REPUBLIC OF SLOVENIA
FISCAL COUNCIL

Assessment of compliance of the draft revised budget of the Republic of Slovenia for 2020 and of the proposal for the Ordinance amending the Ordinance on the framework for preparing the general government budgets for the 2020–2022 period with the fiscal rules

September 2020

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The assessment has been made on the basis of the following documents: Draft revised budget of the Republic of Slovenia for 2020 and Proposal for Ordinance amending the Ordinance on the framework for preparing the budgets for 2020-2022 received by the Fiscal Council on 31 August 2020 and on 4 September 2020. Account has been taken of data available up to and including 8 September 2020.

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EXECUTIVE SUMMARY

The Fiscal Council has received for assessment the draft revised budget of the Republic of Slovenia for 2020 and the Proposal for Ordinance amending the Ordinance on the framework for preparing the budgets for 2020-2022. Due to exceptional circumstances, a temporary deviation from the fiscal rules is allowed this year, but the Fiscal Council has some important reservations with respect to the submitted budget documents.

Taking into account the realisation so far, the expenditure in the draft revised budget proposal is forecast to be very high, both related to Covid-19 and excluding these measures. As regards components of expenditure, the projected relatively high reserves have not been sufficiently explained. At the same time, the Fiscal Council calls attention to the high level of borrowing this year, which does not fully reflect the budgetary needs and which, despite the currently favourable financing conditions, brings additional costs, while historical experience shows that debt reduction may be difficult. In the current situation, it is therefore even more necessary for economic policymakers to be aware that, despite the inevitable and urgent expenditure related to the epidemic, the government spending in the part that does not include this one-off expenditure should be prudent, efficient and development-oriented. In particular, possible structural increases in expenditure must be avoided. The reservations also relate to budgetary planning, which, despite the uncertain situation, with the help of a properly set out medium-term framework should focus on the period beyond the expected end of the crisis.

In the process of preparing the revised national budget, there was also a mismatch with the usual and legally set time frame for the preparation of macroeconomic forecasts, since updated forecasts will only be available at the time of adoption of the revised budget by the National Assembly. This, given the differences in comparison to the end of June forecast based on which the draft revised budget and the proposal of the Framework were prepared, may at the same time mean that both documents mentioned above will not be prepared on an adequate basis.

The economic situation and thus also the macroeconomic bases, which form the basis of budget planning, have significantly deteriorated this year justifying the preparation of a revised budget and a change in the framework. Real GDP is expected to drop by around 7% this year, affecting in particular service activities. The labour market situation has also deteriorated, which is evident from the rising unemployment rate. The government's measures contributed to alleviating the decline in activities and employment, while after the end of the period of restrictive measures in mid-year, activity indicators began to show economic recovery.

Fiscal indicators and their projections reflect the deteriorating macroeconomic situation and functioning of automatic stabilisers, and in particular measures to limit the effects of the epidemic. Following the draft revised budget, the state budget balance is expected to show a deficit of 9.3% this year, the general government balance 8.6% of the projected GDP, while the state budget debt increased by more than EUR 5 billion in seven months. According to the draft revised budget, measures to limit the consequences of the epidemic are expected to amount to EUR 2.6 billion this year, or slightly less than 6% of GDP. Their implementation over the first eight months amounts to just over half of this amount, so that the government is creating a lot of room for manoeuver with the revised budget for the rest of the year. The envisaged scope of measures is otherwise comparable to the average of such expenditure in other EU countries. Differences in the scope of action between countries confirm the need to create room for manoeuver for fiscal policy in more favourable times. In the case of individual countries, this crisis has once again shown that in the absence of adequate room for manoeuver, the possibility of taking action in difficult times or in the event of exceptional events is limited.

State budget expenditure not related to Covid-19 measures is projected to grow fast or much faster than last year and in the adopted budget for 2020, while growth is expected to accelerate in the final months of the year. The general government sector expenditure, which does not include one-off expenditure, is otherwise in line with the maximum allowed under the Fiscal Rule Act, given the currently estimated cyclical situation. However, it would become non-compliant even with a slightly smaller volume of one-off expenditure and a milder decline in the economic activity than currently projected. Simulations suggest that the resulting maximum deviation in respect of the currently known data could be just under one per cent of GDP.

