2nd Meeting of the Advisory Panel

Minutes
October 3, 2014

Council for Budget Responsibility
Imricha Karvaša 1
Bratislava 1, 813 25

Advisory Panel Meeting

October 3, 2014

Venue: National Bank of Slovakia, Imricha Karvasa 1, 30th floor, Bank Board Meeting Room

Advisory Panel Members Present: George Kopits, Kevin Page, Daniele Franco
CBR Members Present: Ivan Šramko, Ľudovít Ódor, Michal Horváth
Secretariat of the CBR: Viktor Novysedlák (Executive Director) and Members of the Technical Staff of CBR

Apologies: Simon Wren –Lewis, Philip Lane (comments sent beforehand)

Session: Opening remarks

Presented by: Ivan Šramko

Within the opening session, Mr. Šramko presented the outcomes of CBR's work and activities since the first meeting of the Advisory Panel in October 2013.

With the transposition of 'Fiscal Compact' into national legislation, the Council was entrusted with a new task such as the evaluation of the compliance with the balanced budget rule. The CBR's role is to assess the activation of the correction mechanism in case of significant deviation from the MTO (or from the path leading to it) and to assess circumstances for triggering escape clauses that suspend the correction mechanism. The first evaluation report of the CBR was published in July 2014, which concluded that no significant deviation occurred and hence there was no need to trigger the correction mechanism. Since September 2014, the CBR has been a full member of the Tax Revenue Forecasting Committee and together with other committee members, it is responsible for the evaluation of the official tax revenues forecast.

The CBR has been actively taking part in the international discussions related to macroeconomic and fiscal analysis. By organizing Macroeconomic and Fiscal Affairs (MaFiA) seminars on a regular basis, it has provided access to recent developments and a network of foreign researchers not only for CBR experts but also other public institutions and Slovak universities and contributed to the exchange of knowledge on the methodological and implementation issues related to the Fiscal Compact.

In the field of international cooperation, the CBR has been actively working together with the network of EU Independent Fiscal Institutions (IFIs) as well as the OECD Network of Parliamentary Budget Officials (PBO). As the temporary moderator of the EU IFIs Network, the CBR has organized two informal meetings for the representatives of the individual councils in order to discuss the possibilities of closer cooperation and provide space for information and knowledge exchange. Further technical issues were discussed also within the OECD PBO workshop. These first activities and publications have already raised the interest of the public, media and professionals in the field of public policy and finance.

Apart from the publications related to the implementation of the 'Fiscal Compact', the CBR has also published several discussion and working papers, analytical commentaries, blog posts and presentations, in both Slovak and English language.

The CBR has also identified its main challenges for the near future which involve relations with EU institutions and the EU IFIs network, further methodological issues in the field of implementation of the Fiscal Compact and an effective communication strategy.

The members of the Advisory Panel praised the CBR for the outstanding work and significant progress it had done in several fields of its activities, from institutional matters to methodological issues and showing leadership in relation to the EU IFIs network. The main topic of the subsequent discussion was the extent to which these achievements resonated in the media and public.

The Advisory Panel members asked about the impact of the work on key policy-makers, media and the public awareness. The CBR's main publications caught the most attention. The assessment of the 2014-16 budget proposal was not only heavily quoted in the Slovak Parliament but also discussed by ordinary people. Furthermore, the long-term sustainability report was very well covered in the media as it contained new elements in terms of generational accounts. The evaluation of the balanced budget rule raised some interest but since it was considered rather confusing because of the similar legislative framework on the EU and national level, it did not have any significant impact.

Furthermore, the members of the Panel were interested in the nature of relations of the Council with other public institutions (e.g. the government and the Ministry of Finance), media and its activities to improve the relations with them. As CBR noted, because of the significant progress in consolidation in the previous year and despite some differences in the methodology, the positive outcome of the CBR's evaluation did not lead to any confrontations or direct criticism of the national authorities. For this reason, the relations with public institutions have been fairly good. It is not sure how they may change in case future developments required a more critical stance towards the authorities. However, as Mr. Kopits noted, confrontations and exchanges of views are an inevitable part of this work.

