REPUBLIC OF SLOVENIA
FISCAL COUNCIL

Assessment of compliance of the general government budgets with the fiscal rules in 2017

April 2018

Document number: 30-2/2018/8

TABLE OF CONTENTS:

FIGURES:

TABLES:

SUMMARY

In accordance with the provisions of the Fiscal Rule Act the Fiscal Council made an assessment of the compliance of the executed general government budgets with the fiscal rules in 2017. The Fiscal Council assessed that last year's fiscal policy was countercyclical and restrictive, which is appropriate in view of the economy’s currently estimated cyclical position. Although the appropriate medium term fiscal objective was not yet achieved in 2017, the dynamics of approaching the objective were faster than required. The decrease in the share of general government debt in GDP was appropriate, too. The rules referring to the general government expenditure were not observed in the past year. Considering the legally prescribed expenditure restrictions, the general government balance should improve even more, thus increasing the fiscal policy leeway in the future years.

Favourable macroeconomic conditions, with last year's economic growth being the highest after the onset of the crisis a decade ago, were reflected in a considerable and broad-based growth of general government revenue. These revenues made it possible to increase expenditure above the level determined at budget drafting. Since the increase in revenue nevertheless exceeded the increase in expenditure, fiscal consolidation continued and the general government balance showed a slight surplus for the first time. Last year also saw a sufficient decrease in the structural deficit. The improvement of the primary balance was less considerable, which indicates the important role of interest in the improvement of the state of public finances. The share of gross debt in GDP was further reduced, while the state continued active debt management enabled by the favourable situation in financial markets.

Despite favourable trends, the Fiscal Council estimates that the opportunity for sustained improvement of public finance was missed in 2017. Favourable macroeconomic trends and the related growth of general government revenue enabled the accelerated dissolution of the austerity measures adopted during the crisis. According to the Fiscal Council, economic policy makers should have also seized upon the favourable conditions in past years, including in 2017, for the drafting and adoption of measures contributing to a lasting improvement in the state of public finances. This is also important in the light of risks related to the projected fiscal consequences of demographic changes. The projections of the Stability Programme – 2018 amendment, which were based on the scenario of unchanged policies, namely show that the implementation of the strategy of fiscal consolidation in recent years, when austerity measures were gradually relaxed alongside the improving economic situation, will no longer be possible because the austerity measures have been largely abolished. Despite favourable economic and public finance trends, there is an increasing need for substantial measures to ensure adequate reserves for the period when the economic growth is reduced; this would provide a firmer basis for sustainable public finances in the medium term, which are one of the conditions for increasing the long-term economic potential and subsequently the welfare of the population.

Table 1: Compliance with fiscal rules

		2017
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)	0.0
	Medium term objective	*0.25*
	Change in structural balance (in % BDP)	*1.0*
	Required change in structural balance (in% BDP)	*0.6*
B	Growth in net expenditure (in %)	3.0
	Reference rate to be applied - nominal (in %)	*2.5*
C	Gross public debt (in % GDP)	73.6
	Reference level of debt (in % GDP)	*78.7*
D	Level of public expenditure (mio EUR)	18,645
	Maximum level of public expenditure - Framework May 2017 (mio EUR)	*18,460*

Source: SORS, MoF, FC estimates and calculations.

Legislative Basis

According to point 4 of the second paragraph and point 3 of the third paragraph of Article 7 of the Fiscal Rule Act (ZFisP), the Fiscal Council is obliged to submit an assessment of the compliance of the executed general government budgets from the previous year with the fiscal rules by 30 June of the current year. The Statistical Office of the Republic of Slovenia published the data according to the ESA methodology on the Main Aggregates of the General Government 2014–2017 on 30 March 2017, and the Report on the Excessive Deficit and Debt 2014-2017 on 20 April 2017. In addition, the Fiscal Council acquired from the Ministry of Finance the data of consolidated public finance balance sheet based on the methodology of cash flow, the Proposed Annual Financial Statement of the Budget of the Republic of Slovenia for 2017 and the Public Debt Management Report of the Republic of Slovenia for 2017.

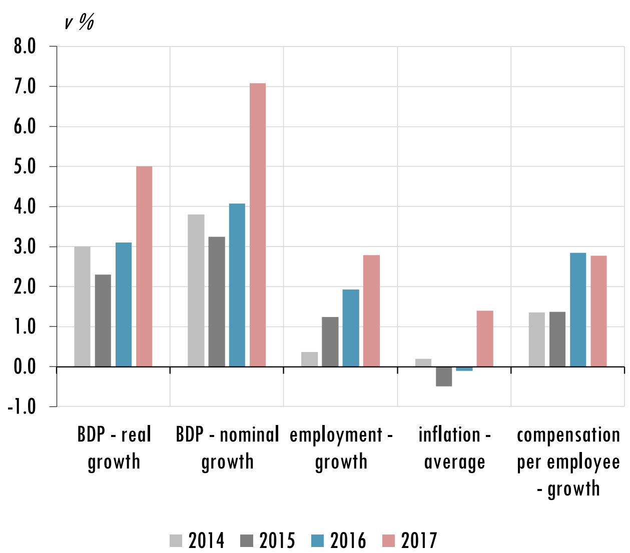
In accordance with Article 15 of the ZFisP, in the period when Slovenia is approaching its medium-term fiscal target, general government budgets are deemed balanced in the medium term if the structural balance of the general government approaches the medium-term fiscal target in accordance with the dynamics determined on the basis of the Stability and Growth Pact (SGP). The current medium-term fiscal target for Slovenia is the structural balance of 0.25% of GDP. According to the available estimates, Slovenia is drawing closer to the target but has not yet reached it. Therefore the Fiscal Council used the approach verifying (i) compliance with the fiscal rules referred to in Article 15 of the ZFisP and (ii) compliance with the domestic fiscal rule referred to in Article 3 of the ZFisP.

1. Macroeconomic and Fiscal Trends in 2017

The economic growth further strengthened in 2017 and significantly enabled further improvement in the state of public finances. The gross domestic product increased by 5.0% in real terms and by 7.1% in nominal terms, which was the highest growth after 2007. As economic conditions in our trading partners are favourable, export remained the most important factor of the economic growth, which has become more broad- based. The continued growth of household and government consumption and the revival of the investment activity have, namely, caused a significant growth of domestic demand in comparison to previous years. Such a structure of economic growth markedly increased the growth of tax bases, too. Employee compensation increased by 6.0%, which was primarily the consequence of an even higher growth of employment (2.8%) than the year before. The moderate wage growth continued, too, which contributed, together with favourable situation in the labour market and a high level of trust of consumers, to further strengthening of private consumption. Last year also saw a considerable improvement in companies' business results, which was reflected in the stronger growth of gross operating surplus. The increase in prices picked up slightly because of the enhanced domestic demand and higher prices of raw materials, but remained moderate.

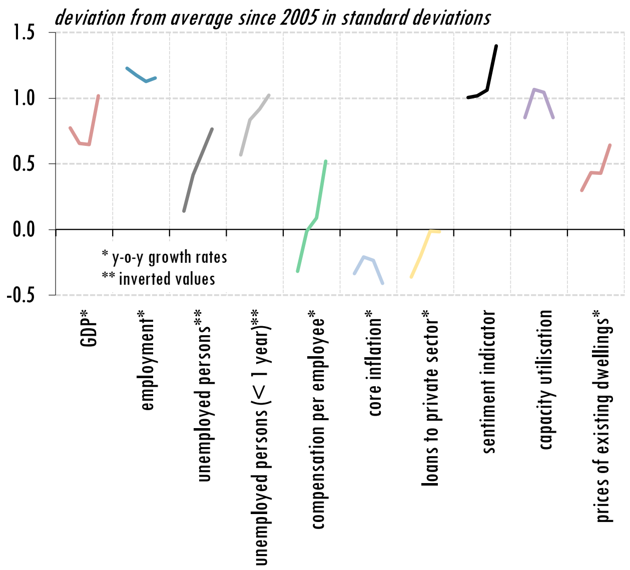
The Fiscal Council estimates that the negative output gap was closed in 2017, while the examination of a broader set of indicators for determining the cyclical situation of the economy shows that major macroeconomic imbalances were not yet generated in the Slovenian economy last year. According to the estimates of most institutions that make estimates for Slovenia, in 2017 the output gap entered the positive range.[1] The estimates of the output gap differ because of differences in methodologies and input data; the fact that they change significantly over time should be considered, too (see Figure 1.3). According to both domestic institutions (IMAD, Spring Forecast 2018, MoF, Stability programme - 2018 amendment) last year's output gap was close to the equilibrium level, while the estimates of the EC and IMF based on this indicator suggest that the economy was already overheating in 2017. The estimate from the EC is especially extraordinary, stating that since the spring of 2016 the level of actual GDP in Slovenia in 2017 was considerably higher than the level

Figure 1.1: Macroeconomic indicators



Source: SORS; FC calculations.

