

# **Lessons learned: Financial Policy Institute at the Ministry of Finance of the Slovak Republic**

## ***Case study***

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## 1. Introduction

The purpose of this case study is to describe the Financial Policy Institute (FPI) – the analytical body of the Ministry of Finance (MoF) of the Slovak Republic and contribute to sharing the Slovak experience from public finance reforms with other countries in the region. The report describes institutional reform undertaken in the area of macroeconomic and fiscal analysis and forecasting in Slovakia with particular focus on lessons learnt and recommendations for transition countries facing similar challenges.

The report contains mainly the following information:

- A brief description of the general context of the public finance reform in Slovakia (political and economic conditions, reform strategy and objectives) with a particular focus on macroeconomic and fiscal forecasting systems in Slovakia.
- A description of the reform initiatives undertaken in the area of macroeconomic and fiscal analysis and forecasting.
- A description of the Financial Policy Institute – its mission, goals, structure, activities, outputs, roles within the Ministry of Finance, linkages to external environment.
- Key success factors of the reform as well as obstacles and recommendations.

## 2. Public finance reform - reform strategy and objectives

Since 2000, Slovakia has made significant progress in improving the management of public finances. However, the changes introduced in 2000 - 2001 were rather a consequence of external pressure related to the EU pre-accession process, than the expression of an internal desire to improve public finance management. The changes were isolated, without common links and were more of a technical and methodological character, without creating the necessary institutional framework. Personal, organisational and information capacities were based on the enthusiasm of individuals, rather than the creation of a system.

More sustainable changes in public finance management were required to ensure consistence of the reforms by setting priorities and a timeframe. Additional changes would also ensure that government fiscal plans are more strictly adhered to and limit the impact and occurrence of any unexpected fiscal events. Therefore the complex **public finance management reform** project was launched by the MoF together with the World Bank assistance in 2002. Main objectives of public finance reform which took place mainly in 2002 – 2004 were:

- **Transparency and methodology of public finance reporting**  
The key factor in increasing the public finance transparency was implementation of the common European System of Accounts (ESA95) methodology - system of uniform statistical definitions and classifications aimed at achieving a harmonised quantitative description of the economies of the EU Member States. Application of this methodology in public finance reporting significantly prevents occurrence of cover-ups and shifts in deficit report which were very common before 2002. ESA95 methodology enables international comparison of fiscal

indicators at accrual basis. The use of ESA95 methodology was stipulated in new law on budget regulations. The Government completely stopped offering state credit guarantees and eliminated almost all state funds.

- **Strategic planning - program budgeting and three-year budget**

The strategic planning and effective use of public resources have been strengthened by implementation of program budgeting and a three-year budget. Hard budget constraints were introduced as well with the aim to stop uncontrolled indebtedness in some public sectors, mainly in health care, regional education, railroads, public radio and television broadcasting.

- **Improvement in macro economic and fiscal analyses and forecasts**

Analytical capacities at the Ministry of Finance were strengthened by significantly improving macro economical analyses and forecasting capacities. The Financial Policy Institute (FPI) of became central analytical capacity of government for economic policy. Two committees - Macroeconomic Forecasting Committee and Tax Revenue Forecasts Committee were established. Their members are reputable economists and analysts from both public and private sector. Periodic forecasts by FPI (three times a year) are discussed in the committees before officially released and are published on the MoF's web.

- **Liquidity concentration into state treasury and professionalization of debt and liquidity management**

Since 2005, all the financial flows of public administration with the exception of local governments are concentrated in the state treasury. It creates direct and indirect savings for the state budget. Direct savings have the form of lower interest margin between paid and received interests (that was collected by private banks in the past) and lower costs for state debt management. Indirect savings result from a stronger state position on financial market thanks to the concentration of resources in the state treasury and thanks to creation of Agency for debt and liquidity management. This agency manages the state debt, while strategic debt management remains the responsibility of the Ministry of Finance.

As part of the public finance reform, additional organizational and procedural changes took place at the MoF. These changes contributed to overall improvement of public finance management. During the year 2003, an organizational, functional, procedural and information audit was conducted at the MoF. As a result, competencies at the ministry were restructured, resulting in new organizational structure. Number of job positions decreased of by 30%. For example, job positions at the biggest budget section decreased from 147 to 88, while a new department of budget analyses was created. In 2004 – 2006 the Ministry continued improving the management by implementing the managerial quality system. Since 2005 the MoF of the Slovak Republic is a member of EFQM (European Foundation of Quality Management). In October 2005 it gained the first level of the EFQM award (Committed to Excellence) and in May 2006 the second level award (Recognized for Excellence).

Funding of public finance management reform was ensured from several sources. The major part of the reform (e.g. performance budgeting, methodological tools for macroeconomic budgeting, methodology

for multi-annual budgeting, accounting, training for State Treasury clients, etc.) was funded from the loan provided by the World Bank and co-financed from the state budget. This loan provided funds for technical assistance. The implementation of State Treasury and Debt and Liquidity Management Agency was supported by the EU's PHARE project. Training activities mainly during the pilot project of program budgeting were financed and conducted by United States Treasury Department. The reform of public finance was accompanied by several other structural reforms during 2002 – 2006, mainly the tax reform, fiscal decentralization reform, pension reform, health-care reform and education reform. They significantly contributed to stable macroeconomic environment, including strong economic growth in subsequent years and improved position of public finance.

#### **Institutional changes in budgeting – OECD recommendations**

The OECD identified seven key institutional elements, which are necessary for effective public finance control. These are:

- medium term fiscal framework;
- conservative predictions;
- budgeting from „top-to-bottom“, based on priorities;
- transparency;
- liberalization of central control of inputs;
- results orientation;
- modern financial management procedures.

Even though the above are mentioned as seven independent elements, in reality they are mutually related and they must be understood as a package.

*Source: Budget Reform in OECD Member Countries: Common Trends. Meeting of Budget Directors from the G-7 Countries. Berlin, Germany, 5-6 September 2002.*

### **3. Transition to modern macroeconomic and fiscal forecasting systems in Slovakia**

Before 2003, the MoF had its own but insufficient analytical capacities for macroeconomic forecasting which were spread among existing sections including FPI. Organizational structure was unclear and inefficient; the communication with the public and analytical experts was weak. There was no consistent macroeconomic model, detailed and reliable models for tax revenues forecast were absent while some of the analysis (long-term sustainability, fiscal impulse) were not conducted at all. Forecasting of parameters for macroeconomic environment was taken over from several inconsistent sources, which did not enable operative simulations of various options of political decisions in real time.