The members of the Advisory Panel highlighted the importance of effective and constructive communication with the media. They suggested a systematic approach to educating the media (and the public) in order to ensure better interpretation of the CBR's work. This should involve specialized workshops and meetings with representatives of media explaining them the technical terms and implications to make sure that the right messages will be transmitted to public in the right way.

Session: The future role of fiscal councils in Europe

Presented by: Ľudovít Ódor
Lead discussant: Simon Wren-Lewis

Changes to the conduct of monetary policy (MP) were enormous in the last few decades. Despite recent problems after hitting the zero lower bound (ZLB), Blinder rightly calls this development as a “quiet revolution”. Independent central banks, inflation targets, transparent communication of objectives and policy and monetary research all contributed to a much better understanding of monetary policy. On the other hand, the more important macro policy tool from a social welfare point of view – fiscal policy (FP) – is still conducted on an ad-hoc basis and in a very opaque environment in many countries. Leeper (Leeper, "Monetary Science, Fiscal Alchemy", *NBER*, 2010) is talking about “monetary science and fiscal alchemy”. Mr. Ódor presented 2 papers: one about a possible “quiet revolution” also in the area of fiscal policy and one critically reviewing the current fiscal architecture in Europe (The Good, The Bad and the Ugly).

The main messages were the following. Changes to the institutional set-up in MP can serve as a useful guide also for FP. Of course the analogy is not perfect, since FP has high distributional consequences and can have also significant supply side effects. But clearly there is ample scope for de-politicization of many aspects of FP. Ódor stated that from a practical point of view, the elimination of the deficit bias (as efficiently as possible) should be the most important policy objective. The main instrument would be some mix of simple fiscal rules and independent fiscal institutions as watchdogs. Since the source of the deficit bias is country specific, one-size-fits-all solutions in a monetary union can be sub-optimal. On a top of that, the current fiscal architecture in Europe is extremely complex and contains many inconsistencies.

After careful analysis of the EU framework and the parallels between MP and FP Ódor recommended the following de-centralized set-up.

The description of the layers is the following.

No bail-out –it is important to restore the credibility of the no bail-out clause as much as possible. Private sector involvement, partial restructuring or bail-ins seems to be essential to limit the risk of contagion between banks and the sovereign and also among sovereigns. Private investors should remain responsible for their investment decisions.

European fiscal rules - they should *not* try to fine-tune local budgets every year. Instead they should be simple and should be effective only if domestic frameworks are not able to function without "gross policy errors" (the original idea behind the SGP). For example long-term debt limits (possible country-specific) can serve this purpose relatively well. Another possibility is to have fiscal rules for the EU budget – if there is a political will to have a stronger fiscal union.

European watchdog - it should i) check the compliance with EU-wide fiscal rules (if existent), ii) check whether minimum standards regarding rules and institutions are respected at the national level and iii) make recommendations if rules or standards are violated.

Minimum standards – these can be formulated both for fiscal rules and fiscal institutions. In case of local IFIs it might be helpful to assure: independence, mandate, professional skills and quality of outputs or for example sufficient funding. In case of local fiscal rules, their legal power, coverage and counter-cyclicality might be assessed.

The last two layers – local fiscal rules and local IFIs – should be country specific, tailored to national circumstances.

In order to implement this framework one should clearly design not only the "layers" but also the linkages between them. While duplicities should be avoided, appropriate checks and balances are needed to utilize all the possible synergies. Moreover, free flow of information and results of technocratic work between the layers is necessary to have clear policy messages.

Simon Wren-Lewis was the lead discussant in this session. He made the following useful suggestions/observations.