* * *

In uncertain times and given such a marked deterioration in the position of public finances, as assumed in the revised budget and in the amended Framework, additional transparency is to be expected in the preparation of budget documents. The Fiscal Council thus recommends that the government provide additional clarifications regarding:

i) bases for determining the expenditure related to Covid-19 measures,

ii) the purpose of expenditure under the item "reserve",

iii) differences in changes regarding the volume of general government expenditure and changes in the volume of state budget expenditure and the Health Insurance Fund expenditure; and

iv) the expected dynamic of the state budget and the general government sector debt.

The legal basis

On 31 August 2020, the Ministry of Finance submitted to the Fiscal Council a draft revised budget of the Republic of Slovenia for 2020 (hereinafter: revised budget proposal), and on 4 September 2020 a proposal for the amended Ordinance on the framework for preparing the general government budgets for the 2020-2022 period (hereinafter: the Framework proposal) for assessment of compliance with fiscal rules. The Fiscal Council subsequently obtained more detailed data from the Ministry of Finance on the draft revised budget items and data on implemented expenditure related to the Covid-19 epidemic.

The Fiscal Council is obliged to prepare an assessment of compliance with fiscal rules in the draft revised budget on the basis of point 2, and an assessment of compliance with fiscal rules in the Framework proposal in the period of exceptional circumstances on the basis of point 8 of paragraph two of Article 7 of the Fiscal Rules Act (hereinafter: FRA). Pursuant to paragraph six of Article 6 of the FRAF, a proposal for amending the framework for drafting the general government budgets must be submitted to the National Assembly and the Fiscal Council upon revising the state budget, and should be adopted by the National Assembly simultaneously. Pursuant to paragraph two of Article 9g of the Public Finance Act (hereinafter: the ZJF), changes to the framework and the budget must be brought in line. The Fiscal Council is obliged to prepare an assessment of the draft revised budget pursuant to paragraph two of Article 9f of the ZJF and an assessment of the framework proposal pursuant to paragraph five of Article 9f of the ZJF within fifteen days of receipt thereof. The deadline for the assessment of the draft revised budget, which the Fiscal Council is to submit to the National Assembly is 15 September 2020, while the deadline for the assessment of the Framework proposal is 19 September 2020.

On 17 March 2020, the Fiscal Council assessed[1] that the declaration of the epidemic in Slovenia is an unusual event which under Article 12 of the FRA allows for the imposition of exceptional circumstances for measures aimed at mitigating the consequences of such event, and thus a temporary deviation from the medium-term balance of public finance.[2] The possible temporary deviation from the medium-term balance means that the Fiscal Council in this document provides an assessment of the compliance of public finance trends presented in the draft revised budget and in the Framework proposal with fiscal rules based on points 2 and 8 of paragraph two and points 2 and 5 of paragraph three of Article 7 of the FRA. As a result of declaring exceptional circumstances, the implementation of the medium-term balance, as specified in Article 3 of the FRA, is not assessed.

Under Articles 3 and 15 of the FRA, the Fiscal Council monitors compliance with the fiscal rules for the entire general government sector in accordance with the European System of Accounts methodology (ESA, 2010) pursuant to Article 2 of the FRA. The state budget constitutes the largest unit, but still only represents slightly more than one-third of the general government sector and is thus, like other public finance budgets (social protection systems, local communities) prepared according to the methodology of the International Monetary Fund for monitoring government financial statistics (GFS) based on the

[1] http://www.fs-rs.si/introduction-of-conditions-enabling-the-application-of-exceptional-circumstances-under-the-fiscal-rule-act-and-the-publication-of-the-assessment-of-the-coalition-agreement/

[2] On 23 March 2020, the EU Council, on a proposal from the EC, adopted a decision permitting "the possibility of a general deviation" (a general escape clause) from fiscal compliance during the pandemic.

cash flow.[3] The government must ensure compliance with the fiscal rules applicable to the general government sector in accordance with a combination of the public finance budget and institutional unit items that constitute the general government sector. In addition to the draft revised budget, only data on projected expenditure and the general government balance were presented, while the Framework proposal only contains changes for 2020. In this assessment (i) we provide an assessment of the revenue and expenditure projections in the draft revised budget, (ii) we check the compliance of the draft revised budget with the Framework proposal and (iii) we check whether the draft revised budget and implicitly the Framework proposal contains an appropriately determined part of the expenditure that is not related to exceptional circumstances.

