# 3rd Meeting of the Advisory Panel

Minutes
September 30, 2016

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

# Advisory Panel Meeting

September 30, 2016

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

**Advisory Panel Members Present:** George Kopits, Kevin Page, Daniele Franco[1]
**CBR Members Present:** Ivan Šramko, Ľudovít Ódor
**Network of EUIFIs**: Michal Horváth
**Secretariat of the CBR:** Viktor Novysedlák (Executive Director) and Members of the Technical Staff of CBR

**Apologies**: Simon Wren –Lewis (comments sent beforehand), Anetta Čaplánová (CBR)

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## **Session**: CBR activities in the past two years

**Presented by**: Ivan Šramko

Mr. Šramko welcomed the members of the advisory panel and kicked-off the meeting with an overview of CBR's activities in the last two years.

Since 2014, the CBR took part in many international conferences/seminars related to macroeconomic and fiscal analysis. In order to better integrate academic and policy-related research, the CBR started to organize Macroeconomic and Fiscal Affairs Seminars (MaFiA Seminars), where international researchers have been invited to present their work. Inspired by the good cooperation of central banks and monetary researchers, the CBR organized a major international fiscal conference in 2015: Rethinking Fiscal Policy after the Crisis with active participation of many top level fiscal economists. The two keynote speakers were Eric Leeper (Indiana University) and Charles Wyplosz (Graduate Institute, Geneva). The collection of papers presented at the conference will be published by the Cambridge University Press.

Staff members were also very active in presenting their work at international seminars or conferences. In particular, improvements in microsimulation modelling (SIMTASK, *what_if*), DSGE model for Slovakia and estimation of fiscal limits were appreciated by the academic community and other independent fiscal institutions.

The CBR has been also very influential in establishing close links between independent fiscal institutions in Europe. In September 2015, 17 representatives of fiscal councils agreed on mutual cooperation, signed a joint cooperation Agreement in Bratislava and formally established the Network of EU IFIs. Since then, the number of member institutions grew to 23. Mr. Ódor was elected as a Deputy Chair of the Network and Mr. Horváth as an Advisor to the Network.

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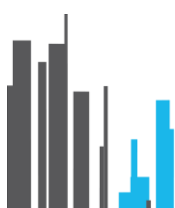
[1] Philip Lane is no longer a member of the advisory panel due to his responsibilities as Governor of the Central Bank of Ireland.



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During the last two years CBR has published several discussion papers (5), working papers (5), analytical commentaries (13), blog posts, presentations in both Slovak and English languages and prepared Infographics and easy-to-use interactive tools ("Budget in bubbles"). Council members also reflected within time frames established by law the legislative acts (Fiscal Responsibility Act (14), Act on General Government Budgetary Rules (3)) and gave opinions on legislative proposals.

Mr. Kopits suggested to organize specialized workshops with members of the parliament in order to establish closer links with the legislature.

Mr. Šramko identified the following two main challenges for the CBR: exchange of information with EU institutions and the newly established European Fiscal Board and effective application of the comply-or-explain principle (fiscal compact).

**Session**: **Network of EU IFIs**

**Presented by**: Michal Horváth

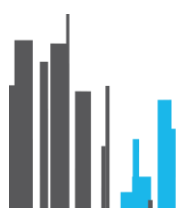
Following a brief excursion into the history of the formal establishment of the Network of EU IFIs, Mr. Horvath informed about its activities, ongoing initiatives and suggestions for improvements.

Mr. Horváth highlighted the substantial differences in resources EU IFIs have to operate with in spite of having similar mandates, and presented a ranking of IFIs according to their potential to provide effective scrutiny of public finances. This was measured by a range of input indicators (number of tasks, budget/employees per task, access to information, public awareness, relationship with Parliament and reaction from government). Mr. Page suggested to include a measure of "transparency" of the local institution.

Slovakia (CBR) is positioned in the top third of EU IFIs, handling a high number of tasks with relatively low number of internal employees per task, but with a potential to improve public awareness of its activities as well as its relationship with the legislature.

The current agenda of the Network of EU IFIs involves further improving the relationship with EU Authorities, including securing better access to information at the EU level, and triggering action at the EU level to reinforce the standing of EU IFIs and the functioning of the national fiscal frameworks.

To this end, the Network will also work on own initiatives to be discussed in the upcoming meeting in Paris in November.



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## **Session**: What should we include in the Fiscal Space Review?