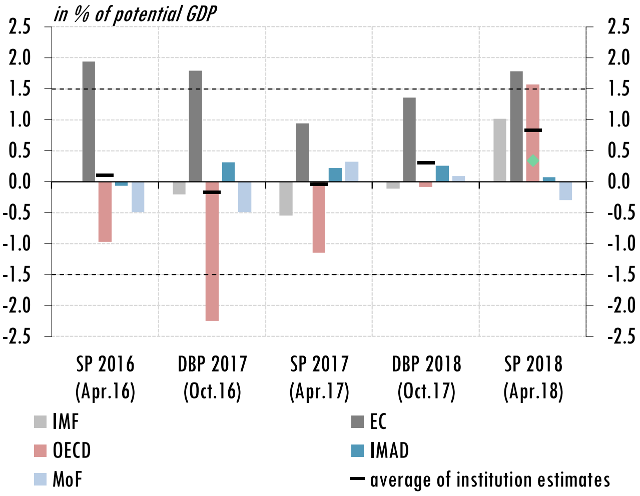
Figure 1.2: Indicators of economic cycle dynamics in 2017



Source: SORS, ECB, Eurostat, Employment Service of Slovenia, FC calculations.

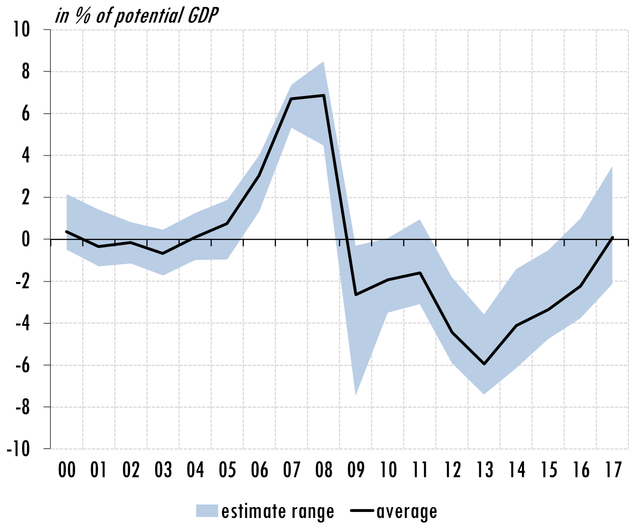
[1] In the latest available estimates, however, the Ministry of Finance and the OECD estimate that the output gap was still slightly negative last year.

Figure 1.3: Output gap estimates for 2017 available at time of preparation of budget documents



Note: Horizintal lines indicate value of change in the required structural effort.
Sources: IMF, MoF, OECD, IMAD, EC; FC calculations.

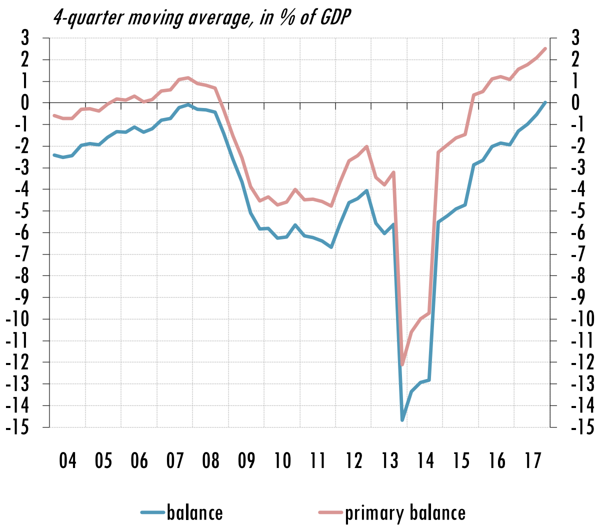
Figure 1.4: Output gap estimates



Note: Range of estimates of various institutions is shown. See note under Table 4.3 in Assessment of the compliance of the fiscal policy with the fiscal rules based on the draft SP 2018 amendment (FC, April 2018).
Source: IMAD, EC, OECD, IMF, MoF, FC calculations.

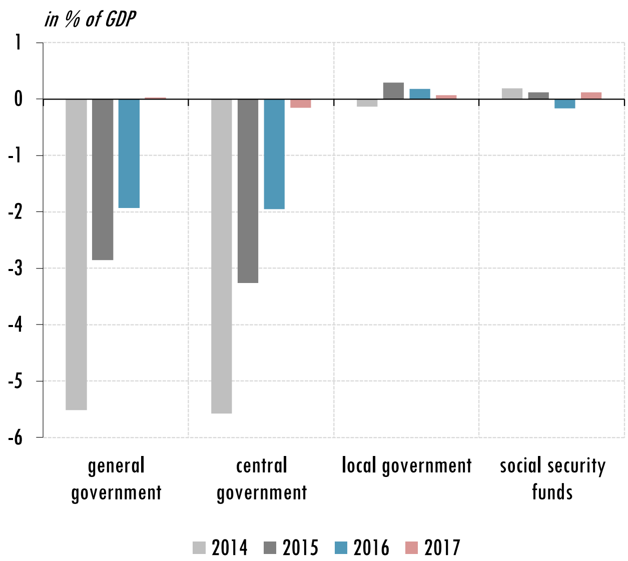
of potential GDP. Besides estimates of other institutions, the Fiscal Council applies some other methodological approaches to make estimates of the output gap.[2] In addition, it examines a broader set of indicators to determine the situation of the economic cycle. In 2017 some indicators (economic growth, employment, confidence) exceeded multi-annual averages and approached the highest levels so far, while restrictions for the operation of the business sector were increasingly notable on the part of the supply, especially in the labour market. On the other hand, the growth of prices and wages remained moderate while the level of indebtedness of the business sector was, after a multi-annual process of deleveraging, much lower than before the crisis. The volume of loans began increasing only towards the end of the year, while the surplus in the current account of the balance of payment further increased. The Fiscal Council estimates, on the basis of the currently available information, that the

Figure 1.5: General government balance and primary balance



Sources: SORS, FC calculations.

Figure 1.6: Balances of sub-sectors of general government



Source: SORS.

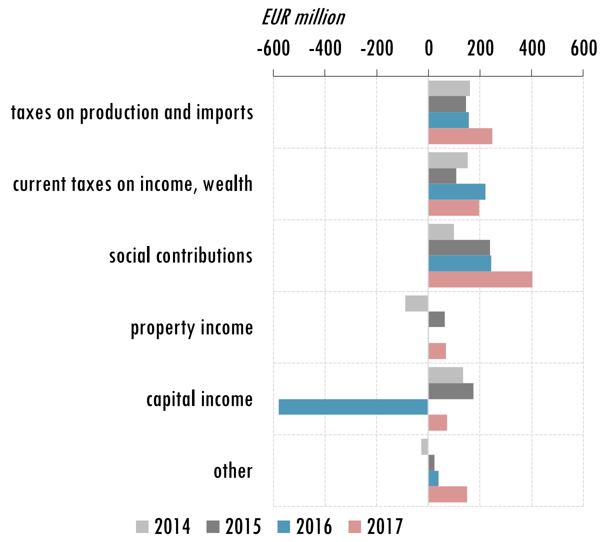
[2] See Report on the Fiscal Council's operations in 2017, Chapter 2.3. (pp. 23-26).

Slovenian economy in 2017 went through the so-called normal times according to the EC definition[3] since significant macroeconomic imbalances did not occur yet.

The general government balance further improved last year and the general government demonstrated a slight surplus for the first time (0.0% of GDP, or EUR 13 million). The general government balance increased by 1.9 p.p. of GDP in comparison with 2016; the increase in the surplus of the primary balance, which does not include interest expenditure, was slightly smaller (from 1.1% in 2016 to 2.5% of GDP). The improved balance was primarily a result of a stronger revenue growth (6.5%), which was linked to the high and broad-based economic growth and further improvement of the labour market situation. After a drop in 2016, the expenditure rose, too (by 1.9%), especially as a result of further relaxation of the remaining austerity measures in the field of social transfers and compensation of employees. A considerable increase was also recorded in expenditures on intermediate consumption. A review of the general government sub-balances indicates that the improvement of the general government balance in 2017 was mainly due to the improvement of the central government sector; this sector, however, still showed deficit (-0.2% BDP). Social security funds recorded a slight surplus after the deficit in 2016. The situation is similar in the local government sector, where the surplus slightly decreased.