[3] The structure of the general government sector is available at: - http://mf.arhiv-spletisc.gov.si/en/areas_of_work/general_government_finance/public_finances/general_goverment_sector/index.html

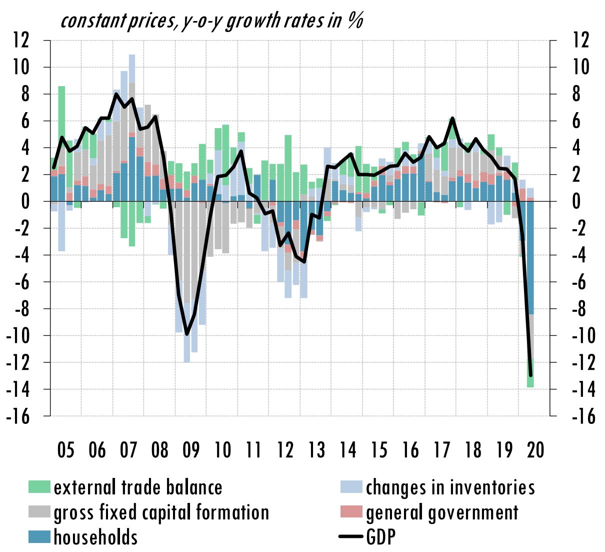
1. Macroeconomic trends in 2020 and forecasts

Key findings

- The first half of 2020 was marked by a sharp decline in economic activity, associated with a shock to demand from abroad and domestic measures to curb the spread of the epidemic.
- The most affected were service activities, while among the consumption components the most affected were household consumption, mainly the consumption of durable goods, and investment spending. Also in the context of foreign trade, which fell sharply, the service part was affected to a greater extent.
- The situation on the labour market has deteriorated significantly, but unemployment has so far increased less than during the last global financial and economic crisis. Due to the delayed effects of the crisis and the cessation of measures that prevented a major rise in unemployment in the first wave, it is expected to increase further.
- By mid-year, a number of indicators were already indicating a recovery. The overall annual decline in activity is thus expected to be smaller than in the first half of the year, while forecasts of a fall in GDP stabilised at around −7% after large differences in the initial shock.
- Such developments undoubtedly constitute much worse macroeconomic starting points for the preparation of budgetary projections than at the time of the preparation of the 2020 budget.

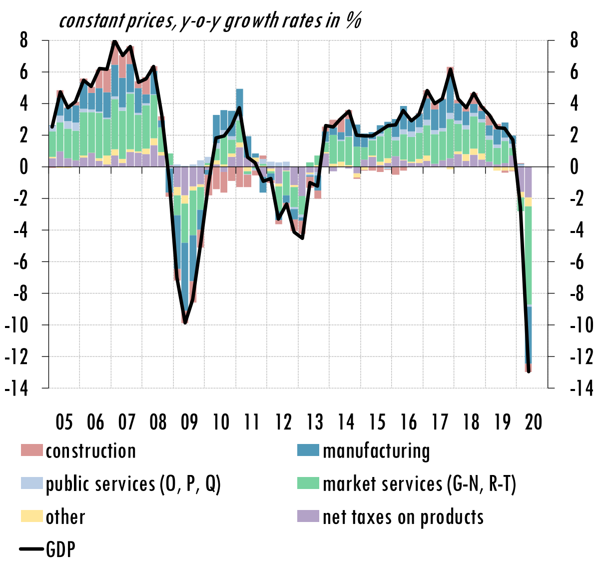
The first half of 2020 was also marked by a sharp decline in economic activity, which was more significant than in 2009 and among the largest in the EU. Cumulatively, the fall in GDP over the first two quarters was 14%, while in the two quarters after reaching the peak at the beginning of the global economic and financial crisis in Slovenia in 2008, the drop reached around 4%. The decline intensified as the quarterly decline doubled in the second quarter compared to that of the first.