**Presented by**: Ľudovít Ódor
**Lead discussant**: Simon Wren-Lewis, Michal Horváth

One of the most important tasks of independent fiscal institutions (IFIs) is to assess and communicate fiscal risks. Draft budget evaluations, long-term sustainability reports or costings of policy measures all contain valuable information about potential risks associated with the central (baseline) fiscal scenario. However, by publishing a comprehensive Fiscal Space Review (FSPR), independent fiscal institutions might be able to better "summarize" the current state of public finances and provide comprehensive measures of risks compared to some generally accepted definition of soundness or optimality. The session discussed what should be included in such a review in order to provide clear signals to voters, policy makers and financial markets.

Mr. Ódor highlighted three important reasons to produce FSPRs. The first one is based on the work of Roel Beetsma and Xavier Debrun (2016). Asymmetric information between voters and elected policymakers is in the heart of their model. Beetsma and Debrun show how a society might benefit from the presence of an independent fiscal institution tasked to minimize the noise surrounding signals of competence of the incumbent government. A comprehensive evaluation of fiscal trends through the publication of the FSPR towards the end of the election period can increase the effectiveness of this "signaling" channel.

Second, when thinking about publishing FSPRs, one can draw a parallel with financial stability reports prepared (usually) by independent central banks. Financial stability reports review the condition of the financial system as a whole by identifying risks to the system and suggesting policy changes to address the most important shortcomings. One of the main reason to produce those reports is to see the forest and not just individual trees. One can argue that the same might be true for fiscal stability. Policy makers might benefit from a comprehensive risk assessment when preparing fiscal policy plans, especially at the beginning of the election period.

Third, in order to evaluate the current state of public finances, benchmarks are inevitable. One has to have an idea what does it mean to be sustainable or to have the main fiscal indicators in sound (or optimal) positions. This exercise of defining benchmarks might promote fiscal research on the one hand, on the other hand it can help quantify the magnitude of fiscal space needed to have acceptable (low) probability of fiscal stress. This way there will be more pressure on policy makers to create adequate fiscal spaces.

To sum up, the main value added of fiscal space reviews is in delivering clear signals to voters, policy makers and financial markets.

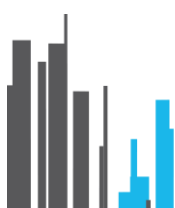
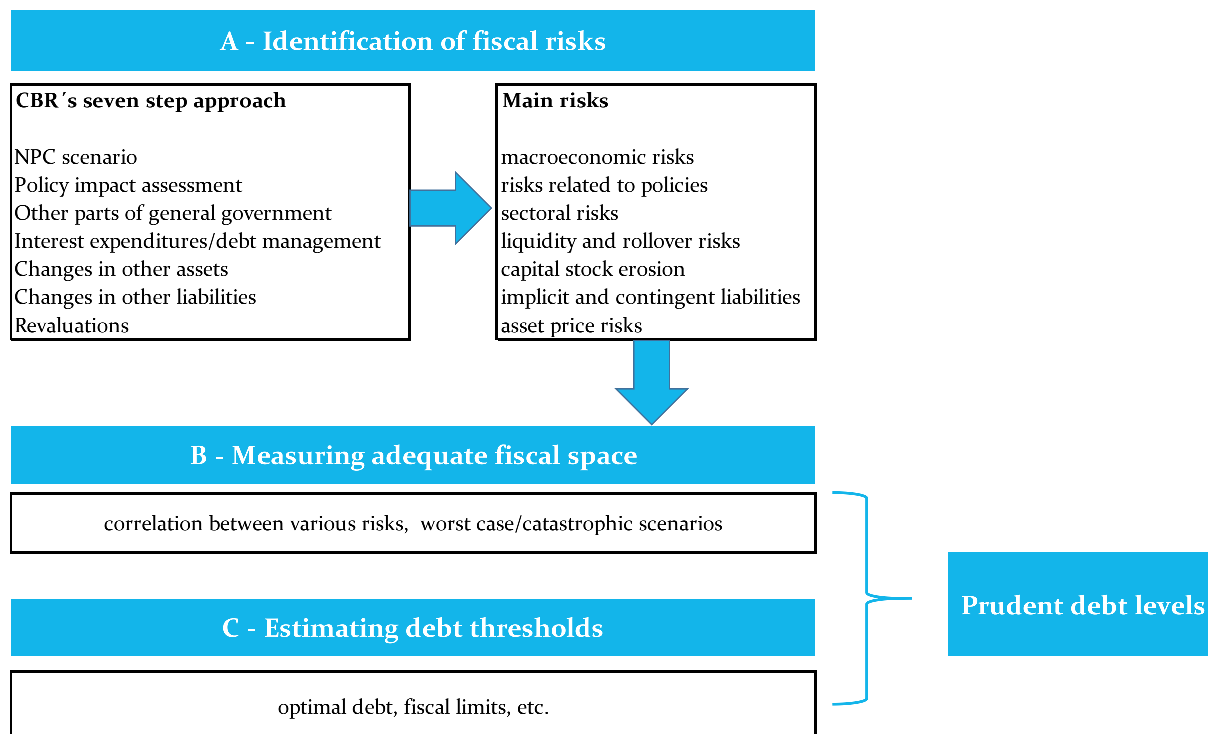


Figure 1 presents the conceptual framework the CBR intends to use in its Fiscal Space Reviews. It has three important parts: A) identification of fiscal risks, B) measuring adequate fiscal space and C) estimating debt thresholds.