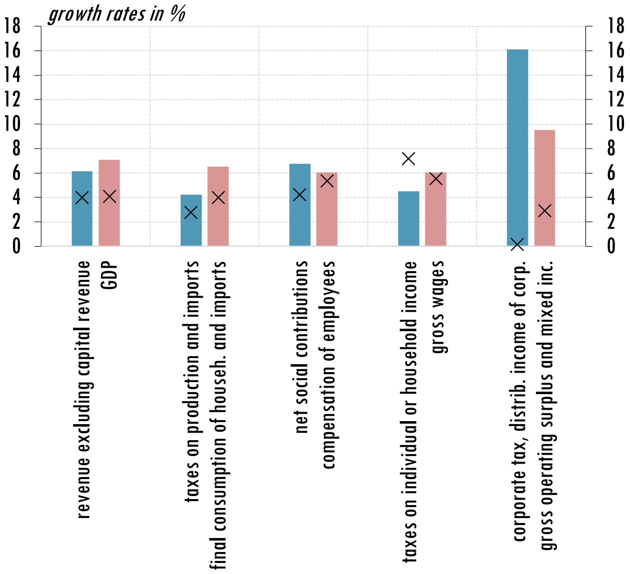
In 2017 general government revenues increased by EUR 1.140 million or by 6.5%, especially as a result of the favourable economic situation. Almost three quarters of the increase was due to higher taxes and social contributions in connection with the stronger growth of tax bases. A further improvement in the labour market situation and subsequently stronger growth in the compensation of employees caused another considerable increase in the income from social contributions and from the taxes on individuals and households income.[4] The strengthened nominal growth of final consumption contributed to the higher growth of revenue from taxes on production and imports (VAT included). The same applies to the revenue from taxes on income or profits of corporations since the increase in the

Figure 1.8: Year-on-year change of the components of general governement revenue



Source: SORS.

Figure 1.8: Revenue types and their bases in 2017



Note: Crosses denote growth rates in 2016.
Source: SORS, FC calculations.

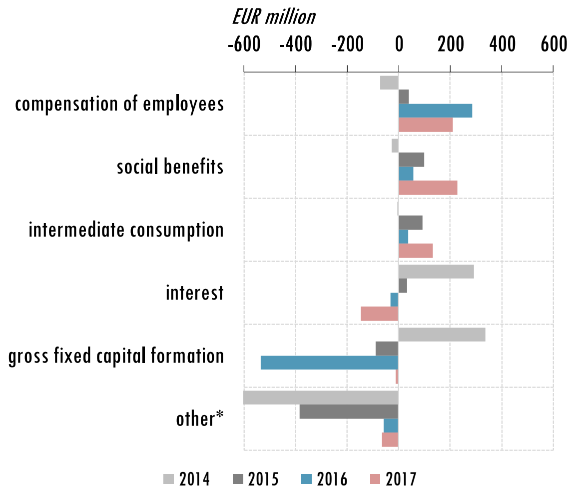
[3] EC defines normal times as a period when the output gap is between -1.5% and 1.5% (Vade Mecum on the Stability and Growth Pact 2018 Edition, p. 38, March 2018).

[4] The increase in taxes on individual and household income was smaller than the year before despite the higher growth of gross wages due to the amendments to the Income Tax Act that came into force on 1 January 2017. The income scale changed with the introduction of a new third income bracket, and the income tax rate in the fourth grade was lowered. The income threshold for entitlement to a higher additional general tax relief also increased, and the payment of personal income tax on remuneration based on business performance was limited, which means that it is no longer necessary to calculate personal income tax on up to 70% of the average salary.

gross operating surplus of companies, due to a favourable macroeconomic situation, was much higher than in 2016. In addition, the taxation rate grew from 17% to 19% in 2017. The increase in the total growth of revenue in relation to 2016 was based especially on higher capital income, which was considerably reduced a year before upon the transition to the new European financial perspective (-79%). Nevertheless, other capital income in 2017 remained low and fell behind plans, which reflects two missed years in drawing on European funds. Among other groups of income, the growth of revenue from selling goods and services and especially other current revenue was strengthened last year. Among the current revenue, the revenue from property in connection with major payments of dividends of state-owned economic companies was higher than the year before.[5]

2017 also saw an increase in the general government sector expenditure in the amount of EUR 346 million, or 1.9%. This increase was mainly due to compensation for employees and social transfers. The growth of social transfers (3.2%) was considerably higher than the year before in connection with further relaxation of austerity measures and adoption of new measures[6], including for pensions[7], which increased such expenditure above the levels projected at the drafting of budgets. The growth in compensation of employees slowed down last year (4.6%) after a considerable growth in 2016. The employment growth was even higher (by 1.8 % or 3,100 persons) amid higher growth in the public administration, defence and compulsory social protection, as well as in education. Although the employment growth in healthcare and social care slightly slowed down in comparison to 2016, it remained the highest among all activities of the general government sector. In 2017 the growth in compensation of employees per employee slowed down from 5.0% to 2.6%. It was based on promotions at the end of 2016 with financial effect in 2017, and on the wage scale rise in October 2016. In addition, there was an increase in the pay for annual leave and premium for collective

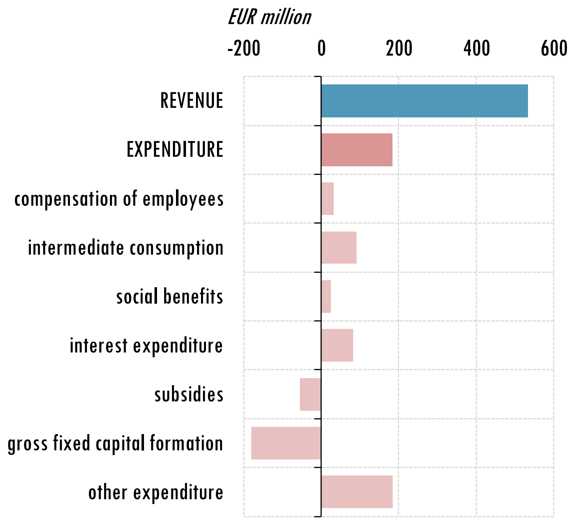
Figure 1.9: Year-on-year change of components of general government expenditure



** 2014 :-3.338 million EUR (as a result of high expenditure due to bank recapitalization in 2013.)*

Source: SORS.

Figure 1.10: Actual outcome compared to SP17



Sources: SORS, forecast: SP17 (MoF); FC calculations.

[5] Higher than a year earlier and higher than expected were notably the dividends of financial companies and the budget payment based on the surplus of revenues over the expenditure of the Bank of Slovenia.

[6] Increase in the number of beneficiaries of financial social assistance and care allowance, valorisation of disability allowance and determination of the assistance and attendance allowance, increase in the number of beneficiaries of the subsidised primary and secondary school meals, introduction of a subsidized single public passenger transport ticket, changes in the payment of health services for military veterans.

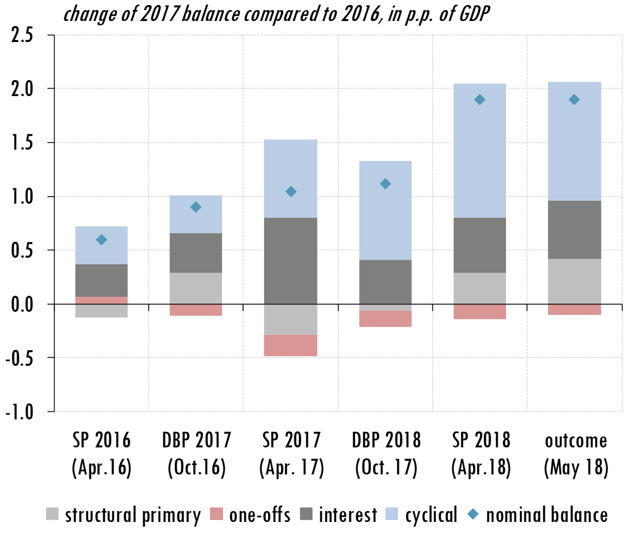
[7] In addition to January's regular adjustment of 1.15% there is also a change in the amount and thresholds for paying the annual allowance to pensioners and raising the minimum pension for a full pension period at the minimum retirement age of up to 500 EUR. Moreover, the number of all pension beneficiaries has remained virtually unchanged for the second consecutive year (0.2% growth compared to 2016).

supplementary pension insurance. During the course of the year an agreement was concluded on the remedy of anomalies up to wage grade 26 and for authorised persons.[8] Among other categories of expenditure, last year saw a considerable increase in expenditure for intermediate consumption (5.1%), particularly in the last quarter of the year when the year-on-year growth was as high as 11 per cent. The growth in intermediate consumption expenditure increased in comparison with 2016 at all levels of the general government sector, while their total share in total expenditure was the highest so far (14.6%). In contrast, the decrease in interest expenses was considerably higher than the year before, which reflects favourable conditions in financial markets as well as effective debt management. The expenditure on investments dropped slightly further after the almost 30% decline in 2016 and stayed behind the plans. This reflects especially inefficient drawing on European funds.