- There is an important issue about independence, and it may be more critical for institutions established as a result of EU legislation compared to those that are 'home grown'. If the legislation can be satisfied by establishing token fiscal bodies that in reality have little independence, then the 'quiet revolution' may be a little slower arriving!
- There is a much greater consensus about what the goals of monetary policy are, so that allows greater delegation. Monetary policy delegation involves delegation of control, whereas fiscal policy delegation involves delegation of advice.
- Appropriate rules will depend on the fiscal credibility of governments. This is because there is a tension between rules that are optimal and rules that are effective at controlling deficit bias. This is in itself a strong argument for establishing home grown rules and institutions, rather than imposing uniform rules across all Union economies.
- Are annual deficit targets sensible? It may be better to have a longer term deficit target, and leave the fiscal authority some discretion in how it approaches this.
- Mr. Wren-Lewis argued that an independent fiscal body should only advise about appropriate paths for debt and deficits, and not about how those deficits should be achieved (i.e. by changing taxes or expenditure), as this is essentially a political decision. However he also questioned the operational advantages of focusing on expenditure rather

than deficits. In the UK, failure to achieve deficit targets have often arisen because of structural shifts in tax yields, and it would seem odd not to react to these.

- Can rules be set at both a national and Union level? This can be discussed at the level of what an ideal arrangement might look like, or what is politically practical. These levels are very different! For example, national policies could involve a gradual reduction in debt, whereas rules at the Union level would prevent debt increasing. The logic here would be that national rules and institutions would be concerned with what is optimal nationally, whereas the Union is only concerned where there are important externalities involving other Union members.
- An alternative setup would be for the European Commission to simply act as a quality controller. There would be no national fiscal rules imposed at the Union level, but instead the Commission could simply ensure that national rules were compatible with Union wide goals. In this regard, the Commission could play a useful role as the defender of independent fiscal institutions.
- The paper hardly mentions issues of countercyclical stabilisation. In principle the necessity of fiscal policy playing an active countercyclical role (i.e. going beyond the automatic stabilisers) when part of a monetary union has important implications for the design of an independent fiscal institution. In many respects that institution has to take on many of the characteristics of a central bank. It also becomes more difficult for such an institution just to focus on deficits, when some fiscal instruments are clearly more effective at demand stabilisation than others.
- There are also interesting issues in relation to fiscal policy rules. In principle it would seem appropriate to focus on cyclical variables (inflation, output) in the form of deviations from the Union average, and rely on ECB monetary policy to take care of stabilisation at the Union level. The exception of course is the one we are currently in, when ECB policy becomes ineffective. However the need for fiscal policy to substitute for monetary policy in a liquidity trap would seem to be something that clearly requires coordination at the Union level, and so this could perhaps be ignored in the design of national countercyclical fiscal rules.

Philip Lane stated that in general, the 'Another Quiet Revolution?' paper and the 'Good, Bad and the Ugly' are very welcome. He highlighted some points for discussion:

- While it might be neater to have clear lines of responsibility between EU level and local monitoring, the counter-argument is that fiscal/macro analysis is sufficiently contested that it is helpful to have "two pairs of eyes" looking at the same set of issues. (Monopolies are not good.) This is especially the case when there is a scarcity of economic talent (both at local and EU levels), so that major errors are possible if only institution is doing the monitoring. Where major differences of judgement arise, it is helpful to be able to look at the underlying analyses from both EU and local entities.
- He agreed strongly with vetting IFI council members for professional qualifications - that could be done at EU level maybe to provide EU-wide reassurance
- He agreed that IFIs should be conducting background applied fiscal research - but that could include funding relevant academic work.

George Kopits echoed Mr. Wren-Lewis´s comment about the importance of de facto independence and non-partisanship in the case of fiscal councils (even if the institution is part of the government or the legislature de jure). When designing fiscal councils it is necessary to distinguish between non-partisanship vs. bi-partisanship. Large bodies (as in Austria, Belgium, Germany), where almost every interest group is presented, for the sake of bi-partisanship, should be avoided. As far as the future set-up of the euro area is concerned, Mr. Kopits favoured a more de-centralized model, where "home-grown" institutions and local fiscal rules are the first line of defence against the deficit bias. In his view the bulk of counter-cyclical policy should be the responsibility of the centre.