## Figure 1 – Conceptual framework for Fiscal Space Reviews

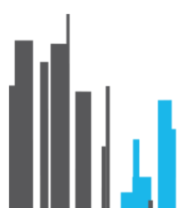



Mr. Ódor proposed the following structure/content for the report:

1. Description of current fiscal trends – main indicators, ex post evaluation of risks, compliance with fiscal rules, etc.
2. Identification of major fiscal risks (7-step approach).
3. Measuring prudent fiscal space via synthesis of identified risks.
4. Discussion of optimal/prudent debt levels.
5. Recommendations (institutional aspects, pace of consolidation (if needed), elimination of risks, etc.)

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

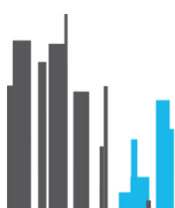
- In his view there is a slight confusion in the paper between issues concerned with optimal debt levels (if there was no financing issue) and issues to do with market access. Although the two are related, in situations where a central bank provides no support (in the sense of acting of a sovereign lender of last resort), considerations of market access are likely to bite first. In contrast, in countries with their own currency, there is no independent financing constraint, although that view is not universal. In that case the only issue is sustainability.



- The centrality of the monetary policy regime also points to an additional problem. As we have seen in 2012, if the central bank offers potentially unlimited support (even though it is with conditions), this creates a half-way house between the extremes of having your own currency and having no sovereign lender of last resort. (The point is not that the ECB might come to the rescue, but that this possibility means that the market never requires it to.)
- As the markets are only concerned about default, their only interest is on whether other market participants think governments have the political will to raise taxes or cut spending to make some post-shock level of debt sustainable. That assessment is inherently political, which means what might be considerable acceptable for some countries would be considered unacceptable in others (in the sense that politicians would prefer to default). The Keynes beauty contest element means that any calculations and economist might do on debt levels that might induce default should then be halved (?) to get what the market will tolerate before demanding a default premium.
- In terms of what an optimal debt level (ignoring financial constraints) might be, Mr. Wren-Lewis does not think economists have really begun to address this properly. There are good reasons (tax distortions, capital stocks that are too low) why governments should accumulate assets to finance their spending.
- All this suggests that the appropriate thing for a fiscal council to do is to use past evidence, plus their own judgement about domestic political circumstances and culture, to assess at what level of debt the market might start to require a higher default premium if there was no sovereign lender of last resort. The extent to which that should become a long run target will then depend on an assessment of the extent and reliability of the OMT cushion.
- Mr. Wren-Lewis considered the idea of subtracting a 'risk buffer' from long run targets to get an actual target a bit ambitious at this stage. He would instead concentrate on just developing the kind of scenario analysis which the OBR does in its annual 50-year ahead forecasts. Some risks have very different intertemporal profiles than others. In terms of market access, a major risk has in practice been risks associated with the domestic financial sector.

Michal Horváth as a second lead discussant made two additional points:
- Fiscal councils should be very careful when presenting optimal debt levels based on theoretical considerations. At this juncture it is more useful to rely primarily on empirical approaches.
- The idea of presenting worst case/catastrophic scenarios is useful, since there are many "unknown uknowns" in the real world. Policymakers should be aware of potential tail risks even if these are hard to quantify in a model-based approach. FSPR might investigate what are the policy options in case of major negative (or positive) shocks to public finances.

George Kopits welcomed the idea of a comprehensive measurement and presentation of fiscal risks. However, he did not recommend to use the concept of "fiscal space" in the name of the report. He pointed out that there are different uses of this concept in the literature: one emphasizing the room for short- and medium-term discretionary fiscal policy, while the other measuring the difference between actual and potentially dangerous debt levels. Mr. Kopits also expressed his doubts about some of the tools presented to synthetize fiscal risks. Contrary to



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Mr. Horváth, Mr. Kopits was not recommending using worst case scenarios or historical episodes from other countries. He also favored annual frequency for the report.

Kevin Page agreed with Simon Wren-Lewis that monetary policy is a key factor in discussing prudent debt levels. Measuring fiscal space is therefore much more important in countries without independent monetary policy (like the euro area). He saw important role for the community of IFIs to work on approaches to identify and communicate fiscal risks. Page highlighted that Canada was in a relatively good position to prepare stimulus packages in the first phase of the Great Recession especially because of sufficient fiscal buffers accumulated during good times.