Figure 1.1: Gross domestic product - expenditure side



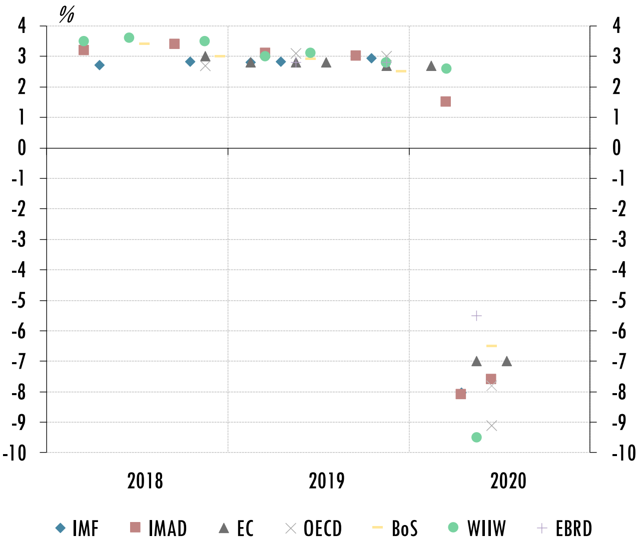
Source: SORS, FC calculations.

Figure 1.2: Gross domestic product - production side



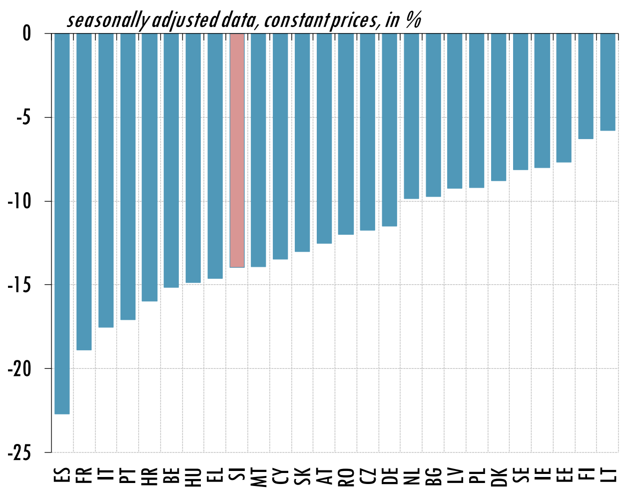
Source: SORS, FC calculations.

Figure 1.3: Forecasts of real GDP growth for 2020



Sources: IMF, IMAD, EC, OECD, BoS, WIIW, EBRD.

Figure 1.4: GDP change 2020Q2 compared to 2019Q4



Source: Eurostat, FC calculations.

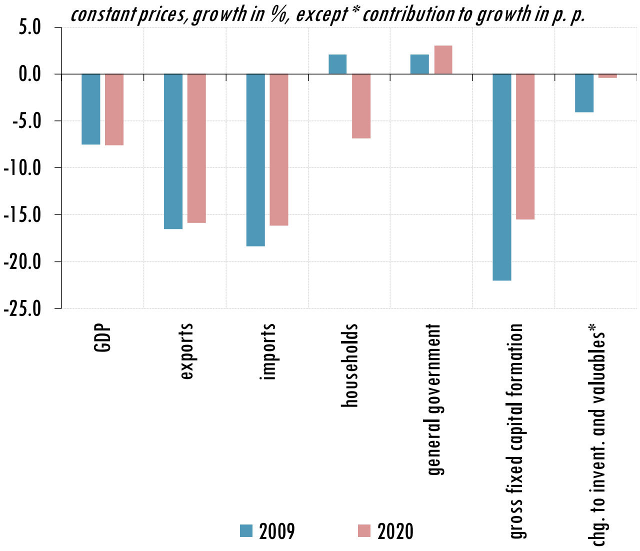
In addition to the shock of demand from abroad, this was due to a complete or partial shutdown of a large part of business, especially service economic activities between mid-March and mid-May. On average, household consumption and gross fixed capital formation decreased the most in the first half of the year, while government consumption slightly increased in line with intervention measures. Uncertainties and constraints, especially in travel and transport, affected the decline in exports of services by a fifth; the decline in exports of goods was about half smaller, with total exports falling by an average of 13% in the first half of the year. Accordingly, the decline in value added was largest in services, especially in trade, transport, storage and catering. Compared to the declines in other EU countries, the decline in GDP in Slovenia in the first half of the year was among the largest, also compared to that in some of the most important trading partners. Among the latter, an even larger decline than in Slovenia was observed in France, Italy and Croatia.