Kevin Page did not consider overlaps in terms of accountability between the local and European level as appropriate. Analytical work can be carried out at both levels, however responsibilities should be clearly separated. He also saw scope for gradual transformation of the current model to a de-centralized set-up. However he warned that setting the deficit target is a political exercise and therefore it will not be straightforward to delegate it to technocratic bodies.

Daniele Franco stressed that the "quite revolution" in case of fiscal councils is not the same as in monetary policy due to the fact, that IFIs are watchdogs and not policy makers. He also warned that policy objectives can be very different at the EU and local level, so differentiated approach is needed. He also saw some role for more involvement of fiscal councils in the analysis of the expenditure side of the budget. Lastly, he considered local expenditure ceilings as potentially useful operational targets.

Session: Fiscal risk assessment at the CBR

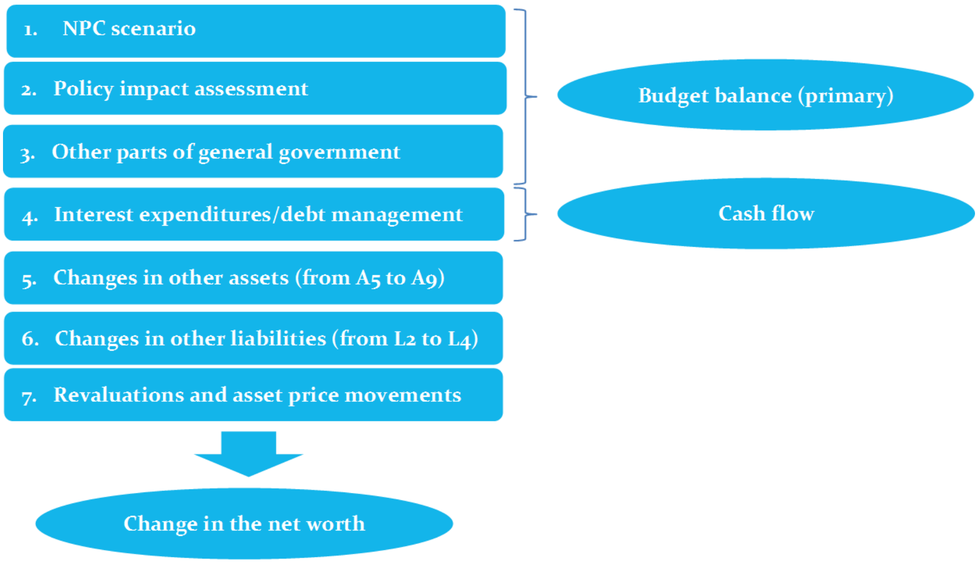
Presented by: Ľudovít Ódor
Lead discussant: George Kopits

Mr. Ódor highlighted that fiscal risk is a multi-faceted concept. Usually is defined as „a source of fiscal stress that could face the government in the future" (Polackova Brixi and Schick eds., "Government at Risk: Contingent Liabilities and Fiscal Risk", *World Bank Publications*, 2002) or as „the possibility of deviations of fiscal outcomes from what was expected at the time of the budget or other forecasts" (Cebotari et al., "Fiscal Risks: Sources, Disclosure, and Management", *IMF*, 2009). In practice there can be numerous reasons for deviations from targets: different macroeconomic development, windfall revenues, underestimated impact of government policies, bailing out financial institutions, aging problems etc. The time dimension is also important, since different risk factors can materialize in a short-term than on long-term horizons. To capture all these aspects in one framework, different authors used different schemes mainly on an ad-hoc basis.

The Council for Budget Responsibility uses a somewhat different approach to organize thinking about fiscal risks: the framework is centred around the concept of inter-temporal net worth (INW). It has the advantage over other frameworks that: i) is directly comparable to budget figures (both ex-ante and ex-post), ii) easier to communicate to policy makers, iii) do not rely on ad-hoc categories but is directly linked to the inter-temporal budget constraint, iv) is embedded in the constitutional Act on Fiscal Responsibility and v) promotes easier detection of fiscal gimmicky.