Daniele Franco stressed the importance of highlighting fiscal risks to policy makers. In the actual context, he pointed out that problems in the pension system (due to ageing) are relatively well understood. On the other hand, there are areas, where much more work needs to be done: rising healthcare costs, long-term care expenditures or for example the likely "normalization" of interest rates. Independent fiscal institutions should be well equipped to remind those risks to policy makers. Mr. Franco also expressed his conviction that public finance issues cannot be separated from the broader discussion of structural issues and measures. Fiscal risk assessment therefore might also contribute to a more thorough discussion of structural reforms.

At the end of the session, Mr. Ódor informed the panel about the intention to organize a joint seminar with the OBR on fiscal risks.

## **Session**: Introducing expenditure ceilings in Slovakia

**Presented by**: Ľudovít Ódor
**Lead discussant**: George Kopits

Mr. Ódor started his presentation by highlighting the main reasons to adopt expenditure ceilings in Slovakia. The first Council recommendation to introduce binding expenditure ceilings in Slovakia appeared 12 years ago. More importantly, the five-year old constitutional act on budget responsibility (FRA) explicitly states that expenditure ceilings are the most appropriate fiscal rules to ensure long-term sustainability of public finances in Slovakia. The FRA assumes the introduction of expenditure limits via ordinary law. Unfortunately, there is no deadline in the constitutional act for the implementation. According to Mr. Ódor, respecting the letter of the FRA should be sufficient to initiate public discussion on the implementation of expenditure ceilings. However, he pointed out five other important arguments to kick-start such a debate.

First of all, expenditure ceilings were included in the FRA´s fiscal framework as the main operational instrument. Debt limits were supposed to play only an anchoring role, since these are influenced by many exogenous factors outside the control of the government. The absence of an operational target substantially decreases the accountability of the government.

Secondly, Slovakia has recently started to implement the so called "value for money" initiative (Filko et al., 2016). It is included in the program manifesto of the government and has the full support of major economic associations and the president of the republic. International experience shows, that long lasting efficiency gains are more likely if spending reviews are embedded in a framework of hard medium-term budget constraints. Binding expenditure ceilings might serve this purpose relatively well.

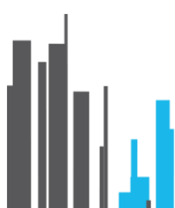
Thirdly, one of the main shortcomings of the original Stability and Growth Pact was the lack of motivation to consolidate in good times. The same criticism can be currently applied to Slovakia. Despite substantial windfall revenues, deficit targets are not being met and for politicians there is no incentive to move towards the MTO. Well-defined expenditure targets might be a useful instrument to achieve a structurally balanced budget in good times.

Fourth, the budget approved by the parliament is nothing more than just a reference. The minister of finance can make substantial changes during the year and practically almost nothing is binding. Mr. Ódor argued, that in democratic societies there should be better balance of power between the parliament and the government in budgetary matters.

Lastly, the Public Finance Management Reform in 2003 (financed by the World Bank) made a huge improvement in the Slovak fiscal framework. However, international best practices have changed substantially in the last thirteen years and Slovakia has gradually lost its position in international comparisons. The OECD index for medium-term budgetary frameworks (MTBF) ranks Slovakia close to the bottom of the list and the evaluation of the European Commission describes the Slovak framework as one of the least binding in the EU.

After presenting the main incentives to introduce expenditure ceilings, Mr. Ódor discussed the most important principles for designing those. Based on international best practices, he identified nine crucial elements:

- binding expenditure ceilings should be set by the parliament,
- the ceilings should be linked to basic fiscal objectives; derived from the GAP indicator or the MTO (expressed preferably in nominal terms),
- the planning horizon should cover the full election cycle,
- as broad institutional coverage as possible (with the exception of subnational governments),
- in order to allow for some flexibility for the government, the parliament should set only one aggregate number per year,
- some expenditures should be excluded: unemployment insurance, interest expenditures, EU funds,
- limited possibility for carry-overs (as a % of the ceiling),
- ceilings should be binding on the 4-year horizon with the exception of: i) discretionary revenue measures, ii) structural reforms affecting long-term sustainability of public finances and iii) well-defined escape clauses triggered by the CBR,
- in case of overshooting, the ceilings should be reduced in the current and next years.



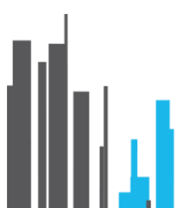
Mr. Ódor also presented a concrete technical proposal for introducing expenditure ceilings in Slovakia, respecting the above-mentioned principles. He briefly mentioned also other measures to strengthen the medium-term fiscal framework.