In 2003 and 2004 the „reform“ of the FPI took place. **The aim of the reform was creation of a central unit authorised to develop macroeconomic and tax revenue forecasts for public administration.** These forecasts would then be used by all public institutions as mandatory. In addition, FPI was expected to present and defend these forecasts in public. FPI became, together with the Budget Policy

Section, responsible for the design of medium-term fiscal framework (the Budget Policy Section develops multi-annual budget reflecting (and limiting) expenditure priorities of individual ministries).

The reform of the FPI was preceded by a comprehensive personnel and process audit at the MoF (mentioned above). As a result, new description of main duties and position of the FPI within the MoF was prepared. It was recognized that the analytical capacity at the FPI needs to be improved both in terms of institutional settings and human capital in order to provide transparent and reliable macroeconomic and tax revenue forecasts and analysis. Reform steps can be divided into five areas: 1) organizational and personal restructuring, 2) relations with the public, 3) reliable and consistent analytical models and tools, 4) increasing transparency 5) education and training program.

- **Organizational and personnel restructuring**

The staff was to a large extent changed. Changes in staffing started by appointing a new director, a crucial step for the success of the reform. Large portfolio of tasks and outputs as well as institutional reform gave the position high credibility and responsibility. Reputable and well-known director, not affiliated with any political party, was a necessary precondition for building a high-quality analytical staff.

- **Reliable and consistent analytical models and tools**

There are several analytical models and tools that have been gradually developed to analyse Slovak economy and provide relevant recommendations. Model for estimating potential output, cyclically-adjusted balance, structural models for tax revenue estimate, ageing model and short-term forecasting model are among them. The models also rely on microsimulations and work with panel data.

- **Relations with the public**

Setting-up the forecasting committees provide an adequate degree of openness and transparency of the forecasting process. The two committees - macroeconomic forecasting committee and tax revenues forecasting committee – were established (see section below and annex for detailed description).

- **Education and training program**

Via World Bank's project, aimed at education and improvement of skills, some international experts worked closely with internal staff at the FPI and staff members participated at the courses held at prestigious foreign institutions (London School of Economics, Oxford, OECD courses in Vienna and Budapest, IMF courses in Washington and Vienna, CEF Ljubljana, etc.). Access to up-to-date economic literature and databases has been also gradually ensured in order to provide timely and relevant information. This improves quality of analysis, contributes to a modern working environment and provides extra motivation for candidates when applying for the job.

- **Increasing transparency**

Besides some internal analyses for the minister of finance which require a degree of confidentiality, all the FPI outputs are published on the official [webpage](http://www.finance.gov.sk/en/Default.aspx?CatID=291)<sup>1</sup>. This includes strategic documents, forecasts as well as working papers and policy briefs (see below for detailed description). Also, relevant databases are published and provide useful source of analytical information for the general public.

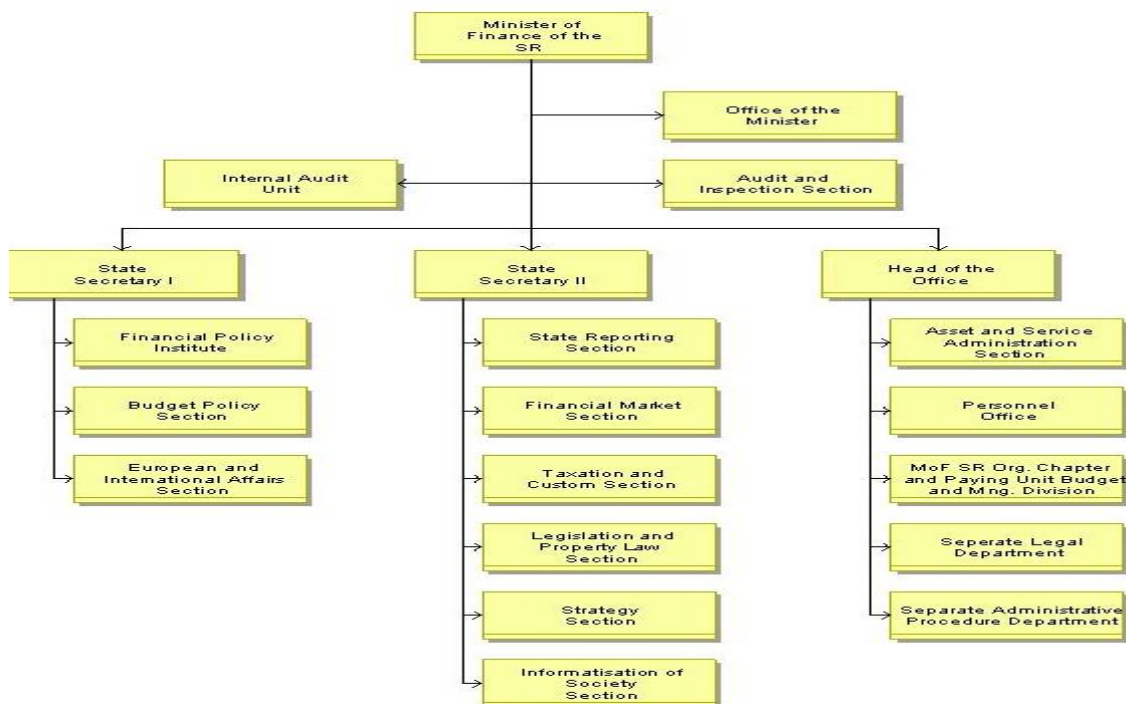
As a result of the reform, FPI is a well established analytical unit. It has its own analytical-forecasting capacities, able to produce reliable macroeconomic, tax, fiscal as well as structural analyses of standard quality achieved in EU countries and is core institution in producing such forecasts and fiscal reports for both internal and external purposes.

## 4. Description of the Financial Policy Institute

### 4.1. Structure of the Ministry of Finance

The MoF is a central agency of state administration responsible for the areas of finance, taxes and fees, customs, financial control, internal audit and government audit. It is also a central body of state administration responsible for the informatisation of society, coordination of state aid in the area of pricing and price control, except for the pricing and price control of the goods regulated by separate laws.

Figure 1: Structure of the Ministry of Finance



Source: MoF SR

<sup>1</sup> <http://www.finance.gov.sk/en/Default.aspx?CatID=291>



The Ministry:

- a) Develops and implements policies in the areas mentioned above, including the budgeting of the aggregate general government deficit; develops and implements the central government budget and financial market policy, including consumer protection in the provision of financial services, and develops and implements a policy for the management of assets owned by public administration, public-service sector and non-business sphere.
- b) Manages the state financial assets and liabilities, mortgage banking and building saving scheme, foreign exchange management, the single accounting and reporting system, and gambling policies.
- c) Oversees the implementation of social insurance, compliance with the conditions for granting government premium to building saving schemes, compliance with the conditions for granting government contribution to mortgage loans, over the operations of the Export-Import Bank of the Slovak Republic and over the financial management of the Social Insurance Agency.

