

## EXECUTIVE SUMMARY

Having examined the draft Stability Programme (SP 2018) for the 2018–2021 period, the Fiscal Council has established that the projected fiscal trends do not comply with fiscal rules. The SP 2018 has been drafted based on the scenario of unchanged economic policies, since the Government of Slovenia is of the opinion that its regular duties do not include changes in policies to ensure the respect of fiscal rules in the period of the Stability Programme and thus achieve mid-term fiscal sustainability. For the same reason, the Government did not draft an amendment to the framework for drafting general government budgets.

The opinion of the Fiscal Council concerning the procedure of drafting the spring budget documents is as follows:

- The drafting of the Stability Programme based on the scenario of unchanged policies is deemed appropriate in the current political situation, when the Government is limited to performing its regular duties.
- The decision of the Government to not draft an amended framework because of performing its regular duties is generally understandable. Within the framework, the Government should determine measures to achieve target balance and ensure that the maximum general government expenditure in the period until 2021 is not exceeded. The assessment about acceptability of the procedure, however, does not apply to 2018, in which the Government will be operative for most of the year and should thus ensure the respect of fiscal frameworks by taking appropriate measures.

The Fiscal Council's statements about the macroeconomic situation are the following:

- The economy is not yet overheating. The continuation of rapid economic growth, especially the consequent restrictions in the labour market, is increasing the possibilities for the emergence of macroeconomic imbalances.
- Our assessment is that negative risks for economic growth are increasing, especially in the international environment.

The principal findings concerning compliance with the applicable fiscal rules (see Table 1) based on the submitted scenario of unchanged policies in the SP 2018 are the following:

- the appropriate mid-term fiscal objective for Slovenia is a surplus in structural balance of 0.25% of GDP, which will not be achieved in the period of projection. The SP 2018 defines the mid-term fiscal objective as a balancing of the structural balance by 2020, but this is not in accordance with the Fiscal Rule Act. In fact, the Stability and Growth Pact does not define the year when the objective must be achieved, but only the dynamics of the convergence towards the objective;
- in conditions of high economic growth, the structural effort in 2018–2021 will be insufficient both at the annual level and in the average of two years. The structural balance is even expected to deteriorate again in 2018 and 2019. There is also a possibility of significant deviations from the required structural efforts almost throughout the period;
- the expenditure rule will not be complied with in 2018–2019, because net expenditure will

grow faster than the long-term potential output adjusted for the required structural effort. The pursuing of the expenditure rule also brings the risk of excessive deviation in the case of realisation of the scenario of unchanged policies, at least in 2019;

- the debt rule will be fulfilled throughout the period concerned because the share of debt in the GDP will decrease with adequate dynamics. This should be enabled by the projected primary surplus of the general government balance, which is, however, cyclical to a large extent;
- the domestic fiscal rule will not be fulfilled, because, according to the scenario of unchanged policies, projected levels of expenditure exceed the legally determined expenditure ceilings in the framework from November 2017 in all years.

In view of a high risk of persistent and significant deviations from the fiscal rules in the 2018–2021 period, the Fiscal Council:

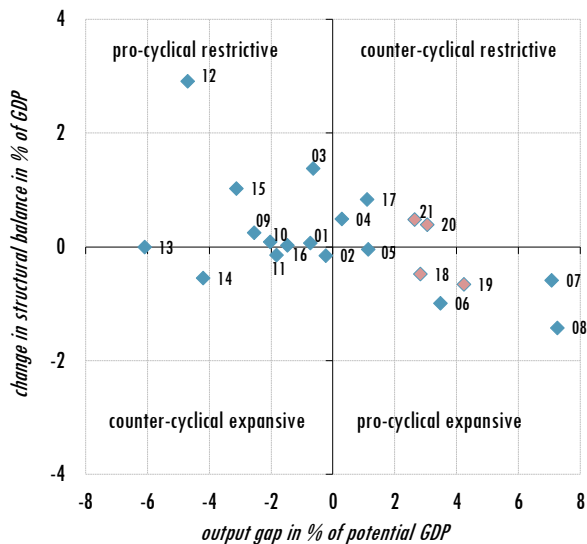
- estimates that the deterioration of the structural balance in 2018 and 2019 based on the SP 2018 constitutes a significant deviation from the convergence towards the mid-term fiscal objective at an inappropriate moment, especially during conditions of high economic growth and given the approaching peak of the economic cycle;
- calls for the adopting of measures to reduce expenditure growth so that the expenditure in 2018 does not exceed the expenditure ceiling set in the framework from November 2017. This would make the fiscal policy in 2018 at least neutral;
- estimates that measures ensuring mid-term fiscal sustainability would not hinder economic growth in the current favourable macroeconomic situation. On the contrary, the Fiscal Council assesses that the structural adjustment of public finance could be a factor contributing to more stable and sustainable conditions for economic growth, simultaneously creating necessary leeway for action in less favourable times;
- notes that the need for action is also dictated by risks to which fiscal trends are subject. There is an increase noted in short-term risks in the national and international environment that could threaten the prospects for achieving mid-term fiscal sustainability. If actions are not taken, Slovenia will also be exposed to considerable long-term risks because of the expected strengthening of unfavourable fiscal effects of demographic trends;
- estimates that risks include the possibility that a new government is not formed before the beginning of budget-related activities in the autumn. As a consequence, the uncertainty concerning the fiscal policy orientations for 2019 would increase further;
- notes that the indicated general non-compliance with the fiscal rules in the entire period requires that new measures are adopted as soon as possible after the formation of the new government; these measures should guarantee mid-term and long-term fiscal sustainability and therefore compliance with fiscal rules. Measures that will comprehensively address the costs of population ageing should be adopted and implemented already in the first half of the new government's term;
- stresses that compliance with the fiscal rules is not an end in itself. A consistent counter-cyclical fiscal policy based on credible mid-term planning is necessary for creating sufficient surpluses leaving adequate leeway for action when the economic cycle turns. This is also confirmed by the experience with the consequences of a pro-cyclical economic policy in the past.