George Kopits was the lead discussant in this session. He stressed the importance of a well-defined operational rule, which is firmly embedded in a binding medium-term budgetary framework. Mr. Kopits concurred with most of the principles presented by Mr. Ódor, however he made an alternative proposal for setting expenditure ceilings. Instead of calculating nominal aggregate expenditure ceilings from the MTO or GAP targets, Mr. Kopits discussed the possibility of setting ceilings for discretionary expenditures, derived from a real debt target. It can be implemented in four steps: i) setting of the real debt target and time path, ii) calculating primary surpluses to reach those debt targets, iii) forecasting mandatory expenditures and tax revenues and iv) setting binding ceilings for discretionary expenditures.

Mr. Kopits highlighted that focusing on discretionary expenditures only, there is a closer link between the ceilings and the fiscal space available for policy makers in the short- and medium-term horizon. This (short-term) definition of a fiscal space might be useful to understand to what extent are the hands of current politicians tied by decisions of previous parliaments. At the end of his discussion, Mr. Kopits warned that fiscal space is narrowing in many countries (illustrated by recent estimates for the US and Germany) and it will be an important challenge in many advanced countries to re-create it, largely by undertaking structural reform in taxation, public pensions and other social entitlements. There are obvious limits to taxation and rising thresholds for mandatory expenditures driven by populist pressures ageing, along with eventual rise in the interest bill. Independent fiscal institutions should play an important role in ensuring that governments will use real measures and not just fiscal gimmickry to create more fiscal space ("repressed deficits"). In particular, they should anticipate the narrowing room for discretionary action by preparing medium-term no-policy-change forecasts of fiscal space, in the context of annual or semiannual macro-fiscal forecasts.

Kevin Page underscored the importance of parliaments in setting fiscal goals. Binding aggregate expenditure ceilings should be set by the parliament and governments should be held accountable for respecting those. Contrary to Mr. Kopits, Mr. Page was not entirely convinced that one should distinguish between mandatory and discretionary spending when setting the ceilings. In his view, the definition of mandatory items is not clear-cut and laws defining those can be changed on a medium-term horizon. Mr. Page advocated for setting ceilings in nominal terms, since it greatly enhances accountability and ex post assessment. Based on a Canadian experience, he expressed his doubts about setting expenditure limits at the European level. In his view, operational targets should be home-grown and tailor made and not one-size-fits-all solutions. He also touched upon the issue of value-for-money initiatives. Medium-term budgetary constraints are essential to deliver long-lasting results in this area.

Daniele Franco informed the panel that he made a similar proposal for Italy some years ago. His proposal was largely ignored in the policy debate, which highlights the political difficulty of introducing binding expenditure ceilings. In his view, there is a higher chance for success in critical times, when governments are under the pressure of financial markets or other international lenders. Mr. Franco stressed the importance of three additional factors. First, one



has to have a clear accountability framework for local/regional governments, since those cannot be put under a centrally defined expenditure ceilings. Second, one-off and temporary expenditures should be identified and monitored. Third, expenditure ceilings often have a negative-side effect in postponing investments. This should be somehow reflected in the design of the medium-term framework.

## Session: Minimum standards for fiscal frameworks in the euro area

**Presented by**: Ľudovít Ódor
**Lead discussant**: Kevin Page

Mr. Ódor started his presentation with a discussion of current trends in the euro area. The financial and sovereign debt crisis has shaken the very foundations of the common currency. In order to calm down financial markets, European governments and institutions have adopted a wide variety of measures to avoid the break-up of the currency union. These trial-and-error and learning-by-doing methods were sometimes successful, but not always reached the desired outcomes. Hence there is a clear consensus among economists and policy makers that additional steps are necessary to increase the resilience of the euro area to future crises.

According to Mr. Ódor, at the heart of the sovereign debt crisis in Europe lies the fundamental contradiction between bail-outs and fiscal sovereignty inside a monetary union. One cannot have both at the same time. With a benefit of hindsight, it is clear that absenting resolution mechanisms and strong links between bank and sovereign risks were the main factors behind the bail-outs in the initial phase of the crisis. Since then major progress has been made to set up resolution schemes and to present a roadmap towards a banking (financial) union. These are absolutely necessary building blocks of any successful currency union.

Ódor and P. Kiss (2015) argue that changes are inevitable also in the European fiscal framework. They propose a solution similar to the arrangement advocated by Wren-Lewis (2003). The first line of defense against irresponsible fiscal policy behavior should be at the local level, using home-grown fiscal rules and independent fiscal institutions. Their design, however, should fulfil commonly agreed minimum standards. If a Member State operates with no significant fiscal risks and if spill-over effects are unlikely, no yearly intervention from the community level is necessary.