Ministry is lead by the minister, two state secretary's (political nominations) and the head of office. It has approximately 700 employees separated in 12 sections. There are few agencies under direct MoF supervision: Cash and debt management agency (ARDAL), Tax directorate, Customs directorate, Financial audit authority (Správa finančnej kontroly), Datacentre (Datacentrum) and State Treasury (Štátna pokladnica).

#### **4.2. The role of the Financial Policy Institute (FPI)**

FPI is a special unit of the ministry, with status of a section. The FPI serves as an analytical capacity for the MoF and its mission is to provide a high-quality, transparent and reliable macroeconomic and fiscal analyses and forecasts for the Government. It clusters all the analytical tasks and knowledge related to the macroeconomic, tax and fiscal as well as structural policies analyses at one place. Although other alternatives were considered, two arguments were crucial when deciding for this model. Firstly, international experience, although not scientifically supported in literature, shows that critical mass of experts (some 7-10 people) needs to be put at one place as a team in order to achieve a creative environment and provide high-standard outputs. Secondly, having such capacity "in the house" brings other value added such as being able to react and provide recommendations in macroeconomic, fiscal and tax policy on a more operational basis, according to the current needs of the ministry. Spreading the tasks among the other sections without having a separate analytical body or "outsourcing" these activities by creating a separate institution are therefore less favourable alternatives.

The FPI focuses particularly on the following areas:

- macroeconomic analyses and forecasts (basis for the budget),
- tax analyses and forecasts (tax budgeting, impacts of the legislation changes on the budget, supervision of the payroll taxes budgeting),
- fiscal analyses and forecasts (public debt, rate of consolidation, current account balance, fiscal impulse, ageing),
- structural reforms monitoring - Lisbon Strategy, respectively EU2020 (coordination with the ministries, monitoring and evaluation of the policies and recommendations),

- recommendations for the tax and fiscal policies (examination of the initiatives of the private pension funds, employee bonus, proposals of the public finance deficits in line with the Stability and Growth Pact (SGP) and with the long-term sustainability of the public finance, recommendations for the pension system),
- analytical service for the management of the ministry (papers, speeches, presentations, ad hoc analyses).

#### 4.3. The mission

FPI's main goals are:

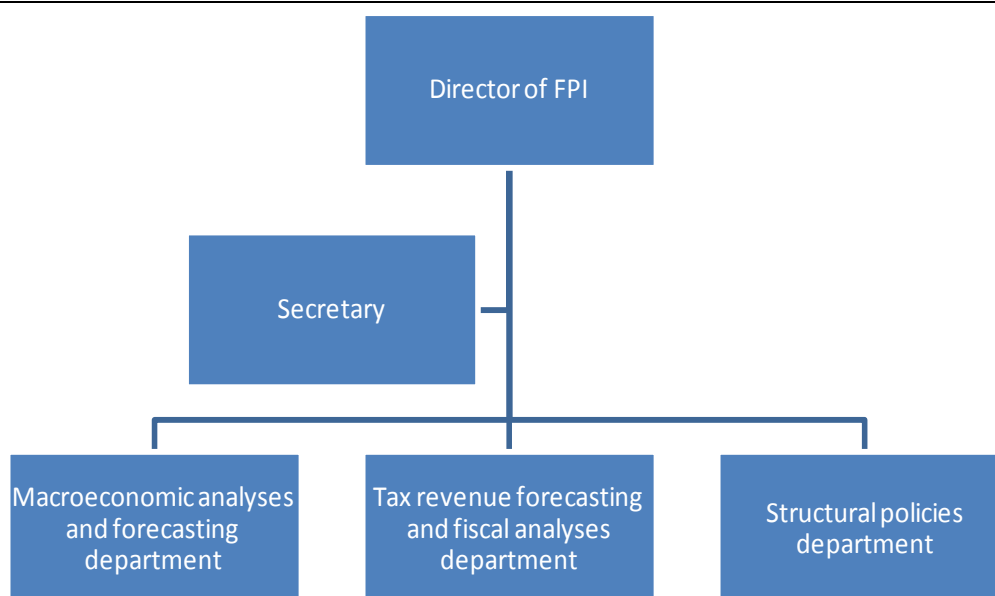
- **budgeting transparency** (macroeconomic and tax forecasts, methodology and reporting of the tax revenues),
- **sustainability of public finance** (financial dimension – consolidation, pension system, use of the privatization revenues),
- **quality of the public finance** - tax system that is efficient, simple, motivating for business and employment (exceptions, rebates, special regimes, different rates).

#### 4.4. The structure and activities of the Financial Policy Institute

FPI is lead by its director and is comprised of 20 staff members including the administrative assistant. They are divided among 3 departments, each supervised by department's director:

- The macroeconomic analyses and forecasting department (1+6)
- The tax revenue forecasting and fiscal analyses department (1+7)
- The structural policies department (1+3)

Figure 2: Structure of the FPI



*The macroeconomic analyses and forecasting department conducts the following tasks:*

- Produces short-term and medium-term forecasts of the macroeconomic development with a view to the convergence process of the economy and the medium-term government goals, regularly evaluates and forecasts the fulfilment and sustainability of the Maastricht convergence criteria in Slovakia with the focus on inflation.
- Analyses the macroeconomic development in Slovakia in the context of the development of the global economy and the economic policy of Slovakia, analyses the sensitivity of the development of the Slovak economy with respect to changes in the internal as well as external environment.
- Provides strategic management of the government debt and related financial risks via managing the government debt management strategy and controlling its implementation, cooperating with ARDAL in the area of estimates of costs of servicing the government debt in the medium-term horizon.
- Prepares in cooperation with the tax revenue and fiscal analyses department the Stability Programme for Slovakia and regular reports on macroeconomic development and public finance development in Slovakia and forecasts of development until the end of the year.

*The tax revenue forecasting and fiscal analyses department conducts the following tasks:*

- Estimates tax revenues including the quantification of legislative changes of tax laws, the public administration debt and proposes public administration deficits for the public administration budget, prepares evaluations of the tax revenues for the final account of the general government, provides estimates of taxes on a monthly basis for the State Treasury and ARDAL for the purposes of managing the liquidity of state financial assets, prepares estimates of social contribution revenues.
- Analyses the effective and marginal tax rate, prepares international comparisons of tax burden, distributional analyses of taxes according to different population groups, quantifies the impact of legislative changes on the size of the tax revenues, monitors the tax and social contribution revenues.
- Prepares fiscal analyses including the analysis of long-term sustainability of public finance, evaluates the anticipated development of the fiscal position and the government debt in relation to the ageing population aspect.
- Formulates recommendations in the area of fiscal and tax policy in the short to medium-term horizon.
- In co-operation with the MF SR State Reporting Section and the Statistical office of Slovakia proposes the methodology for the accrual recording of tax and social contribution revenues following the ESA 95 methodology, provides data about the amount of the tax and social contribution revenues for the purposes of elaborating Excessive Deficit Procedure (EDP) notification tables about the state of public finance following the ESA 95 methodology and quarterly national accounts.