Despite the improvement of the general government balance, the Fiscal Council estimates that the opportunity for sustained improvement of public finance was missed in 2017. Last year saw an improvement in the public finance balance despite the accelerated removal of the austerity measures implemented during the crisis years, which was mostly due to very good economic conditions. In addition, a large part of the high growth in revenues was also intended to increase expenditures that had not been fully envisaged when drafting budgets. The Fiscal Council asserts that economic policy makers should have also seized upon the favourable conditions in the past years for the drafting and adoption of measures contributing to a lasting improvement in the state of public finances. This is also important in light of the risks related to the fiscal consequences of demographic changes. The projections of the Stability Programme – 2018 amendment, which were based on the scenario of unchanged policies, namely show that the implementation of the strategy of fiscal consolidation in recent years, when austerity measures were gradually relaxed alongside the improving economic situation, will no longer be possible because the austerity measures have been largely abolished. Despite favourable economic and public finance trends in the past year, there is an increasing need for substantial measures to ensure adequate reserves for the period when the economic growth is reduced, and for ensuring mid-term fiscal sustainability.

Figure 1.11: Changes to 2017 general government balance forecast

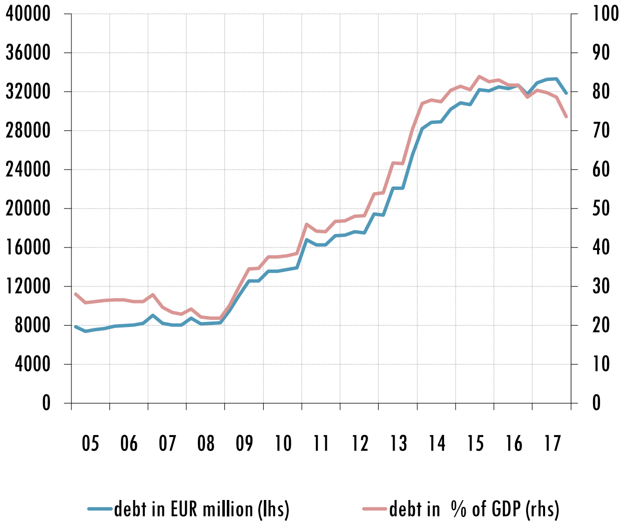
change of 2017 balance compared to 2016, in p.p. of GDP



Source: forecasts: MoF, outcome: SORS; FC calculations.

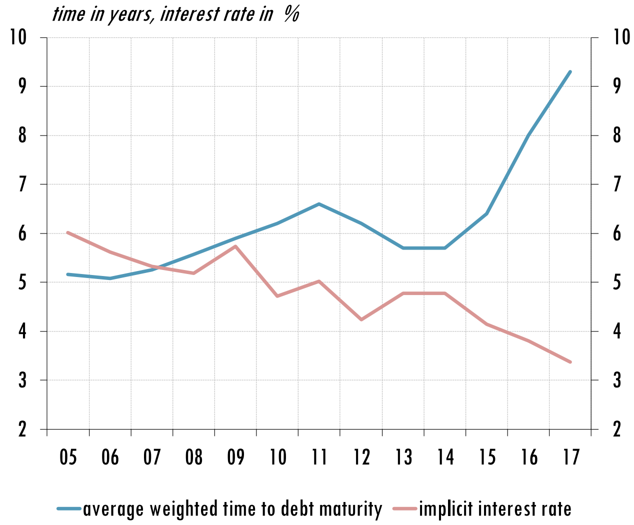
[8] Among the austerity measures in the field of labour costs, only the freezing of regular performance-related bonuses, the limitation of the amount of payments for increased workload, and the still lower holiday pay and premiums for collective supplementary pension insurance have remained valid.

Figure 1.12: Consolidated gross debt of general government (ESA)



Source: SORS, FC calculations.

Figure 1.13: Average weighted time to debt maturity and the implicit interest rate



Sources: MoF, SORS; FC calculations.

Gross general government debt grew by EUR 107 million in 2017, but its share in GDP decreased due to the high economic growth. At the end of last year, the debt amounted to EUR 31.8 billion and constituted 73.6% GDP, which is less than projected in individual budget documents. The debt thus still exceeds 60% GDP, which increases, inter alia, the demands for the reduction of the structural deficit.[9] The total extent of borrowing amounted to EUR 6.3 billion in 2017. It was once again significantly influenced by the continuation of active debt management. Borrowing for the exchange of bonds issued in US dollars with a high interest rate in the period 2012-2014 amounted to EUR 2.6 billion. Last year, too, borrowing took place in favourable conditions on the financial markets. The required return on the Slovenian 10-year bond was further reduced (from the average of 1.15% in 2016 to the average of 0.96% in 2017), and the credit rating improved again.[10] As the money market liquidity remained high, the required return on short-term borrowing instruments remained below 0%. The implicit interest rate of the total debt further decreased by 0.4% p.p. in 2017 to 3.4%, while the average time to maturity of the existing debt was extended by 1.3 years to 9.3 years.[11]

[9] In line with the requirements of the Stability and Growth Pact the same cyclical economic situation requires a greater structural effort for countries with a debt above 60% of GDP (Vade Mecum on the Stability and Growth Pact, 2018 Edition, p. 38, March 2018).

[10] Standard&Poor's raised the credit rating by one grade to A+ in June, while Moody's raised it by two grades to Baa1 in September

[11] Public Debt Management Report of the Republic of Slovenia for 2017 (May 2018). This is about two years more than the average term to the maturity of the existing debt in developed countries (Fiscal Monitor 2018, IMF, p. 12, April 2018).

2. Compliance with the Fiscal Rules in 2017

In accordance with Article 15 of the ZFisP, in the period when Slovenia is approaching the medium-term fiscal target, general government budgets shall be deemed balanced in the medium term if the structural balance of the general government approaches the medium-term fiscal target in accordance with the dynamics determined on the basis of the Stability and Growth Pact. In its assessment of the compliance of the executed general government budgets with the fiscal rules for 2017, the Fiscal Council verified the following: (i) whether the medium-term fiscal objective was achieved; (ii) whether the dynamics of approaching the medium-term fiscal target were appropriate in view of the cyclical situation of the economy; (iii) whether the planned dynamics of general government expenditure were in line with the expenditure rule. In addition, the rule on the reduction of the general government debt still applied for Slovenia in 2017; this rule applies for three years after the general government deficit falls below 3% of GDP, which happened in Slovenia in 2015. We also checked the compliance with the domestic fiscal rule set forth in Article 3 of the ZFisP.

Although the appropriate medium-term fiscal objective was not yet achieved in 2017 according to the Fiscal Council's assessment, the dynamics of approaching the medium-term fiscal objective were in accordance with the rules in view of the cyclical situation of the economy. The decrease in the general government debt was appropriate, too. The rules referring to the general government expenditure, however, were not observed in the past year. The growth of net general government expenditure exceeded the allowable growth under the expenditure rule of the SGP. General government expenditure also exceeded the maximum allowable scope under the Framework, but the expenditure of individual public finance budgets according to the cash flow methodology was lower than the maximum allowable expenditure.

2.1. Achievement of MTO and Compliance with the Rule on the Structural Effort

In 2017 the structural balance of the general government amounted to 0.0% of GDP in terms of the average of currently available estimates. On the basis of the EU rules[12] Slovenia has determined the structural surplus in the minimum amount of 0.25% GDP as the currently appropriate medium-term fiscal target.[13] The estimates of the structural balance differ due to the varying estimates of the output gap. The range of all structural balance estimates that are monitored in the preparation of estimates of the compliance of the general government budgets with fiscal rules is from -1.6% of GDP to 1.1% of GDP for 2017.[14] However, no institution that makes estimates of the output gap estimates that the structural surplus in 2017 was higher than the medium-term fiscal target. Nevertheless, last year's structural balance was the highest so far and was balanced for the first time. The structural primary surplus, which amounted to 2.5% of GDP, was the highest so far, too.

In 2017 the structural effort or the improvement in the structural balance of the general government sector was higher than required in view of the cyclical situation of the economy. The required structural effort is determined in accordance with the SGP rules in relation to the cyclical situation of the economy and on the basis of a special matrix.[15] In 2017 Slovenia ranked among

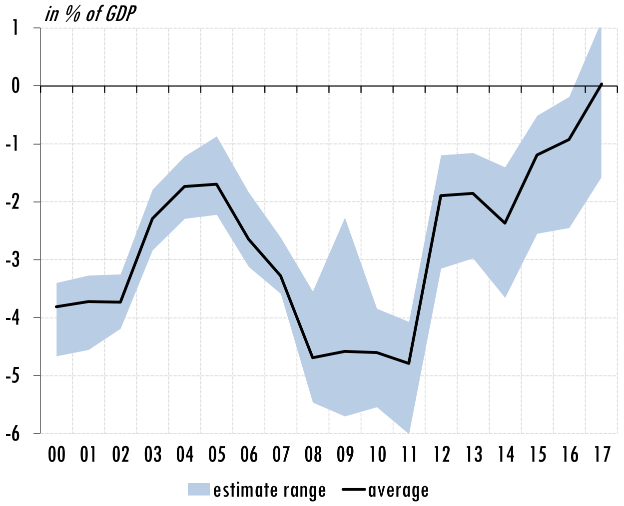
[12] On the basis of EC Regulation no 1466/97.