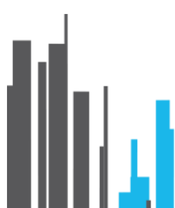
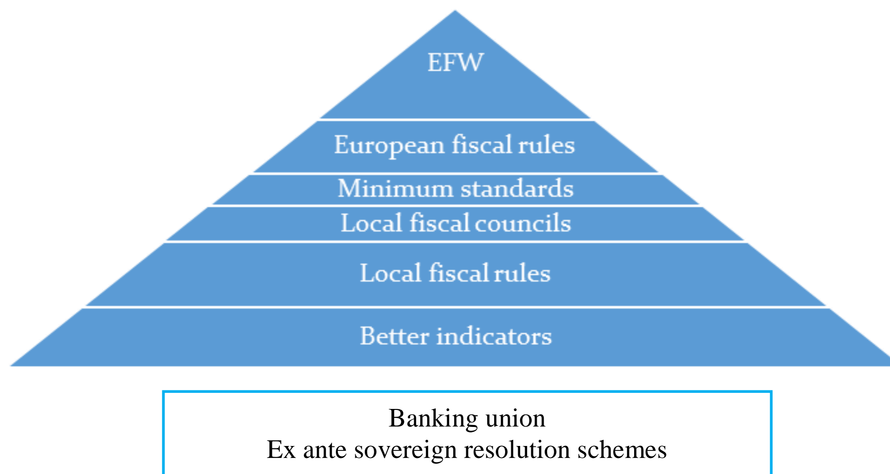


**Figure 2 - Proposal for a new European fiscal framework**




*Source: Ódor and P. Kiss (2015)*

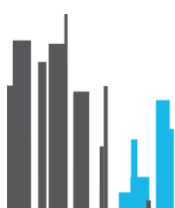
One important role of the center in a de-centralized framework of fiscal responsibility would be the supervision of national frameworks. Rather than analyzing national budgets every year, this would involve the definition of minimum standards applicable to national fiscal frameworks. An EU-level process would be triggered only in the case of gross policy errors at the national level. Minimum standards should ensure that essential basic principles are respected when national fiscal frameworks are designed.

Local fiscal frameworks consist of fiscal rules, independent fiscal institutions and various procedures. Properly designed minimum standards should cover all important aspects of these frameworks. What should be included in those minimum standards? According to Mr. Ódor, there are at least four (partially inter-related) important areas, where the definition of minimum standards is clearly warranted:

- rules for transparency and data availability,
- presentation of basic fiscal indicators,
- requirements for effective medium-term budgetary frameworks (including smart fiscal rules),
- functioning of independent fiscal institutions.

Some kind of minimum benchmarks already exist in different pieces of EU legislation for many aspects of national budgetary frameworks. For example, in the area of medium-term budgetary frameworks, the problem is implementation or enforcement rather than the absence of such standards. To some extent, this is true for access to data as well. On the other hand, detailed minimum standards for independent fiscal institutions have not yet been set out in EU legislation or quasi-legislative documents. Mr. Ódor presented three options how minimum standards can be embedded in the European fiscal framework:

- amendment to the Directive on national fiscal frameworks,
- adoption of Code of Conduct



- voluntary implementation by Member States.

However, Mr. Ódor warned that the definition of minimum standards is just part of the story. Effective enforcement is at least as important. Since we are talking about respecting standards and not policy prescriptions, the European Court of Justice (as in case of the Fiscal Compact) would be a natural body to enforce the requirements (if embedded in EU legislation). The newly created advisory European Fiscal Board is a natural candidate to assess compliance, and if the gaps are not eliminated, it should have the power to bring those cases before the ECJ. The EFB should closely cooperate with national IFIs.

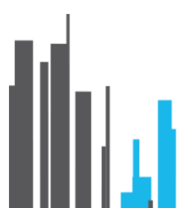
Kevin Page was the lead discussant in this session. He compared the current framework in the euro area with the situation in Canada. According to Mr. Page, a more de-centralized framework for fiscal responsibility together with a strict no-bailout rule has many advantages over a complex system of centrally enforced fiscal rules. The latter imposes unnecessary transaction costs and makes fiscal policy less transparent for the citizens. At the same time, it reduces the accountability of local policy makers. Mr. Page welcomed the discussion on common minimum standards for national fiscal frameworks instead of a common set of rules and procedures. According to him fiscal policy is always political and it cannot be easily assessed at the central level without taking into account national specificities or institutional set ups. The outcome of more centralization is almost always a compromise leading to one-size-fits-none solutions plagued with strong path-dependency. Mr. Page raised three additional important points. First, the need for simplification. Complex sets of rules are very hard to enforce. Second, citizens and local politicians should be presented with main policy trade-offs at the local level. Third, the choice of an adequate fiscal anchor should also be a sovereign decision at the national level. Mr. Page stressed that while de-centralization and de-politicization seems necessary in the euro area fiscal framework, this does not mean that central risk-sharing mechanisms should not be established (like in federations).