- Prepares in cooperation with the Macroeconomic analyses and forecasts department the Stability Programme and its updates and regular reports on the macroeconomic development and the public finance development with a forecast until the end of the year.

*The structural policies department conducts the following tasks:*

- Analyses and formulates recommendations in structural policies (education, research and development, labour market, business environment, energy and climate change)
- Coordinates and methodologically guides the relevant ministries in the implementation of tasks under the National Reform Programme of the Slovak Republic within strategy Europe 2020, previously known as the Lisbon strategy.
- Prepares the National Reform Programme – key government document for structural reforms - and monitors and evaluates its implementation.
- Coordinates the EU agenda at the FPI (Ecofin, Economic and Financial Committee).

#### 4.5. Key outputs

Outputs of the FPI can be structured into three areas:

##### Key documents

- Convergence programme / Stability programme  
Under the provisions of the preventive arm of the Stability and Growth Pact (SGP) euro-area Member States prepare annual stability programmes and other EU member states prepare convergence programmes and submit them to the European Commission and the European Council each year. The aim is to ensure more rigorous budgetary discipline through surveillance and coordination of budgetary policies within the euro area and EU.
- National Reform Programme and implementation reports  
As part of the Europe 2020 strategy for smart, sustainable and inclusive growth, member states submit a National Reform Programme outlining their structural reform plans every year. This, alongside Member States' Stability and Convergence Programmes, aligns reporting on fiscal and structural policies as part of the new EU surveillance structure known as the EU semester since 2011. The agenda was previously known as Lisbon Strategy.
- The report on macroeconomic development and development of public finance in the first half and three quarters of the year  
The reports present the development of macroeconomic and fiscal indicators and their impact on the budget performance in the particular year. It is prepared two or three times per year.

##### Inputs for medium-term budget

- Macroeconomic forecasts
- Tax revenue forecasts
- Recommendation for general government targets/balance

- Recommendation for public debt

#### Others

- Economic analysis (working papers) - complement obligatory outputs described above.
- Policy briefs - are shorter format of an analysis. Together with working papers they are the main analytical outputs used for public presentation and discussion.

## 4.6. The role of the FPI in the budgetary process

FPI plays an important role in the budget preparation process. It provides a medium-term macro-fiscal framework for multi-annual budgeting, while forecasts are transparent and discussed at the macroeconomic and tax revenue forecasting committees and all the government bodies are obliged to use the same macroeconomic assumptions. Fiscal targets are supplemented by analysis of fiscal impulse and long-term sustainability of public finance. FPI also provides the impact assessment of the legislative changes and alternative scenarios.

### 4.6.1 Budgetary process

Budget preparation for each fiscal year which corresponds to the calendar year can be divided into four phases:

#### *Phase 1 - Budgetary framework*

At the beginning of the calendar year, MoF starts preparing the Government Budget Assumptions. First macroeconomic and subsequently tax revenue forecasts (elaborated below) are produced in February and provide essential contribution to the Government Budget Assumptions<sup>2</sup>. Government Budget Assumptions match the macroeconomic and fiscal indicators estimates with desirable general government balance where overall expenditure need to be within this framework and sets the expenditure limits for particular chapters of the public finance (ministries and other public agencies). Government approves the Government Budget Assumptions by the 15<sup>th</sup> April.

#### *Phase 2 – Budget preparation*

During the next stage the ministries prepare their budgets where they distribute their resources into the programs and categories according to the budgetary classification. The MoF in cooperation with other government agencies prepares the budget proposal and submits it to the government by 15<sup>th</sup> August. It includes the other expenditure requests which are subject to subsequent political negotiations. Update of the macroeconomic and tax revenue forecast is prepared for the purpose of the budget proposal. It is typically released by the end of June.

#### *Phase 3 - Budget proposal*

After the proposal's submission to the government, the political negotiations take place. Final decisions on distribution among budget chapters (government agencies) are made and the budget is approved by

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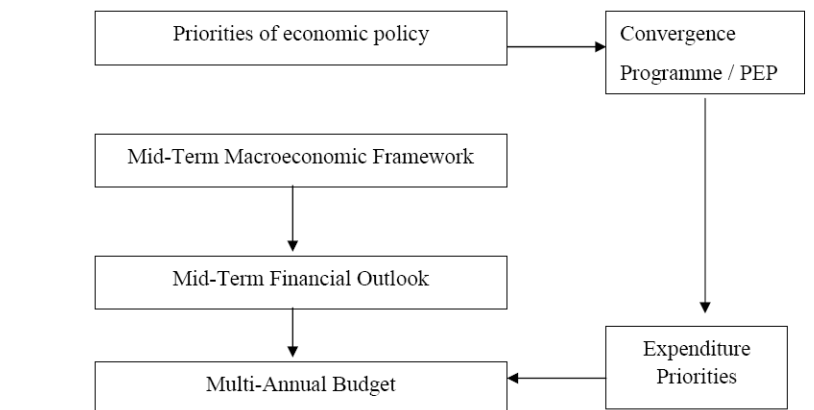
<sup>2</sup> Východiská rozpočtu.

the government by 15<sup>th</sup> October and sent to the parliament. Another update of macroeconomic and tax revenue forecast before final government approval may occur as well.

#### Phase 4 – Budget approval

The parliament negotiates the budget and approves the final version in form of Budget law, typically by the end of the calendar year.

**Figure 3: Budgetary process**

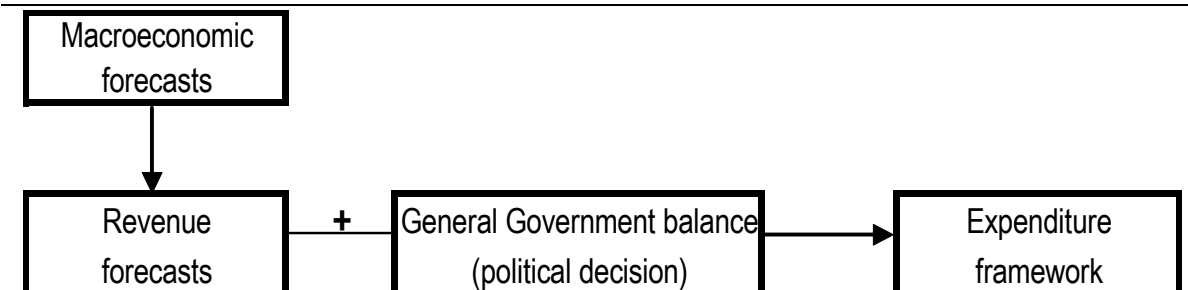


Source: MoF SR

#### 4.6.2 Budgetary framework – macroeconomic and tax revenues forecasts

Macroeconomic and tax revenue forecasts are the starting and determining point of the budgetary process. In both cases forecasts include estimates of the relevant indicators (see annex for the full list of indicators) for next three years which is the time horizon of the medium-term budget.