[13] In 2019 the medium-term fiscal target will be redefined in light of new aging projections published by the EC in May 2018.

[14] For more information on the various approaches used by the Fiscal Council in assessing the output gap see the Report on the Fiscal Council's Operations in 2017, Chapter 2.3 (pp. 23-25).

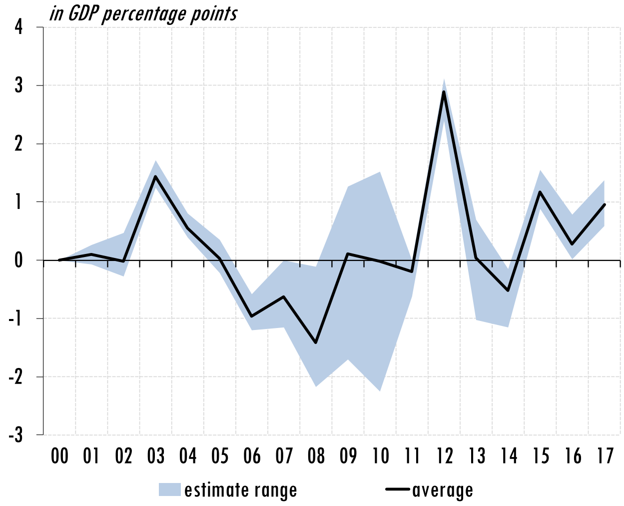
[15] Vade Mecum on Stability and Growth Pact 2018, p. 38 (March 2018).

Figure 2.1: Stuctural balance estimates



Note: Range based on potential GDP estimates of various institutions. See note under Table 4.3 in Assessment of the compliance of the fiscal policy with the fiscal rules based on the draft SP 2018 amendment (FC, April 2018).
Source: IMAD, EC, OECD, IMF, MoF, FC calculations.

Figure 2.2: Structural effort estimates



Note: Range based on potential GDP estimates of various institutions. See note under Table 4.3 in Assessment of the compliance of the fiscal policy with the fiscal rules based on the draft SP 2018 amendment (FC, April 2018).
Source: IMAD, EC, OECD, IMF, MoF, FC calculations.

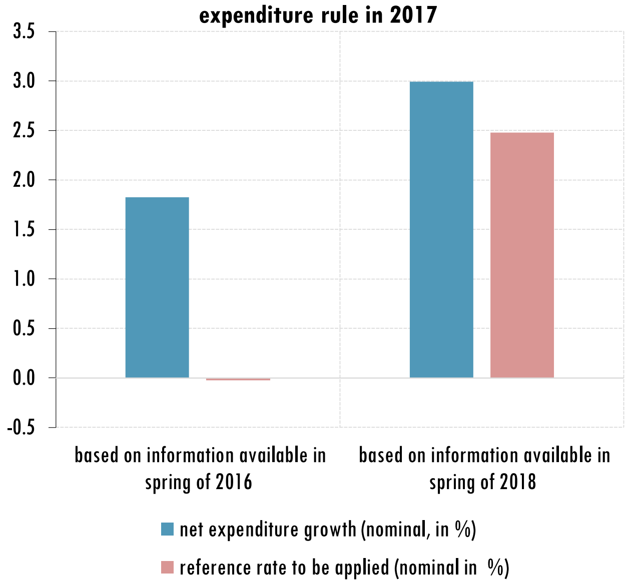
countries where the share of gross debt in the general government sector exceeded 60% of GDP, while the output gap was between -1.5% and 1.5% of GDP; it went through the so-called normal times, and the actual GDP growth was higher than the potential growth. The required structural effort thus amounted to at least 0.6% of GDP. According to available estimates it ranged between 0.6% and 1.4% of GDP, with the average of 1.0% of GDP. The Fiscal Council thus estimates that the structural effort in 2017 was adequate and the fiscal policy was countercyclical and restrictive. The improvement in the structural primary balance was lower (0.4% of GDP), which points to the important role of interest reduction in managing fiscal consolidation.

2.2 Compliance with the Expenditure Rule

The growth of net expenditure exceeded the allowable level in 2017. Within the framework of the expenditure rule the calculation of appropriate expenditure growth excludes certain types of expenditures that cannot be directly influenced by the fiscal policy.[16] The growth of expenditure must not exceed the growth of the average 10-year potential output. Expenditure growth for countries that do not meet the medium-term fiscal target must be even lower or adjusted to the convergence margin that ensures the expenditure rule is harmonised with the required adjustment of the structural balance. The expenditure rule according to the SGP, when determining the allowable increase in expenditure in a given year, uses the assumptions known in the spring of the previous year for 2017, therefore the data known in the spring of 2016. In preparing the assessment of the compliance with the rule for 2017 we also made a calculation with the latest available data considered in the calculation of the expenditure rule. In both cases, i.e. in the calculation with the data known in advance and in the calculation with the data known in retrospective, the net expenditure growth was higher than the growth allowable according to the rule. It should be noted that the allowable growth in net

[16] Eliminated are interest payments, the cyclical component of unemployment benefits, and expenditure resulting from the receipts from EU funds. Given that a country's investments can fluctuate considerably in individual years, the calculation considers a four-year average of expenditure on investments that does not include funds received from EU funds earmarked for investment spending. For more information about the expenditure rule see Vade Mecum on Stability and Growth Pact 2018, pp. 47-53.

Figure 2.3: Estimates of compliance with the expenditure rule in 2017



Source: SORS, MoF, UIMAD; FC estimates.

expenditure in 2017 significantly increased from spring 2016 to the present year due to better prospects for medium-term potential GDP growth.[17]

2.3. Compliance with the General Government Debt Rule

Slovenia also complied with the special rules of the Fiscal Pact on gradual debt reduction in 2017. These rules apply in the three-year period after the country exits expenditure deficit procedures. The transitional three-year period for Slovenia is from 2016 to 2018 because the deficit of the general government sector dropped below 3% of GDP in 2015. The reduction of debt must allow a structural adjustment to be made so that, after the expiry of the transitional period expenditure, reduction rules can be complied with within the preventive arm of the Stability and Growth Pact. Therefore, the country must fulfil the MLSA (minimum linear structural adjustment) rule in the transitional period.[18] This rule is determined on the basis of three indicators: (i) debt adjusted to the economic cycle, (ii) debt taking into account its past trends, and (iii) debt taking into account its future trends. The calculations show that Slovenia complied with the required minimum structural adjustment in 2017 as the debt was lower than the maximum value of the three indicators on the basis of which the compliance with the debt rule in the transitional period is assessed.

Table 2.1: Compliance with the debt rule in transition period for 2017

a) Maximum allowed cyclically adjusted debt	78.7
b) Maximum allowed debt (backward-looking benchmark)	78.5
c) Maximum allowed debt (forward-looking benchmark)	72.3
Maximum (a,b,c)	**78.7**
Debt in 2017	**73.6**

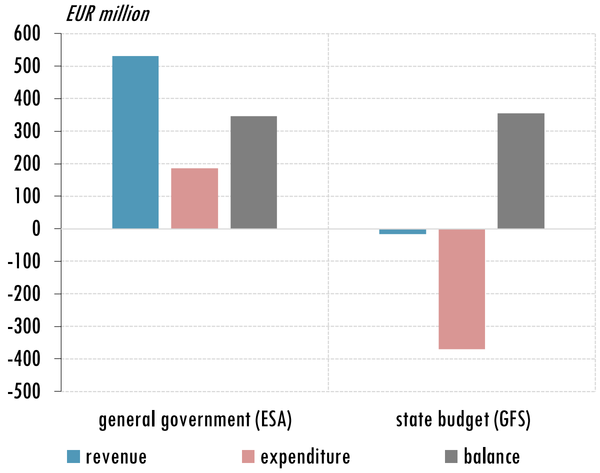
Source: SORS, FC calculations.

[17] The increase in the reference rate to be applied was 0.7% p.p. in this period. According to the expenditure rule, a 10-year average is used as the medium-term growth of potential GDP, taking into account the period of five years before the analysis year and four years after it. For the purpose of calculating, IMAD calculations of potential GDP growth are used because they are the only calculations available for the entire time period to be taken into account in the calculation of the expenditure rule.
[18] Vade Mecum on Stability and Growth Pact 2018, Annex 5, pp. 128-131 (March 2018).