Daniele Franco expressed his conviction that national fiscal frameworks can make fiscal choices more transparent. More transparency might help financial markets to make better decision when dealing with sovereign risks. With weak enforcement of European fiscal rules and government bond purchasing programs of ECB in place there is less motivation for Member States to pursue sustainable fiscal policies. Mr. Franco agreed with Mr. Ódor that the no-bailout clause should be strengthened, but only gradually to avoid short-term market disruptions. He also supported the view calling for a stronger central budget for better risk sharing in the euro area.

George Kopits also supported the idea of introducing common minimum standards for national fiscal frameworks in the euro area.

## **Session:** Policy simulations using microsimulation models at the CBR

**Presented by**: Matúš Senaj and Marián Šaling
**Lead discussant**: Daniele Franco



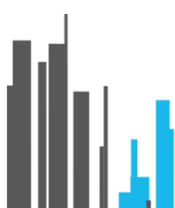
Matúš Senaj presented the evaluation of fiscal consolidation strategies at the CBR, by using a model called *what if*. The model was developed by the CBR staff and is able to evaluate short run as well as long run impacts of tax-benefit measures on economic growth, public finances and income distribution. The model builds on three CBRs' projects finished in the last two years. The first one, called SIMTASK is a microsimulation module able to calculate personal income taxes, health and social security contributions and almost all social benefits for every individual in the sample. The second building block is a labor supply model, where labor supply elasticities at the extensive margin are estimated. The third component is a neoclassical macro model. It employs a CES-type production function that combines capital and labor and assumes a linear cost function including costs related to hiring employees. It is assumed that the process of searching for new employees is costly and for the unemployed it takes time to be matched to a new job. The parameters of the model are calibrated. All three projects are published as CBR working papers. These three modules are integrated in the *what if* model. The model is supposed to answer what if type of questions related to tax and transfer system reforms.

In the empirical part, the baseline, or no-policy-change (NPC) scenario is built on the legislation valid in 2016. Mr. Senaj presented simulation results of several counterfactual scenarios in which either expenditures are decreased or revenues are increased. In doing so, various instruments like family transfers, material need benefits, old-age pensions, personal income taxes, social and health contributions and VAT are used. In the framework of the *what if* model, first the assessment of immediate, or the "day after" impacts are presented. Here, the static fiscal effects and also distributional effects are studied. The labor supply model allows to compute behavioral responses. And finally, the most interesting effects are studied in the long run.

Since there is still a room for further improvement, in the next few months, the CBR's microsimulation team would like to focus on intensive margin elasticities, better incorporation of corporate income taxes, more sophisticated simulation of VAT and dynamic ageing.

Daniele Franco highlighted the importance of accurate estimates of impacts of alternative consolidation packages on income distribution. He also pointed out that the microsimulation models are particularly useful when tax and benefit systems are complex and interact with each other. He singled out the analysis of the trade-off between the impact on GDP growth and the impact on inequality. The most discussed fiscal strategy was the one where material need benefits are decreased. Mr. Franco considered the impacts of this fiscal strategy in the paper as unrealistic. In response to this point Ľudovít Ódor said that it is a work in progress and so far the model misses the simulation of corporate income tax and also assumes that wages are fully flexible.

Regarding the presentation of the results, Daniele Franco stressed the importance of providing quantitative figures for policy makers. He also suggested to present GINI and KAKWANI indexes for different groups of citizens. Although, the current version of the paper contains fourteen fiscal strategies, he suggested to study also the effects of the following instruments: increase in retirement age, cuts of tax subsidies or other subsidies, cuts in purchases of goods and services and wage freezes.



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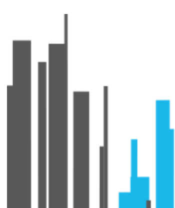
Both Messrs. Kopits and Page also stressed the importance of the topic and he commended the good work of the microsimulation team.

The second part of the presentation was dedicated to the CBR microsimulation model of healthcare expenditures. The main purpose of the model - simulation of various healthcare scenarios and analysis of the long-term sustainability of public finances - was presented in the context of rapid demographic transformation of the Slovak population. Mr. Šaling described the basic model structure, characteristics of the Slovak healthcare data and presented results from various projection exercises. Two aspects of the model were emphasized: the simulation of death-related costs accounts for the fact that bulk of healthcare expenditures are associated with the last years of life and the simulation of disease-related expenditures which enables studying the impact of long-term consequences of changing health status and treatment costs. At the end of the presentation future challenges and further development of the model were discussed.