**Figure 4: Budgetary framework – macroeconomic and tax revenues forecasts**



Open and transparent communication including taking the relevant institutions on board in the process of forecasting is an important prerequisite in order to prepare high-quality and credible forecasts. The Macroeconomic forecasting committee and Tax revenue forecasting committee were established for this purpose with the aim to increase the quality and transparency of the forecasts. The members of the committees include Debt and Liquidity Management Agency (ARDAL), National Bank of Slovakia

(NBS), Slovak Academy of Sciences (SAV), Institute of Informatics and Statistics (INFOSTAT) and private banks, in other words, the main institutions in the Slovak Republic that produce their own economic forecasts or are significantly involved in producing related data or analysis. Some other institutions such as representatives of local and regional governments, employee associations are acting as observers at the committees. In contrast to full members, they do not submit their own forecast. Committees meet at least twice a year to discuss the forecast before the release.

#### **Macroeconomic Forecasting Committee (MFC) – process**

1. Members of MFC send their forecasts prior to the meeting
2. At the MFC meeting MoF presents its own forecasts. It is followed by the discussion where members comment on the forecast.
3. After the meeting, MoF may adjust the forecast based on the discussion at the committee and sends final forecast to MFC members.
4. MFC members assess the MoF forecast (conservative, realistic, or optimistic).
5. Based on objective criteria, the forecast is qualitatively assessed - conservative, realistic, or optimistic.
6. MoF publishes the forecast together with the overall assessment of MFC members.

#### **Tax Revenue Forecasts Committee (TRFC) – process**

1. Only MoF distributes its forecast prior to the meeting.
2. At the TRFC meeting MoF presents forecasts. It is followed by the discussion where members comment on the forecast.
3. After the meeting other members send to MoF their forecasts. MoF may adjust the forecast based on the discussion at the committees and sends final forecast to TRFC members.
4. MFC members assess the MoF forecast (conservative, realistic, or optimistic).
5. Based on objective criteria, the forecast is qualitatively assessed - conservative, realistic, or optimistic.
6. MoF publishes the forecast together with assessment of MFC members.

## **5. Concluding remarks and key success factors**

There is no uniform guideline regarding the extent of changes needed to improve analytical capacities, but there is "best practice" from the countries, which first started to reform the public finance management system and have a long experience in this area. We provide several concluding remarks we see as important in enhancing analytical capacity at the ministry of finance and have been relevant factors for the "success story" of the FPI.

#### **Strategic issues**

- Analytical body at the ministry of finance is crucial for achieving high-quality macroeconomic, tax, fiscal and structural policy analysis, and macroeconomic and tax revenue forecasts. Sound analysis improves the budgetary process in general.



- Transparency is one of the most important issues in the budgetary process, particularly in macroeconomic and revenue forecasts. Typically, ministry's forecast are evaluated as realistic or slightly conservative.
- Reform of the FPI was part of the macroeconomic framework and public finance reform. The implementation seems to be generally more feasible when it is a part of a "bigger package" with adequate political support.

### Organizational structure

- Experience suggests that clustering related tasks and knowledge delivers the high-quality outputs. At least macroeconomic, tax and fiscal analysis should be put at one place in order to achieve this.
- There should be a clear distinction of the decision-making roles (political vs. technical). Macroeconomic and tax revenue forecasts must be strictly expert forecasts, without any political influence. Budget with transparent assumptions can then be comfortably discussed with international institutions, including OECD, IMF, EC. And avoiding political discussion about the revenue forecasts helps to focus on real budgetary problems which are usually on the expenditure side of the budget. The scope of public finance balance and expenditure distribution should be topics for political discussion.
- Forecasting committees give the forecasting process credibility and transparency and also provide a good institutional framework for high-quality forecasts.

### Personnel management

- Appointing credible persons responsible for the reform and analytical outputs is a crucial element of the reform.
- Staffing policy at the FPI was mainly based on hiring the graduates with good understanding of economic concepts, analytical thinking and fluency in English.
- Graduates from reputable foreign schools are typically valuable contribution.
- Training activities at the prestigious teaching institutions provides not only necessary human capital enhancement but also a motivation for the staff members.
- As the tasks of the unit should be recognized as a top priority for the ministry, appropriate remuneration policy must be put in place to retain highly qualified and trained people.
- General reform environment seems to be an additional motivation factor as people would like to be part of the reform team.



## 6. Annexes

### 6.1. Annex 1: Status of the Committee for Macroeconomic Forecasts

#### Article 1 Introductory Provisions

1. The Committee for Macroeconomic Forecasts (the “Committee”) is established by the state secretary of the Ministry of Finance of the Slovak Republic responsible for forecasting of macroeconomic situation, who is also the chairman of the Committee. The Committee is established with the aim of increasing the quality and transparency of the macroeconomic forecasts.
2. Status of the Committee regulates the sphere of authority, composition, tasks and manner of conducting negotiations of the Committee.

#### Article 2 Sphere of Authority of the Committee

1. The fundamental objective of the Committee is increasing the quality of macroeconomic forecasts by information exchange between the Ministry of Finance of the Slovak Republic and relevant public and private institutions.
2. In the process of the preparation of macroeconomic assumptions of government budget are the activities of the Committee aimed at a greater transparency and higher level of professionalism in the macroeconomic forecasting.

#### Article 3 Composition of the Committee

1. The members of the Committee are representatives of the following institutions:
  - a) Ministry of Finance of the Slovak Republic (MFSR)
  - b) Debt and Liquidity Management Agency (ARDAL)
  - c) National Bank of Slovakia (NBS)
  - d) Slovak Academy of Sciences (SAV)
  - e) Institute of Informatics and Statistics (INFOSTAT)
  - f) ING Bank
  - g) Slovenská sporiteľňa (SISP)
  - h) Tatra banka (TB)
  - i) Všeobecná úverová banka (VÚB)
2. The members of the Committee are nominated by the chairman of the Committee.
3. The membership terminates, if:
  - a) A member of the Committee does not present own forecasts in the desired form for the meeting of the Committee two times, or
  - b) A member of the Committee does not prepare the opinion to the forecasts of the Ministry of Finance of the Slovak Republic two times.