2.4 Compliance with the National Fiscal Rule

General government expenditure in 2017 exceeded the maximum allowable expenditure under the Framework for the Preparation of Budgets.[19] The Ordinance on the Framework for the Preparation of the General Government Budgets determines the maximum allowable scope of general government expenditure and the target balance, which is done according to the ESA methodology. It determines the same according to the GFS methodology for the state budget, and the maximum amount of expenditure for health and pension funds. The Ordinance on the Framework referring to 2017 was adopted by the Government of the Republic of Slovenia in April 2016 and then amended twice (November 2016 and May 2017). In 2017 general government expenditure was EUR 185 million higher than the expenditures allowable under the Framework, but, due to better macroeconomic results, revenue was still significantly higher, so the balance was lower than the target balance determined in the Framework. State budget expenditures were lower than the maximum allowable expenditures, which, along with slightly lower revenues, resulted in a deficit smaller than the target deficit. The differences between the state budget outturn and the entire general government outturn can be partly attributed to methodological differences, and partly due to the trends of revenues and expenditures in general government units outside the direct supervision of the Ministry of Finance or the Government of the Republic of Slovenia. According to the Fiscal Council's assessment this primarily points to systemic deficiencies in the planning and implementation of fiscal policy, which were, unfortunately, not effectively eliminated by the Act Amending the Public Finance Act (ZJF-H).

Figure 2.4: Difference between actual outcome and the Framework for 2017



Note: Framework = Ordinance on the Framework referring to the period 2017-2019, May 2017 (Official Gazette of the Republic of Slovenia 26/2017)
Sources: SORS, MoF; FC calculations.

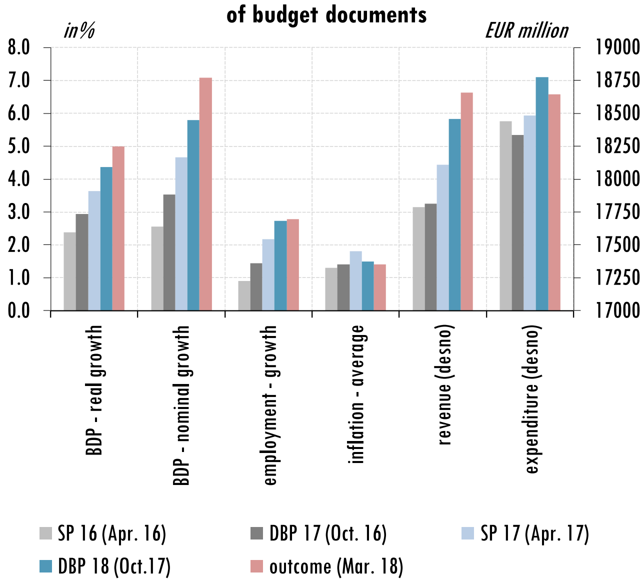
[19] Ordinance on the Framework for the Preparation of the General Government Budget for the 2017–2019 Period, May 2017 (Official Gazette of the Republic of Slovenia 26/2017)

3. Annex: Changes in macroeconomic and fiscal projections for 2017

Macroeconomic projections for 2017 gradually became more favourable from the spring of 2016, which was reflected in general government revenue projections. Macroeconomic projections for the needs of the general government projections are independently produced by IMAD[20] every March and September, following the publication of national accounts statistics. Although projections for 2017 grew increasingly favourable from spring 2016 to autumn 2017, the actual realisation was even higher according to the currently available data of SORS. Initially, more favourable projections were mainly due to a more considerable improvement in the labour market situation, in particular employment growth, which contributed to higher growth projections for private consumption. In the course of 2017 economic growth projections in trading partners increased, leading to higher growth projections for exports. An additional factor behind the more favourable projections was the improvement of expectations for the growth of investment spending, especially the private sector, in view of high demand growth. Higher macroeconomic forecasts have been reflected in the projections of general government revenue, in particular taxes and social security contributions. Projections of revenues also increased due to good business results of state-owned enterprises. By contrast, projections of other revenues, in particular EU funds, underwent a significant downward revision in the autumn of 2016 to provide a more realistic reflection of the weak drawing on EU funds.

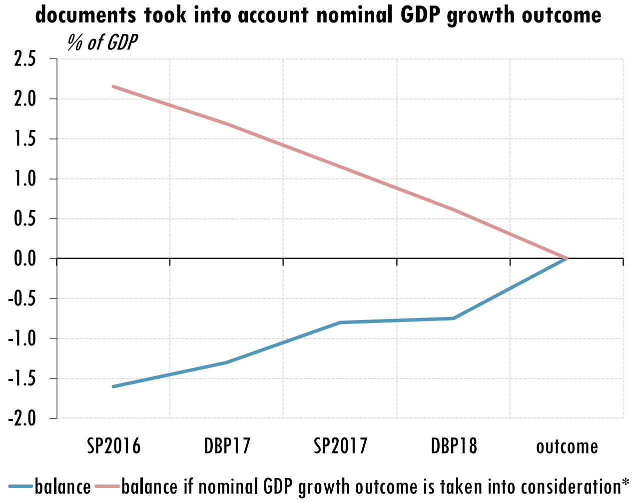
Better prospects for general government revenue were also reflected in higher expenditure growth forecasts. Higher projections of expenditure growth were driven by higher expectations concerning the compensation of employees due to the adoption of new wage agreements in the general government sector, with simultaneous higher employment growth. An additional factor was a faster relaxation of austerity measures in the field of social benefits, which was partially made possible by reduced expenditure for the unemployed in view of the improvement of the labour market situation. Expenditure projections were also affected by interest expenditure, where a favourable situation in financial markets led to a higher volume of borrowing than envisaged, also due to active debt management. Something similar applies to projections of intermediate consumption expenditure, which

Figure 3.1: Forecasts for 2017 available at time of preparation of budget documents



Sources: forecasts: IMAD, MoF; outcome: SORS.

Figure 3.2: General governement balance in 2017, if budget documents took into account nominal GDP growth outcome



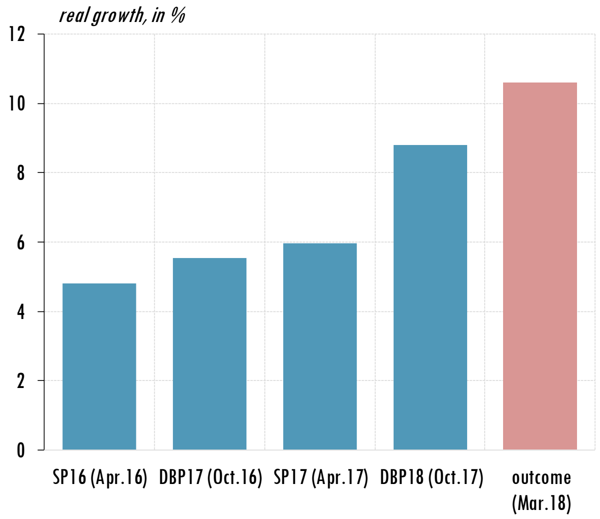
Note: The sum of actual general government balance in 2017 and the product between balance elasticity and the difference between forecast and actual nominal GDP growth.
Source: SORS, forecast MoF, IMAD; FC calculations.

[20] Article 9b of the Act Amending the Public Finance Tax Act (ZJF-H).

increased significantly especially in the autumn of 2017. On the contrary, projections of subsidy expenditures have gradually decreased, which could be partly related to better macroeconomic situation projections. Projected investment expenditure decreased in most of the projections and were significantly affected by expectations of drawing European funds.

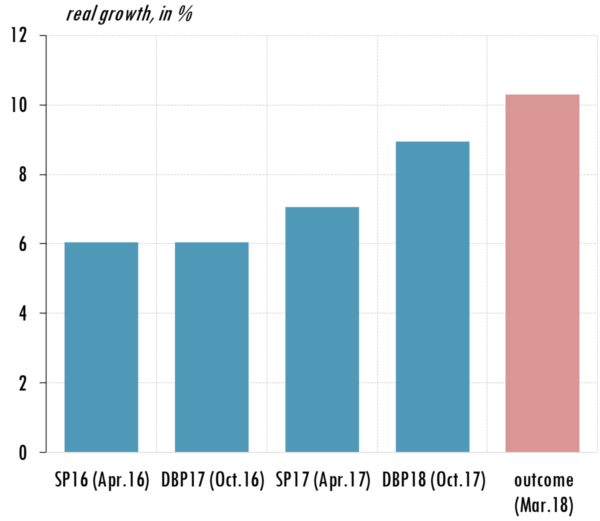
The fiscal policy was thus less restrictive than it would have been in the absence of an adjustment of expenditure to higher revenues, but it nevertheless enabled the improvement of the general government balance. Given that the adjustment was only partial, the favourable macroeconomic situation significantly improved the general government balance. At the same time, a partial adjustment of expenditures to cyclically higher revenues also means that the general government surplus in 2017 was lower than that resulting from the absence of such an adjustment. The Fiscal Council calculations show (see Figure 3.2) that the surplus of the general government sector would have exceeded 2% of GDP in 2017 if we had considered e.g. the difference between the currently known growth of the nominal GDP and the projected growth of the nominal GDP for 2017 known at the time of drafting PS 2016.