**Table 1: Compliance with the fiscal rules**

|   |  | 2017 | 2018   | 2019   | 2020   | 2021   |
|---|--|------|--------|--------|--------|--------|
| A | Medium term objective  | ✗    | ✗      | ✗      | ✗      | ✗      |
|   | Change in the structural balance                                   | ✓    | ✗      | ✗      | ✗      | ✗      |
| B | Expenditure rule   | ✗    | ✗      | ✗      |        |        |
| C | Change in gross public debt  | ✓    | ✓      | ✓      | ✓      | ✓      |
| D | Domestic fiscal rule   | ✗    | ✗      | ✗      | ✗      | ✗      |
| A | Structural balance (in % GDP)                                      | -0.1 | -0.5   | -1.1   | -0.3   | 0.1    |
|   | <i>Medium term objective</i>                                       | 0.25 | 0.25   | 0.25   | 0.25   | 0.25   |
| B | Growth in net expenditure (in %)                                   | 1.5  | 3.4    | 5.0    |        |        |
|   | <i>Reference rate to be applied - nominal (in %)</i>               | 0.0  | 1.0    | 2.6    |        |        |
| C | Gross public debt (in % GDP)                                       | 73.6 | 69.3   | 65.2   | 61.5   | 58.3   |
|   | <i>Reference level of debt (in % GDP)</i>                          |      | 76.3   | 68.8   | 68.4   | 67.9   |
| D | Level of public expenditure in SP2018 (no policy change) (mio EUR) |      | 19,539 | 20,579 | 21,070 | 21,450 |
|   | <i>Maximum level of public expenditure (mio EUR)</i>               |      | 19,111 | 19,932 | 20,776 | 21,363 |

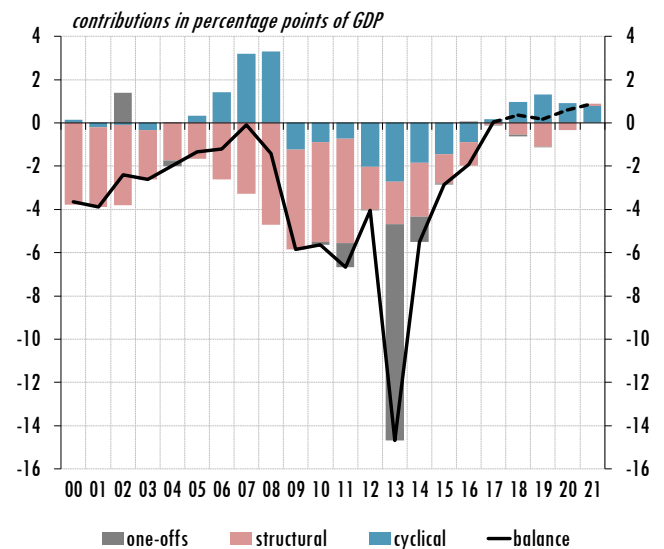
Sources: SORS, Stability Programme 2018, FC calculations and assesment.

**Figure 1: Fiscal policy stance 2001–2021**



Sources: SORS, IMAD, IMF, OECD, EC, SP 2018; FC calculations.

**Figure 2: Contributions to general government balance**



Source: SORS, Stability Programme 2018, FC calculations.