4. Conditions of the membership stated in point 3. do not apply for the institution ARDAL.
5. Chairman of the Committee is deputized by the director of the Financial Policy Institute.
6. If necessary, the number of members of the Committee may be enlarged with the approval of the chairman of the Committee.
7. Each institution nominates one representative to the Committee that is a contact person for the Ministry of Finance of the Slovak Republic. At most two representatives may be present at the meeting of the Committee, except of the Ministry of Finance of the Slovak Republic that may nominate more representatives.
8. If needed, the chairman of the Committee may invite representatives of other institutions that are not members to the meeting of the Committee.

#### Article 4

##### Manner of conducting negotiations of the Committee

1. The meetings of the Committee are initiated by the chairman of the Committee at least three times a year.
2. In exceptional cases (e.g. unexpected substantial macroeconomic shocks), the chairman of the Committee has a right to call an exceptional meeting of the Committee.
3. At each meeting of the Committee a representative of the Ministry of Finance of the Slovak Republic presents a preliminary macroeconomic forecast of the Ministry.
4. Each member of the Committee has a right to present the main characteristics of his own forecast in the desired form and point out the main differences between the preliminary forecast of the Ministry of Finance of the Slovak Republic and the projections of the member's institution. Before the meeting of the Committee, the representative of the Ministry of Finance of the Slovak Republic sends a blank form for the desired forecasts to the members of the Committee.
5. A space for a general discussion is reserved in the end of the meeting of the Committee. Subsequently, the chairman summarizes the results of the meeting.
6. The representative of the Ministry of Finance of the Slovak Republic presents the final forecasts in no more than seven days after the meeting. Each member of the Committee is obliged to express/write an opinion on the final forecasts of the Ministry of Finance of the Slovak Republic in no more than seven days after the dispatch of the forecasts.

#### Article 5

##### General Provisions

1. The opinion to the forecasts of the Ministry of Finance of the Slovak Republic is a short text (10 to 15 sentences) with an overall assessment by using one of the words *conservative*, *realistic* or *optimistic*

stated in the first sentence. The rest of the opinion includes concrete arguments for defending of the position of the given institution.

2. The final forecasts of the Ministry of Finance of the Slovak Republic together with the forecasts and opinions of the members of the Committee are presented at a press conference.
3. The structure of the desired forecasts is an attachment of the Status and the Ministry of Finance of the Slovak Republic has a right to change it according to the actual needs. It includes an obligatory part (key indicators for the government budget creation) and an optional part.

### Article 6

#### Closing Provisions

1. The Status of the Committee is coming to force from January 2<sup>nd</sup> 2007.
2. By this Status coming into force the Status of the Committee valid up to the date is canceled.
3. A change or amendment of this Status is implemented in the form of written supplement.

Attachment No. 1

#### Forecasts of chosen indicators of economic development in SR

A. Obligatory indicators			estimate		forecast		
			t-1	t	t+1	t+2	t+3
1	GDP; current prices	bil. EUR					
2	real growth	%					
3	Final consumption of households; real growth	%					
4	nominal growth	%					
5	Average monthly wages; nominal growth	%					
6	real growth	%					
7	Average employment growth, according to LFS	%					
8	acc. to registered employment	%					
9	Average unemployment rate, according to LFS	%					
10	Consumer Price Index (average growth)	%					
11	Producer Price Index (average growth - inland)	%					
12	Current account balance (ratio to GDP)	%					
13	Final consumption of government sector (real growth)	%					
14	Gross fixed capital formation (real growth)	%					
15	Export of goods and services (real growth)	%					
16	Import of goods and services (real growth)	%					

B. Optional indicators			estimate		forecast		
			t-1	t	t+1	t+2	t+3
17	Balance of trade	bil. EUR					
18	Exchange rate	USD/EUR					
19							
20	BRIBOR 1M (average)	%					
21	10 year bonds yield (average)	%					

22	Output gap (to potential product)	%					
23	Net inflation (average)	%					
24	Deflator growth; GDP	%					
25	final consumption of households	%					
26	final government consumption	%					
27	gross fixed capital formation	%					
28	export of goods and services	%					
29	import of goods and services	%					
30	Current account balance to GDP /ESA 95/ *)	%					
31	FDI in SR (equity interest + reinvest. earnings)	mil. USD					
32	Oil prices (average)	USD/barrel					
33	GDP of Eurozone (real growth)	%					
34	GDP of Czech Republic (real growth)	%					
35	REPO rate of ECB (average)	%					
36	Average inflation in Eurozone	%					
37	Year-end inflation rate in SR (CPI)	%					
38	Average employment growth, ESA95	%					
39	Average unemployment rate, ESA95	%					

\*) starting with the year 2005 excluding the effect of the 2<sup>nd</sup> pension pillar

**Note:**

t – current year; (t±n) – n-year lag forward (+) or backward (-)

## **6.2. Annex 2: Status of the Tax Forecasting Committee**

### **Article 1**

#### **Introductory Provisions**

1. The Tax Forecasting Committee (the “Committee”) is established by the state secretary of the Ministry of Finance of the Slovak Republic responsible for forecasting of taxes, who is also the chairman of the Committee. The Committee is established with the aim of increasing the quality and transparency of tax revenues and social security contributions forecasts.
2. Status of the Committee regulates the sphere of authority, composition, tasks and manner of conducting negotiations of the Committee.

### **Article 2**

#### **Sphere of Authority of the Committee**

1. The fundamental objective of the Committee is increasing of the quality of tax forecasts by information exchange between the Ministry of Finance of the Slovak Republic and relevant public and private institutions. The activities of the Committee are also supposed to contribute to higher transparency in the process of establishing the government budget.
2. Tax Forecasting Committee builds on the work and aims of the Committee for Macroeconomic Forecasting. The estimations of tax revenues have a straight connection to the expected development of the economic environment. Tax revenues and social security contributions constitute the bulk of government revenues. Similarly to the case of economic environment the estimation of tax revenues and social security contributions are marked by a significant dose of uncertainty. The uncertainty brings a potential space for suspicions of an intentional overvaluation or undervaluation of government revenues by the institutions responsible for government budgeting. Therefore, the activities of the Committee contribute to a higher control of government budgeting process by involving experts to the discussion. Simultaneously, the isolation of the professional topics from possible political decisions connected to the government budgeting are aimed.
3. The subject of discussion of the Committee is forecasting of chosen taxes and social security contributions on accrual base. Only the tax revenues that flow entirely or partially to the government budget and to which the Ministry of Finance of the Slovak Republic have the tax authority are discussed. Local taxes that are under the authority of the Higher Territorial Units are not presented because the subjects of the territorial authority may decide about their exercising, tax base, rates, exceptions and administration.
4. In the case of Social Insurance Agency and health insurance companies the revenues which came from the earnings of economically active people from social insurance and public health insurance are mainly discussed. The part of the discussion is devoted to the amount of the pension savings (according to Act No 43/2004 Coll. on old-age pension saving as amended).