ASSETS	LIABILITIES
A1 Buildings	L1 Explicit debt
A2 Infrastructure	L2 Implicit liabilities
A3 Public sector capital stock	L3 Contingent liabilities
A4 Liquid financial assets	L4 Other Liabilities
A5 Net worth of the central bank	
A6 net worth of state enterprises	
A7 Natural resources	**NET WORTH**
A8 Ecological wealth	
A9 Other assets	

The following figure describes all the seven steps included in the analysis.



The individual steps represent different risk factors and therefore the CBR employs a wide variety of models, to measure the uncertainty.

George Kopits was the lead discussant. On the basis of a recent survey (Kopits, "Coping with Fiscal Risk: Analysis and Practice", *OECD Journal on Budgeting*, forthcoming), he stressed that different countries pursue different approaches to measure fiscal risks, though most governments do not go beyond a narrative and estimates of specific risks while a few present fan charts on the impact of general economic risks on fiscal projections. The CBR stands practically alone in an attempt at developing possibly a stochastic approach. In this regard, he identified five methods: i) fair spread or contingent claims analysis, ii) Value-at-Risk (VaR) model, iii) structural and DSGE models, iv) vector autoregressive model and v) fiscal stress index. He was pleased to note that the CBR framework bears strong resemblance to a VaR analysis of the public sector inter-temporal net worth (Barnhill and Kopits, "Assessing Fiscal Sustainability under Uncertainty", *Journal of Risk*, 2004). In addition, the CBR framework seems to draw from the fiscal stress index in formulating an early warning system of traffic lights based on thresholds of vulnerability. Alternatively, the VaR provides scope for setting thresholds in terms of confidence levels for estimating a fat-tail risk.

On balance, Mr. Kopits considered the CBR´s approach as promising. The first step is correctly focused on the estimation of risks in the NPC scenario. While he understood that the paper presented only a draft conceptual framework—that is, "work in progress"—he flagged that the quantitative application will be challenging, including in the selection of risk variables and their correlation in a coherent model-based context. He suggested that the CBR might consider employing outside consultants to assist further work on the methodology and initial application.

Kevin Page raised two points. First, he saw clear benefits in presenting the outcome from a complex risk assessment to MPs. Second, based on his experience, presenting policy impact assessments is crucial to identify risks in real-time and not ex-post only.

Daniele Franco agreed that the inter-temporal net-worth can be a powerful tool in identifying fiscal risks. In his view the government should present the public sector balance sheet in the first place. According to Mr. Franco, not only the overall change in the net worth is important, but also its sectoral distribution (central government, sub-national governments, public companies).

Session: Communicating fiscal risks

Presented by: Ľudovít Ódor
Lead discussant: Daniele Franco

Despite the wide variety of mandates and institutional set-ups of existing fiscal councils, they primary role can be easily summarized as: evaluation and communication of fiscal risks. The first two years of existence of the Council for Budget Responsibility were mainly about building analytical tools, attracting highly skilled human resources and creating stable administrative backing. No serious attempt was made to assemble a fully-fledged communication strategy. According to Mr. Ódor, now it is the time to work more intensively on this second leg of the core function of IFIs. In a short note he briefly summarized the CBR´s communication activities so far and proposed 4 important new tools to increase the public awareness of budgetary trends: budgetary traffic lights, "safe" or "sound" level of debt, Fiscal Space Review and Citizen´s Budget. In addition to these initiatives, some other possibilities were discussed to communicate with politicians and the media.

For the purpose of monitoring budgetary trends in the short- to medium-run the CBR developed an indicator of fiscal stress which combines three elements: i) monthly detection of deviations of regular revenue and expenditure items from targets, ii) expert assessment of irregular and one-off items and iii) medium-term fiscal risks. Compared to the standard literature the CBR does not define fiscal stress as a credit event or spread on sovereign bonds, but rather we focus on the magnitude of deviation of fiscal variables from current and future targets. Significant deviations can signal to the public that the government will probably need to adopt new measures with possible negative welfare implications. The results can be summarized in a single measure, representing a colour on a traffic light.