Daniele Franco summarized the presented paper and stressed two aspects of the model: calculation of death-related costs and the simulation of expenditures related to treatments of diseases. Subsequent comments were directed to the evolution, methodology and results of the long-term projections published by international institutions. It was noted that evolution of healthcare expenditures is influenced by a number of non-age-related factors that are difficult to predict. Therefore, long-term projections are associated with a high level of uncertainty which can be illustrated by a wide range of results generated by varying initial assumptions in the projections. However, Mr. Franco highlighted the use of data associated with diseases in the CBR model as it allows for a more precise definition of costs at the individual level.

Afterwards, Mr. Franco discussed the trends and future policy issues in the healthcare sector. Since 2008, with the economic downturn, healthcare spending has slowed markedly in many OECD countries. However, the introduction of a number of new and costly treatments and rising prices of specific pharmaceuticals give reason to believe that this slowdown will not become permanent. Finding a balance between the budgetary impact of new and costly treatments and the medical needs of the population presents a great challenge for future policy.

Commenting on the possible future developments of the model Mr. Franco emphasized the estimation of costs of curing specific diseases and the need for frequent and regular updates of these estimates. It was noted that improved projections can be of use in planning the future allocation of resources and the need for greater flexibility in health spending and organization was stressed.



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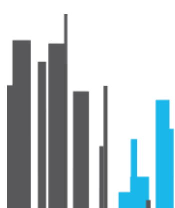
**Session:** Closing remarks and work plan for 2017

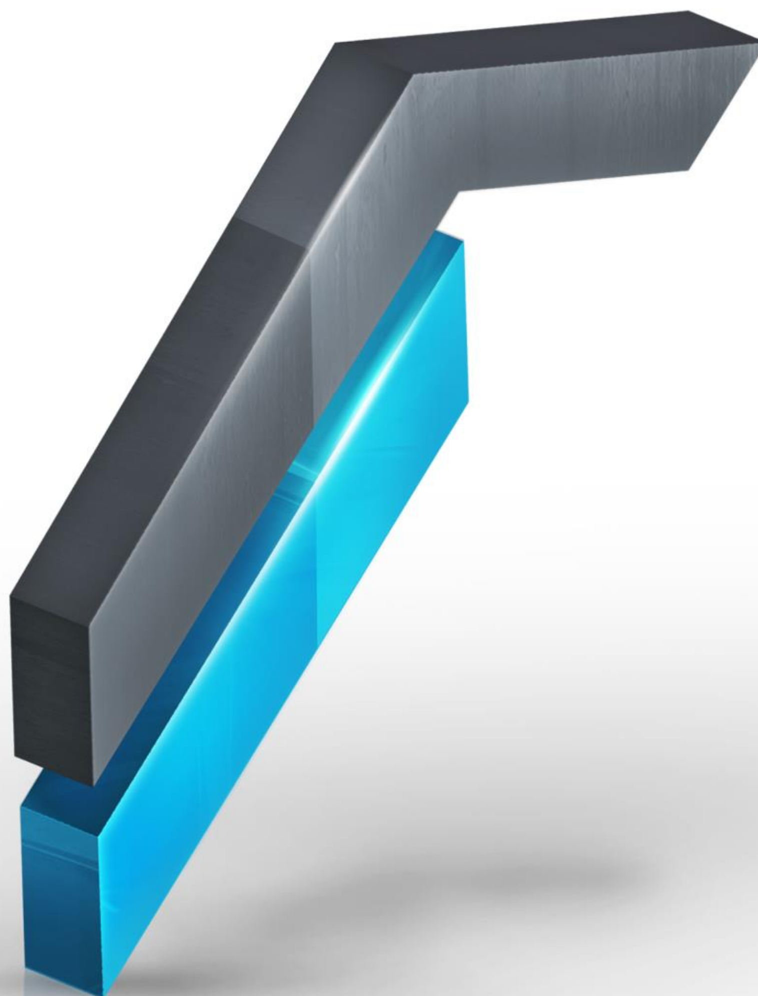
**Presented by**: Ľudovít Ódor

Within the closing session, Mr. Ódor 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:

1. Macro-finance models,
2. Synthesis of fiscal risks,
3. Optimal debt models,
4. Growth-maximizing debt,
5. OLG model for ageing,
6. Social benefits forecasting,
7. State-contingent tax elasticities,
8. Public investment,
9. Refining microsimulation models.

Members of the advisory panel recommended to prioritize the work plan and to focus primarily on fiscal risk assessments.





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Imricha Karvaša 1
Bratislava 1
813 25
Slovakia