Figure 3.3: Changes in the 2017 forecast – exports of goods and services



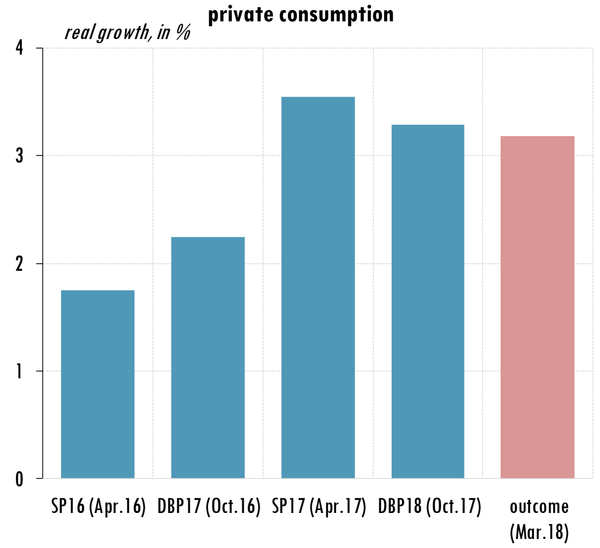
Source: SORS, IMAD forecasts.

Figure 3.4: Changes in the 2017 forecast – gross fixed capital formation



Source: SORS, IMAD forecasts.

Figure 3.5: Changes in the 2017 forecast – private consumption

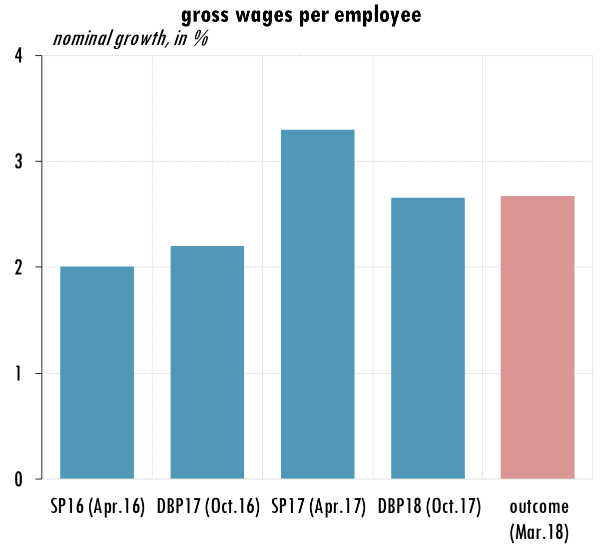


Source: SORS, IMAD forecasts.

Figure 3.6: Changes in the 2017 forecast – compensation of employees

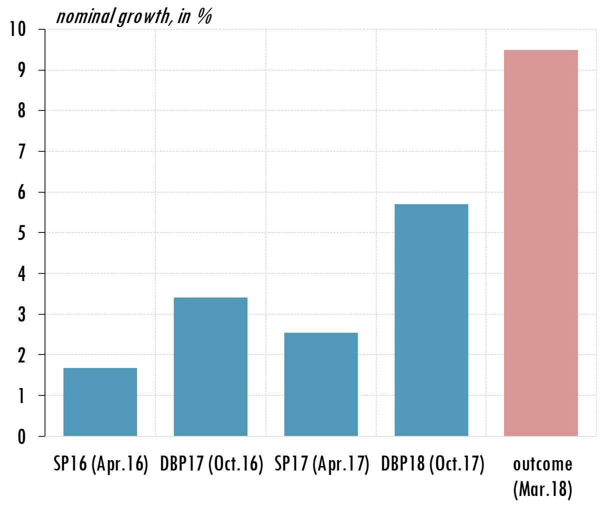
Source: SORS, IMAD forecasts.

Figure 3.7: Changes in the 2017 forecast – gross wages per employee



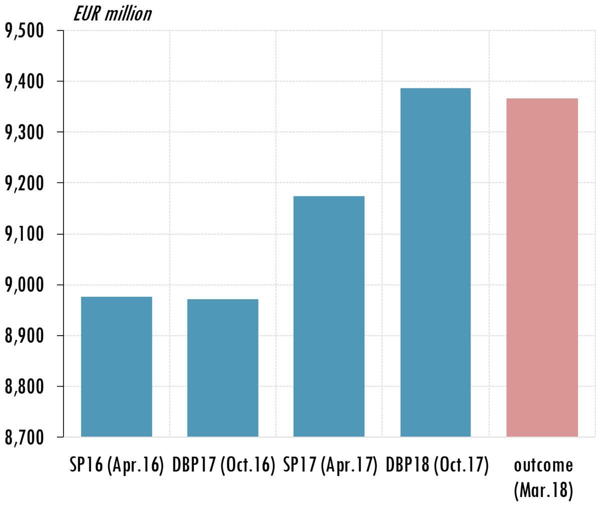
Source: SORS, IMAD forecasts.

Figure 3.8: Changes in the 2017 forecast – gross operating surplus/mixed income



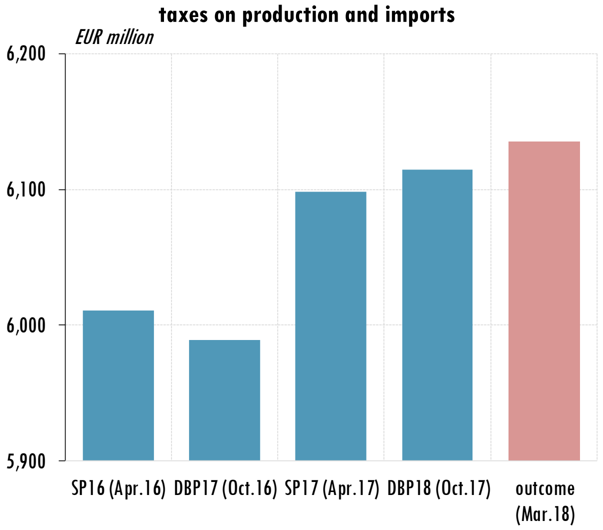
Source: SORS, IMAD forecasts.

Figure 3.9: Changes in the 2017 forecast – total taxes



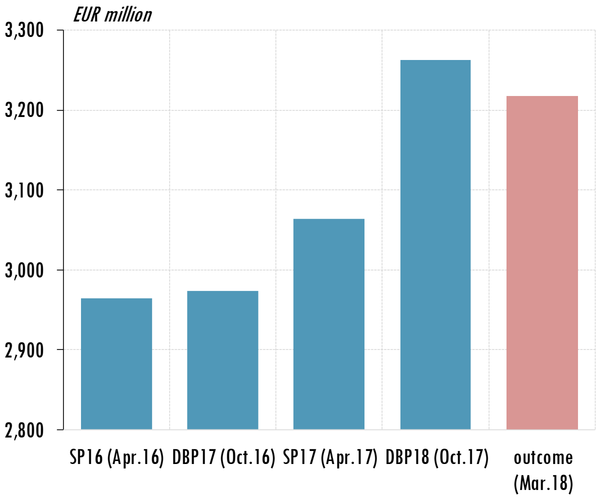
Source: SORS, MoF forecasts.

Figure 3.10: Changes in the 2017 forecast – taxes on production and imports



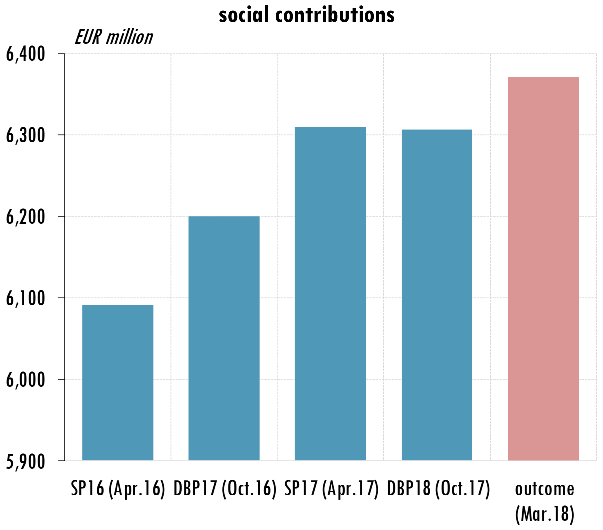
Source: SORS, MoF forecasts.