According to currently available forecasts, economic activity will decline sharply in 2020, although most indicators show an improvement in the mid-year. The IMAD forecast prepared in the summer of 2020[4] served as the basis for the preparation of the revised budget. It projected a 7.6% drop in real GDP and a 5.8% drop in nominal GDP for this year. If the forecast materialise, the fall in real GDP would be the same, but the fall in nominal GDP would be deeper by about 1.5 percentage points than in 2009. Among consumption components, gross fixed capital formation is expected to decrease the most this year, i.e. by around 15%, which mainly reflects the delaying of investment decisions by companies in uncertain conditions. The drop in household consumption is expected to be half of that, which is related to the greater willingness of consumers to spend after the end of quarantine. The volume of foreign trade is expected to shrink by around 16% on both the export and import side. Most economic activity indicators point to renewed growth or a gradual recovery at the turn of the second half of the year. Indicators in retail trade are improving,

[4] The forecast does not include, inter alia, data on GDP developments in the second quarter. The IMAD summer forecast is available at: - https://www.umar.gov.si/fileadmin/user_upload/napovedi/vmesna/poletna_2020/angleska/Poletna_napoved_2020_ANG1.pdf. The IMAD is expected to present updated macroeconomic aggregates forecasts by mid-September, i.e. at the same time as the statutory deadlines for the adoption of the state budget, for which it will not be possible to take them into account in this process. IMAD's macroeconomic forecasts form the basis of budget planning pursuant to the Decree on Development Planning Documents and Procedures for the Preparation of the Draft State Budget and Budgets of Self-governing Local Communities (Official Gazette of the Republic of Slovenia [Uradni list RS], Nos 44/07 and 54/10 and Article 9b).

Figure 1.5: Expenditure side of GDP in 2009 and IMAD summer forecast for 2020

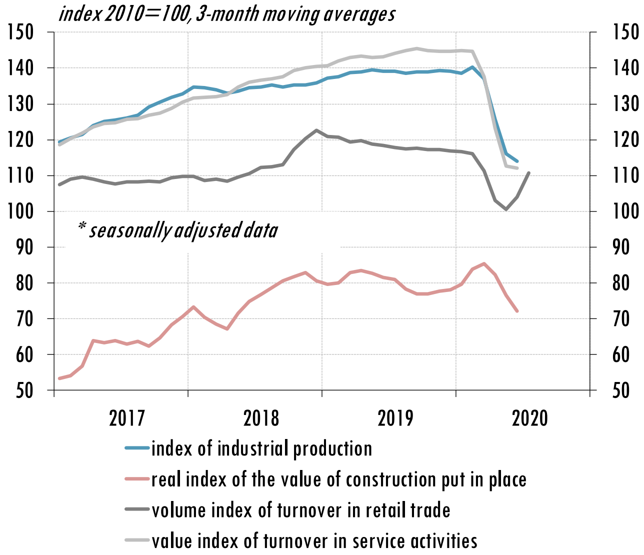
*constant prices, growth in %, except * contribution to growth in p. p.*



Source: SORS, Summer Forecast of Economic Trends 2020 IMAD, FC calculations.

Figure 1.6: Indicators of activity*

index 2010=100, 3-month moving averages



Source: SORS, FC calculations.

particularly in non-food and motor vehicle trade along the recovery of consumer confidence, followed by activity in hotels and restaurants after the end of restrictions.

