objectivity of the government's forecasts.

4.5 Slovakia

Over the past decade, Slovakia has introduced multi-year and programme-based budgetary planning and strengthened its fiscal framework in line with EU legislation. In 2012, it amended its constitutional act to include a rule limiting general government debt (with a strict correction mechanism), establishing a fiscal council, and increasing the independence of the two advisory boards to the ministry of finance that endorse macroeconomic and tax revenue forecasts, and introduced additional requirements related to reporting and the components of the general government budget. In 2013, it transposed into its national legislation (by way of an ordinary law) the rule on the structural budget balance of the general government (including the correction mechanism) according to the Fiscal Compact. The rule took effect in 2014.

Since 2012, fiscal council tasks have been carried out by the **Council for Budget Responsibility** (Rada pre rozpočtovú zodpovednost), which operates under the auspices of the central bank and has no separate budget line. It consists of three members whose 7-year terms are confirmed by the parliament upon the proposal of the government (for the chair) and the president of the state and the governor of the central bank (for the other two members). Its members are assisted by 15–20 experts and an Advisory Panel for methodological issues. The Council monitors compliance with the fiscal rules (constitutional rules and the rule according to the Fiscal Compact) and the functioning of the correction mechanism, analyses the long-term sustainability of public finances and, where required, issues opinions on legislative proposals and prepares other studies.

Medium-term macroeconomic and fiscal forecasts that serve as the basis for budgetary planning are produced by the ministry of finance and assessed by the Macroeconomic Forecasting Committee and the Tax Revenue Forecasts Committee, which operate as functionally independent project units (with external experts) within the ministry of finance.

4.6 Latvia

After introducing medium-term (three-year) budgetary planning in 2007, Latvia has strengthened its fiscal framework in recent years. It has introduced a number of elements that improve budgetary discipline and reduce fiscal risks: (i) the structural budget balance rule for the general government (according to the Fiscal Compact); (ii) the rule requiring expenditure growth to not exceed the rate of potential GDP growth; (iii) binding expenditure ceilings for a three-year period; (iv) a Swiss-type correction mechanism; (v) general management of fiscal risks (including fiscal safety reserve); and (vi) a fiscal council.

Since 2014 fiscal surveillance has been conducted by the **Fiscal Discipline Council** (Fiskālās disciplīnas padome). It has six members elected by the parliament (by a simple majority) for a three- or six-year period upon the proposal of the governor of the central bank, the minister of finance and members of parliament. The members of the Council have an advisory function; they are entitled to fees for attending meetings (eight per year) and the reimbursement of costs (which should not exceed EUR 2,000 in total). They are assisted by a secretariat, which has three full-time employees: a secretary, a macroeconomist (since May 2015) and an expert for fiscal risks (since June 2015). The Council has its own budget and is autonomous in its work, despite close cooperation with the ministry of finance. Its main task is to monitor compliance with fiscal rules in the process of medium-term and annual planning, and to execute general government budgets. It produces and publishes annual reports on fiscal discipline and other reports (e.g. irregularity reports in the event of non-compliance with the rules). It issues opinions on fiscal policy or its measures if required in order to ensure fiscal discipline. The government is obliged to respond to the reported non-compliance according to the "comply or explain" principle.

Macroeconomic forecasts are prepared by the ministry of finance. The Fiscal Council does not confirm the forecasts but only issues a non-binding assessment.

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