On the CBR´s website there is currently a subsection devoted to easy-to-understand presentation of fiscal issues. It contains 3 elements: visual summary of the budget (5-6 major charts with short commentary), basic explanation of fiscal frameworks to the general public and a directory of fiscal expressions, where complicated technocratic words are "translated" into plain Slovak. The CBR is planning to substantially improve the visualization part and to create a new section of FAQs (frequently asked questions). Simple charts (Excel) are not really suited to the needs of customers in the 21st century. Therefore the council has decided to make them more interactive, intuitive and colourful. The plan is to present each budget and final data for t-1 via Data Driven Documents (D3). There will be six aspects to slice the budget:

1. What do we mean by public finances?
2. Revenues and Expenditures
3. Deficit, Debt and Net Worth
4. COFOG – functional classification
5. Basic analytic indicators
6. Budgets in Europe

A fully-fledged analysis of the change in the inter-temporal net worth is definitely not the right channel of communication with the general public. But the underlying analysis can be used to construct an empirical indicator referring to "safe" level of debt. In the literature there is no clear theory to calculate such an indicator (Calmfors and Wren-Lewis, "What Should Fiscal Councils Do?", *Oxford University*, 2010); however a simple empirical framework can help to distill much of the risk assessment into one number understandable to the public.

The work of independent fiscal institutions (IFIs) is generally about risk assessment. Publishing fragmented information throughout the year (via different reports on different topics) may be not enough to educate the public about the "big picture". Therefore it might be useful to publish a complex evaluation of fiscal risks from time to time to send a clear and more complete message to analysts and the public in general. It can be done in a form of Fiscal Space Review – a document similar to the well-known Financial Stability Reviews. Actually, financial stability is one aspect of fiscal risks. The CBR is now considering the possibility to publish such a document based on the 7-step procedure (Ódor, "Fiscal Risk Assessment at the CBR. A Conceptual Framework", *CBR*, 2014) every three or four years before parliamentary elections.

Daniele Franco was the lead discussant. First, he stressed why good communication is important. Broadly speaking, an active citizenship is crucial in democratic societies. And that is the reason why "fiscal institutions must work at the core of the democratic process." The fiscal process can be very opaque and therefore increasing the transparency can in his view improve fiscal outcomes and thus voter´s welfare. Fiscal councils by informing the general public can reduce opportunistic behaviour and make fiscal rules more effective. It is important to recognize that fiscal councils cannot stay outside the political arena, but must be perceived as neutral.

Mr. Franco liked the basic communication matrix presented. He commented on all five groups of "customers". According to him one should not overestimate the importance of tight links to parliamentarians, since in many cases the same political power holds the majority in both executive and legislative branches. Similarly, good communication with national and international technocrats does not mean much for a country. The real challenge is to have the right communication strategy with the media and the public. Ironically, politicians are also much more likely to take a report seriously if they read about it in the newspaper. But the council should not be viewed as a voice of opposition. Mr. Franco liked the idea of budgetary traffic lights. However he emphasized the importance of selection of appropriate targets and thresholds. Furthermore, 3 colours might be too few to design an effective communication device. He also suggested to focus on the tax burden, since people can more easily understand. As far as the Fiscal Space Review is concerned, he liked the idea, especially right after the general elections. On the other hand, he was not sure about the title of such a document.

Kevin Page suggested that it might be a good idea to publish the Fiscal Space Review in the middle of the election term to avoid politicization of the work of fiscal councils. He also recommended using more economic risks in the budgetary traffic lights scheme and to incorporate the concept of the "sound level of debt" into the Fiscal Space Review.