Figure 3.11: Changes in the 2017 forecast – current taxes on income and wealth



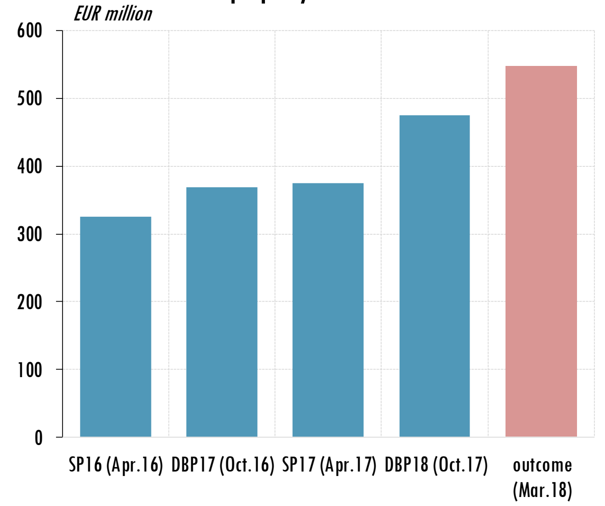
Source: SORS, MoF forecasts.

Figure 3.12: Changes in the 2017 forecast – social contributions



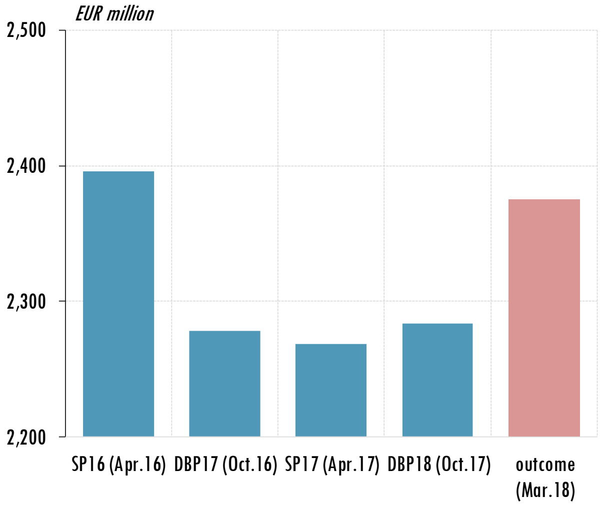
Source: SORS, MoF forecasts.

Figure 3.13: Changes in the 2017 forecast – property income



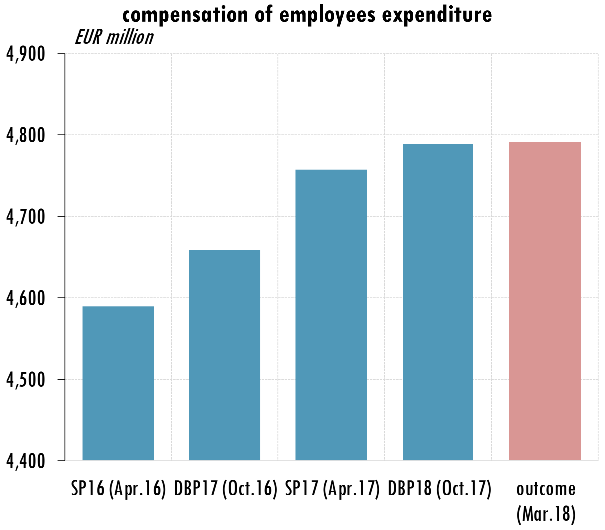
Source: SORS, MoF forecasts.

Figure 3.14: Changes in the 2017 forecast – other income



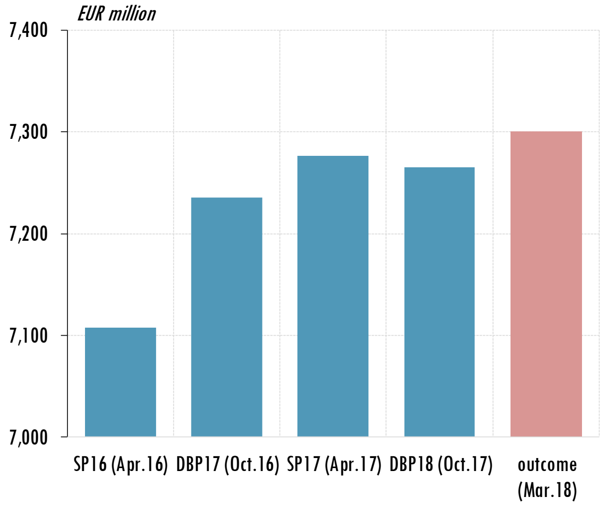
Source: SORS, MoF forecasts.

Figure 3.15: Changes in the 2017 forecast – compensation of employees expenditure



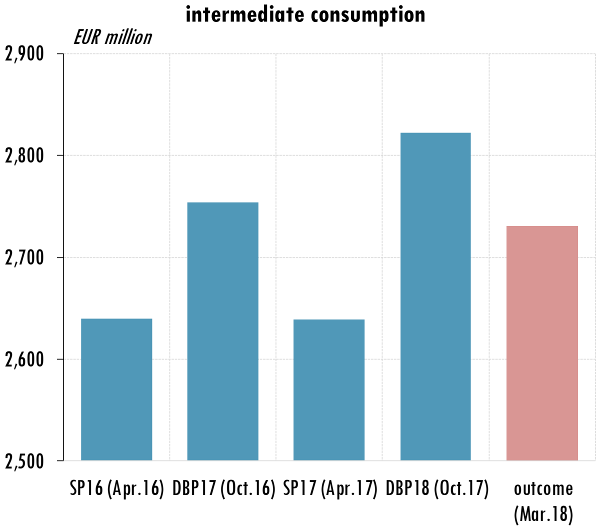
Source: SORS, MoF forecasts.

Figure 3.16: Changes in the 2017 forecast – social benefits



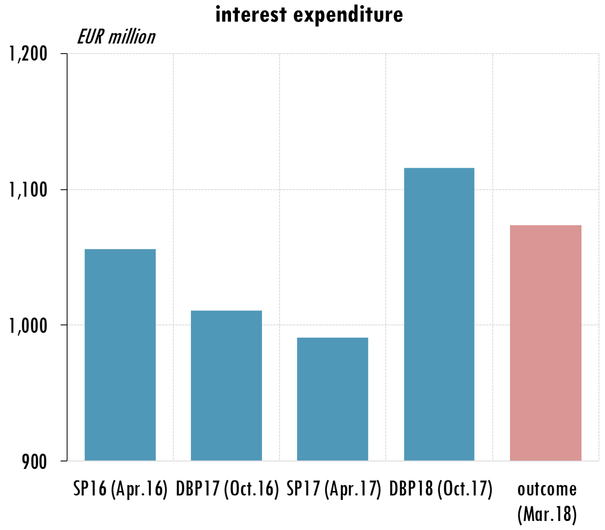
Source: SORS, MoF forecasts.

Figure 3.17: Changes in the 2017 forecast – intermediate consumption



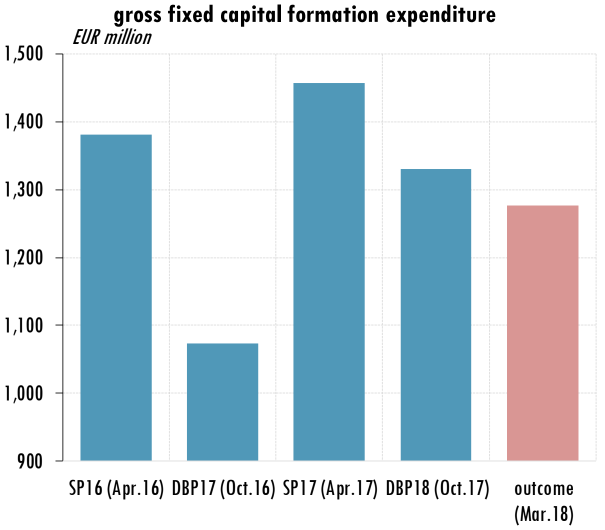
Source: SORS, MoF forecasts.

Figure 3.18: Changes in the 2017 forecast – interest expenditure



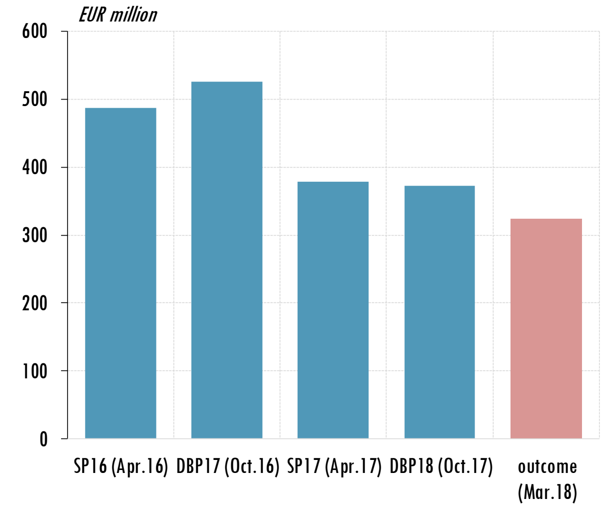
Source: SORS, MoF forecasts.

Figure 3.19: Spremembe napovedi za 2017 – gross fixed capital formation expenditure



Source: SORS, MoF forecasts.

Figure 3.20: Changes in the 2017 forecast – subsidies



Source: SORS, MoF forecasts.