### **Article 3**

#### **Composition of the Committee**

1. The members of the Committee are representatives of the following institutions:
  - j) Ministry of Finance of the Slovak Republic (MFSR)
  - k) National Bank of Slovakia (NBS)
  - l) Institute of Informatics and Statistics (INFOSTAT)
  - m) ING Bank

- n) Slovenská sporiteľňa (SISP)
  - o) Tatra banka (TB)
  - p) ČSOB banka
  - q) UniCredit Bank
  - r) Debt and Liquidity Management Agency (ARDAL)
  - s) State Treasury (ŠP)
  - t) National Union of Employers (RÚZ)
  - u) Federation of Employers' Unions of the Slovak Republic (AZZZ SR)
  - v) Slovak Association of Towns and Villages (ZMOS)
  - w) Union of Towns and Cities of Slovakia (ÚMS)
  - x) Slovak Chamber of Commerce and Industry (SOPK)
  - y) Združenie samosprávnych krajov SR (SK8)
  - z) Statistical Office of the Slovak Republic (ŠÚ SR)
2. The members of the Committee are nominated by the chairman of the Committee.
  3. If necessary, the number of members of the Committee may be enlarged with the approval of the chairman of the Committee.
  4. The membership terminates, if a member of the Committee does not prepare the forecasts or opinions to the tax and social security contributions revenues forecasts of the Ministry of Finance of the Slovak Republic two times.
  5. Condition of the membership stated in the point 4. does not apply for the institutions stated in points i) to q).
  6. Chairman of the Committee is deputized by the director of the Financial Policy Institute.
  7. Each institution nominates one representative to the Committee that is a contact person for the Ministry of Finance of the Slovak Republic. At most two representatives may be present at the meeting of the Committee, except of the Ministry of Finance of the Slovak republic that may nominate more representatives.
  8. If needed, the chairman of the Committee may invite representatives of other institutions that are not members to the meeting of the Committee.

#### Article 4

##### Manner of conducting negotiations of the Committee

1. The meetings of the Committee are initiated by the chairman of the Committee at least three times a year.
2. In exceptional cases (e.g. unexpected substantial macroeconomic shocks), the chairman of the Committee has a right to call an exceptional meeting of the Committee.
3. At each meeting of the Committee a representative of the Ministry of Finance of the Slovak Republic presents a preliminary tax and social security contributions revenues forecast of the Ministry. This

forecast is available for the members of the Committee at least one work-day before the meeting together with the final macroeconomic forecast of MF SR.

4. The members of the committee has a right to send their questions concerning the forecast by e-mail to the director of Financial Policy Institute or another responsible person stated by the director. MF SR reacts to the questions at the meeting.
5. Other members of the Committee may, but are not obliged to present their opinion at the meeting of the Committee.
6. The Ministry of Finance of the Slovak Republic undertakes to gradually present methods that are used for forecasting of the tax revenues at the meetings of the Committee. For this purpose the ministry creates analytical documents that are sent to the representatives of the institutions in advance before the Committee meeting. These documents are subjects of the discussion.
7. At the end of the Committee meeting, the chairman summarizes the results of the meeting.
8. Each member is obliged to send own forecasts made on **the basis of the macroeconomic forecasts of MF SR** (attachment no. 2) in the desired structure stated in the attachment no. 3 in no more than two days after the meeting of the Committee.
9. The Ministry of Finance of the Slovak Republic sends the final forecasts to the members in no more than three days after the meeting of the Committee.
10. Each member of the Committee is obliged to express/write an opinion on the final forecasts of the Ministry of Finance of the Slovak Republic in no more than two days after receiving the forecasts.
11. Schedule with the deadlines of sending the documents between MF SR and the members of the Committee is a part of the attachment no. 1.

## Article 5

### General Provisions

1. The opinion to the forecasts of the Ministry of Finance of the Slovak Republic is a short text (10 to 15 sentences) with an overall assessment by using one of the words conservative, realistic or optimistic stated in the first sentence. This assessment is determined according to 1% deviation from the final forecast of total tax and social security contributions revenues of the government sector of MFSR. The deviation is calculated as weighted average of the institution's deviations from MF SR forecasts in single years of the forecast. The rest of the opinion includes concrete arguments for defending of the position of the institution.

$$O_t = \frac{P(I)_t - P(MF)_t}{P(MF)_t} \times 100$$

$$O_{WAVG} = \frac{\sum_{t=1}^4 w_t * O_t}{\sum_{t=1}^4 w_t}$$

where  $O_t$  is a deviation in year  $t$ ,  
 $P(I)_t$  is a forecast of the institution in year  $t$ ,  
 $P(MF)_t$  is a forecast of the MF SR in year  $t$ ,  
 $O_{WAVG}$  is average weighted deviation of the institution's forecast from the forecast of MF SR,  
 $w_t$  is a weight of year  $t$ ,  
 $t = 1, 2, 3, 4$ ;  $t = 1$  is current year.

Forecast of MF SR is: *realistic, if  $O_{WAVG}$  is in the interval  $<-1; 1>$ ,*  
*conservative, if  $O_{WAVG}$  is greater than 1,*  
*optimistic, if  $O_{WAVG}$  is less than -1.*

Weights of individual years for meetings during the current year (t denotes current year)				
Meeting	t	t + 1	t + 2	t + 3
1 <sup>st</sup> meeting (ordinary February)	30%	50%	15%	5%
2 <sup>nd</sup> meeting (ordinary June)	20%	50%	20%	10%
3 <sup>rd</sup> meeting (ordinary September)	10%	50%	25%	15%

- In the case of exceptional meeting of the Committee, the weights are stated according to the previous regular meeting of the Committee.
- The final forecasts of the Ministry of Finance of the Slovak Republic together with the forecasts and opinions of the members of the Committee may be presented at a press conference.
- The structure of desired forecasts is an attachment of the Status and the Ministry of Finance of the Slovak Republic has a right to change it according to the actual needs.
- Attachment No. 2 includes the list of tax revenues and social security contributions forecasts that consists of obligatory and optional indicators. For easier assessment of the forecasts Attachment No. 2 includes apart from the nominal values also growth rates. Attachment No. 3 includes the list of main economic indicators that are important for tax revenues and social security contributions. Ministry of Finance presents the final forecasts of the indicators according to the previous Committee for Macroeconomic Forecasting in the attachment.