George Kopits described the Dutch example of evaluating election platforms. He however warned that probably it cannot be implemented everywhere. He was also a bit sceptical about choosing appropriate vulnerability thresholds expressed in the form of traffic lights, which may prove to be simplistic and arbitrary. More generally, Mr. Kopits noted a clear trade-off between the degree of analytical sophistication and the ease of communication.

Session: New analytical tools in long-term sustainability analysis of CBR

Presented by: Viktor Novysedlák
Lead discussant: Kevin Page

CBR is now able to analyse all four aspects[1] of the long-term sustainability as scheduled in the first Sustainability report in November 2012. Mr. Novysedlák, presented new tools to the Advisory Panel: construction of public finance baseline scenario (NPC scenario), calculation of potential feedback effects of public finance on economic growth and generational accounts. CBR`s methodology on construction of the public finance baseline scenario for next 50 years, was presented in the first part. This hypothetical development of public finances under current policy frameworks, economic and demographic assumptions without any new government intervention is a crucial tool for public finance assessment over the medium term (size of measures and government consolidation effort) as well as over the long term horizon (sustainability indicators).

In the second part, various scenarios of the potential feedback effects of public finance on economic growth were presented. While in the static baseline scenario the debt to GDP ratio will reach 100% in year 2036, when taking into account the negative effects of rising debt on risk premia and other macroeconomic variables (cost of capital, private investment, etc.), the ceiling could already be reached in year 2028 – eight years earlier. In Slovak circumstances this would present reaching the ceiling two election periods earlier.

In the last part, generational accounts as a tool for assessing intergenerational equity were presented. The results show that currently born individual will receive more from public budgets than he actually pays over his life. Provided the intertemporal budget constraint holds, the future generations will be facing the opposite situation.

According to Mr. Page, CBR has moved quickly over a short period of time to broaden and deepen its capacity to assess fiscal sustainability. One of the weaknesses is the limited assessment of the official macroeconomic forecast, since CBR is not a full member of the Macroeconomic Forecasting Committee. He advised annual ex post assessments of the scenario with deconstruction of measures and other factors. UK OBR´s work in this area was given as an example. According to Mr. Page, the indexation rules in the NPC scenario seem to be logical, however additional transparency on projection of EU funds disbursement might be helpful. He appreciated the depth of deconstruction of the baseline scenario.

According to Mr. Page, the assessment of risks related to the effects of rising debt on economic growth were presented appropriately, more complicated country specific scenarios with uncertainty analysis (confidence intervals) could help to raise confidence with peer groups. However, as discussed, no resonant response had been captured by public or government representatives after the first report. As Mr. Horvath responded, the topic had been overshadowed by other issues published in the same report (Generational Accounts), on the

[1] solvency, stability, growth, and intergenerational equity

other hand, under the presented scenarios unsustainable levels of debt would occur after 2024, i.e. too far from current political cycle to raise some attention. In the medium term horizon, Mr. Page suggested to focus more on the structure of the debt to capture potential risks, e.g. credit risk, maturity mismatch or currency mismatch.

Concerning the presentation of generational accounts, Mr. Page considered the presentation of results in nominal terms per capita as a good way of illustrating the intergenerational equity to the general public.

Mr. Franco suggested to drop the data of the age profile for higher ages, as declining net benefits might lead to misinterpretation (due to data constraints). He also noted that from his own experience, presenting generational accounts to general public is a challenging task. Concerning CBR's own long term projections, he asked about differences between EC pension expenditure projections and CBR`s projections and whether health care expenditure projections also included non-demographic factors.

As regards the pension projection differences between EC and CBR, these are minor, as both institutions use the same pension model and the same macroeconomic and demographic assumptions (EC's and EUROSTAT's). Small deviations are mainly due to differences in assumptions (e.g. impact of increasing life expectancy on shift of disability probability to higher ages etc.). Concerning non-demographic factors, CBR's health care projections include this effect (uses the same assumption as EC) in the form of elasticity of health care expenditures to GDP (1.1 converging to 1 in year 2060).