## Article 6

### Closing Provisions

- The Status of the Committee is coming to force from June 22<sup>nd</sup> 2010.



2. By this Status coming into force the Status of the Committee valid up to the date is canceled.

Attachment No. 1

Working schedule of the Committee		
Step	Date	Note
1.	T - 1	MF SR sends an actual forecast to the members of the Committee.
2.	T	<b>Committee meeting</b>
3.	T + 2	The members send their forecasts to the MF SR.
4.	T + 3	MF SR sends members of the Committee a final forecast and an assessment of the forecast from the view of the members.
5.	T + 5	The members of the Committee send their comments to the final forecast of MF SR.
Notes: T – day of the meeting The number in the column "Date" denotes the number of the work-days.		

### Forecast of chosen tax revenues and social security contributions on accrual basis

#### Obligatory Indicators

No.	Indicator (v thousands of Euro)	Real	Estimate	Forecast		
		t - 1	t	t + 1	t + 2	t + 3
<b>A</b>	<b>Total taxes excluding local end other taxes (A1+A2)</b>					
A1	Direct (A1.1+A1.2+A1.3)					
A1.1	Personal income tax (1+2)					
A1.2	Corporate income tax					
A1.3	Withholding income tax					
A2	Indirect (A2.1+A2.2+A2.3)					
A2.1	Value added tax					
A2.2	Excise taxes (3+4+5+6+7+8+9+10)					
A2.3	Taxes on internat. trade and transactions					
<b>B</b>	<b>Social insurance (EAP + owed) - 1<sup>st</sup> pillar</b>					
<b>C</b>	<b>Health insurance (EAP + owed)</b>					
	<b>CELKOM A+B+C</b>					

#### Optional Indicators

No.	Indicator (v thousands of Euro)	Real	Estimate	Forecast		
		t - 1	t	t + 1	t + 2	t + 3
1	Inc. from dep. activity and function benefits					
2	Inc. from busin. and other self-empl. activity					
3	Excise tax on mineral oil					
4	Excise tax on spirits					
5	Excise tax on beer					
6	Excise tax on wine					
7	Excise tax on tobacco					
8	Excise tax on electricity					
9	Excise tax on natural gas					
10	Excise tax on coal					
11	Local taxes					
12	Other taxes					
13	Social insurance (state)					
14	Health insurance (state)					
<b>D</b>	<b>Taxes and soc. security cont. (A+B+C+11+12+13+14)</b>					
	<b>Taxes and soc. security cont. (% HDP)</b>					
	Government tax revenues (% HDP)					
	Government soc. security cont. revenues(% HDP)					
15	Pension saving (EAP) - 2 <sup>nd</sup> pillar					
16	Pension saving (state) - 2 <sup>nd</sup> pillar					
<b>E</b>	<b>Taxes and soc. security cont. incl. 2<sup>nd</sup> pillar (D+15+16)</b>					
	<b>Taxes and soc. security cont. incl. 2<sup>nd</sup> pillar (% HDP)</b>					

No.	Indicator (growth rate in %)	Real	Estimate	Forecast		
		t - 1	t	t + 1	t + 2	t + 3
1	Inc. from dep. activity and function benefits					
2	Inc. from busin. and other self-empl. activity					
A1.2	Corporate income tax					
A1.3	Withholding income tax					
A2.1	Value added tax					
3	Excise tax on mineral oil					
4	Excise tax on spirits					
5	Excise tax on beer					
6	Excise tax on wine					
7	Excise tax on tobacco					
8	Excise tax on electricity					
9	Excise tax on natural gas					
10	Excise tax on coal					
A2.3	Taxes on internat. trade and transactions					
11	Local taxes					
12	Other taxes					
B	Social insurance (EAP + owed) - 1 <sup>st</sup> pillar					
13	Social insurance (state)					
15	Pension saving (EAP) - 2 <sup>nd</sup> pillar					
16	Pension saving (state) - 2 <sup>nd</sup> pillar					
C	Health insurance (EAP + owed)					
14	Health insurance (state)					
<b>D</b>	<b>Taxes and soc. security cont. together</b>					
<b>E</b>	<b>Taxes and soc. security cont. together incl. 2<sup>nd</sup> pillar</b>					

Attachment No. 3

Forecasts of chosen indicators of economic development in SR

No.	Indicator (%)	Real	Estimate	Forecast		
		2008	2009	2010	2011	2012
1	GDP; current prices					
2	real growth					
3	Final consumption of households; real growth					
4	nominal growth					
5	Average monthly wages; nominal growth					
6	Employment growth, acc. to registered employment					
7	Wage base growth *)					
8	Consumer Price Index (average annual growth)					
9	CPI (average annual growth) - low income households					
10	EURIBOR 3M (average)					

\*) Wage base = average wage \* number of employed acc. to registered employment

### 6.3. Annex 3: List of interviewed people

L. Ódor, advisor to the minister of finance, FPI director (2003 – 2005)  
Z. Krajčír, director of the Macroeconomic forecasting and analysis department, FPI; FPI director (2007-2010)  
J. Tóth, director of the FPI (2010 until now)  
V. Novýsedlak, director of the Tax and fiscal forecasting and analysis department

### 6.4. Annex 4: Literature reviewed

ECORYS Nederland BV (2004), Functional Review of the Budget Process in Slovakia  
Financial Policy Institute, Ministry of Finance of the Slovak Republic, webpage  
International Monetary Fund (2002), Report on Fulfilment of Standards and Rules –Fiscal Transparency Module  
Miklos I. (2005), Book of Reforms, Ministry of Finance  
Ministry of Finance (2004), Strategy of Public Finance Management Reform  
Ministry of Finance, Statutes of Tax Committee  
Ministry of Finance, Statutes of Macro Committee

### 6.5. Annex 5: List of Abbreviations

ARDAL	Cash and debt management agency
EC	European Commission
ECOFIN	The Economic and Financial Affairs Council
EDP	Excessive Deficit Procedure
EFQM	European Foundation of Quality Management.
ESA	The European System of Accounts
EU	The European Union
FPI	Financial Policy Institute
IBRD	The International Bank for Reconstruction and Development
IMF	The International Monetary Fund
INFOSTAT	Institute of Informatics and Statistics
MFC	Macroeconomic Forecasting Committee
NBS	National Bank of Slovakia
OECD	The Organisation for Economic Co-operation and Development
SAV	Slovak Academy of Sciences
SGP	Stability and Growth Pact
TRFC	Tax Revenue Forecasts Committee
USAID	The United States Agency for International Development