Session: Fiscal blocks in CBR´s models

Presented by: Michal Horváth
Lead discussant: Philip Lane

Mr. Horváth made a short presentation of two macro-economic models currently reaching the final stages of development at the CBR: the Medium-Scale Econometric Model and the DSGE model tailored to the main features of the Slovak economy.

He highlighted the key differences compared to standard modeling practices in the literature. The most important are as follows: extensive reliance of the production side on foreign inputs, strong export orientation and the rather limited domestic capital ownership. The fiscal blocks in the models also reflect country-specific procedures in reaching fiscal policy decisions as well as the need to be detailed enough for realistic policy experiments.

The performance of the models has been demonstrated by looking at aggregate dynamics following a standard temporary total factor productivity shock. Implied fiscal multipliers calculated in the context of both models using fiscal shocks were then evaluated. Furthermore, the consequences of alternative consolidation strategies from an initial condition resembling today's state of the world were analyzed. Differences in short- and long-term effects of the consolidation depending on the chosen fiscal instrument of adjustment were highlighted. Finally, future plans in terms of modelling and estimation work were sketched out.

In his comments, principal reviewer Philip Lane appreciated the Medium Scale Econometric Model's role in providing short-term forecasts. Regarding the DSGE model, he advised the CBR to include non-tradable private goods in the model given the crucial role of the relative price of non-tradables in the macroeconomic response to fiscal policy shocks in an open economy. Next, he recommended extending the model by an explicit mechanism capturing cross-border capital flows. This, in his view, is very important for a country with high FDI inflows to account for real appreciation and its interaction with the FDI location decision of investors. It was suggested to test the predictions of the model under a flexible exchange rate regime and relative to evidence from VAR models. It was also suggested that some core model assumptions are reviewed in the light of the relatively high magnitudes of fiscal multipliers obtained in both models, although these might also result from the lack of independent monetary policy, and a genuine productive effect of government investment and public capital formation.

In further discussions, the panel encouraged conducting an estimation of the DSGE model with a view of using it as a forecasting tool. According to the panel, testing within-sample predictions of the models as well as dynamics following fiscal shocks of different duration could also be useful exercises. It was suggested that the models might become useful in modelling NPC scenarios in the macro-fiscal evaluations conducted by the CBR.

In summary, the panel praised the potential usefulness of both models in illuminating the debate on the design of the fiscal policy. It encouraged the use of the models for both theoretical exercises to evaluate the effects of changes in fiscal policy as well as instruments for short- and medium-term macro-fiscal projections.

Session: Closing remarks and work plan for 2014

Presented by: Michal Horváth

Within the closing session, Mr. Horváth thanked the panel for their highly valuable input and promised that the positive feedback received would not lead to complacency. He summed up interesting takeaway points from each session and outlined the work plan for the coming year until the next meeting of the advisory panel in October 2015.

The points noted include:

1. Fiscal councils in Europe: It is worth continuing the discussions within the EU IFIs Network with a view that the EU institutional setting should and might change in the future;
2. Fiscal Risk at CBR: It is important to take into account the interaction among various types of risk in CBR's risk analysis;

3. Communicating fiscal risks to public: Better to take a prudent route and consider timing of reports to avoid getting too much into the political sphere;
4. Fiscal sustainability: More attention could be paid to the risks associated with the profile of public debt;
5. Macroeconomic modelling: Further extensions of the DSGE model, evaluations against results from purely statistical techniques and further policy experiments (temporary versus permanent measures) might yield useful insights

The work plan for the coming year will include building analytical tools for several areas of work, elements of risk assessment, estimation of DSGE, VAR.
In the next year, the CBR will focus on three main topics:

1. Short-term analyses
2. Risk assessment
3. Communication to the public

Furthermore, in the field of EU relations, the cooperation of the EU IFI Network is expected to get more intensive and the progress report of the Network reviewing the activities of the network and their outcomes is due in autumn 2015.

Council for Budget Responsibility

Imricha Karvaša 1
Bratislava 1
813 25
Slovakia

www.rozpoctovarada.sk