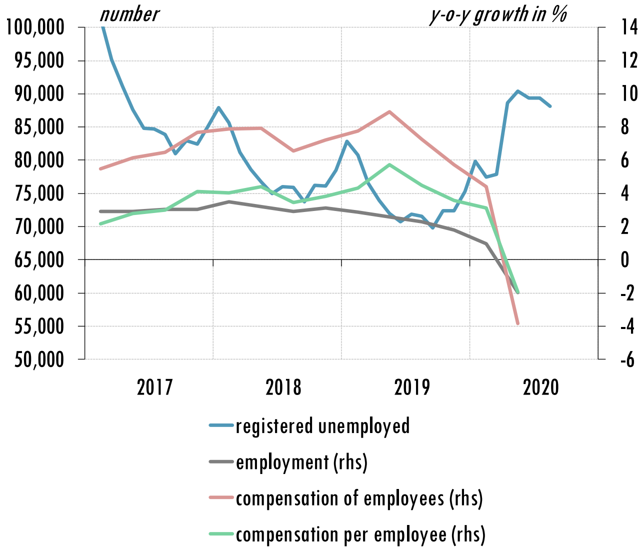
The decline in economic activity was also reflected in the labour market, where a further rise in unemployment is expected due to the delayed effects of the crisis. The situation gradually cooled down throughout 2019, but with the onset of the epidemic, unemployment rose rapidly. In April, the year-on-year increase in unemployment inflows reached almost 9,500 persons. Over the following months, the inflow slowed down in parallel to the increasing outflow from unemployment, but the registered unemployment rate rose to just over 9% in June, despite anti-crisis measures. Unemployment growth has so far been lower than in the global and financial crisis, due to labour market measures and a different starting position which did not reflect such a significant overheating of the economy, especially in labour-intensive activities. Nevertheless, a further rise in unemployment is expected after the cessation of the measures currently in force. According to the IMAD summer forecast, the registered unemployment rate is expected to average 9.8%.

In addition, wage developments largely reflect the effects of intervention measures. These were particularly evident in the high growth of average gross wage in the public sector, which averaged almost 15% year-on-year in April and May. The effects of the decline in economic activity were not significantly reflected in private sector wages, which rose on average by more than 6%[5] year-on-year in the second quarter. Under the definition of national accounts, compensation of employees per employee increased by more than 0.5% year-on-year in the first half of the year, but fell by 1.9% year-on-year in the second quarter after the largest quarterly decline since data became available. This is the largest year-on-year decline since the first quarter of 2013, which reflected the implementation of the ZUJF (Public Finance Balancing Act).

In line with the above trends, the macroeconomic basis for the preparation of the revised budget is much less favourable than when the budget for 2020 was prepared in autumn last year. The

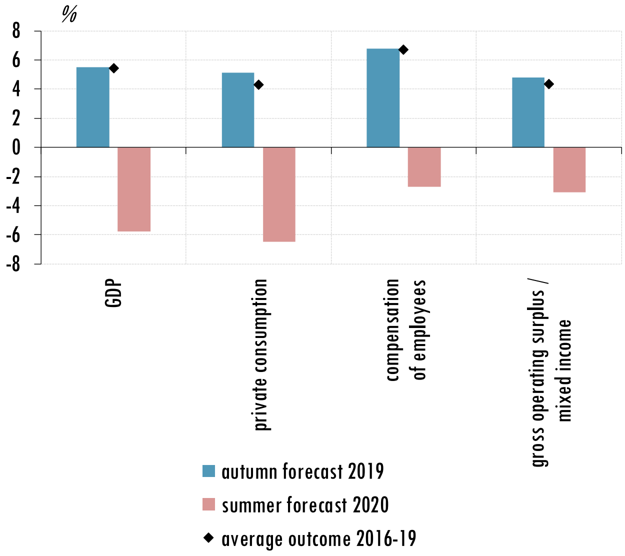
[5] In part, these high growth rates of average wages are also due to the methodological effects of reporting or calculating the average wage. This was particularly pronounced in the private sector, where a large proportion of employees were sent on temporary lay-off, thus reducing the number of employees who received salary at the expense of the employer.

Figure 1.7: Labour market



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

Figure 1.8: Forecast growth of nominal bases for 2020



Source: SORS, IMAD, FC calculations.

forecast levels of nominal GDP and nominal household consumption for 2020 in the IMAD summer forecast are about 12% lower than the forecast levels from the IMAD forecast from autumn 2019,[6] which served as a basis for the preparation of the 2020 budget. The forecast level of nominal gross fixed capital formation is lower by as much as 25% in the same comparison. The smallest, but still significant, reduction between macroeconomic bases of around 8%, also mitigated by the intervention measures in the field of employment preservation, is forecast for the level of compensation of employees.

[6] Available at - https://www.umar.gov.si/fileadmin/user_upload/napovedi/jesen/2019/Angleska/aJNGG_2019-v_objavo.pdf

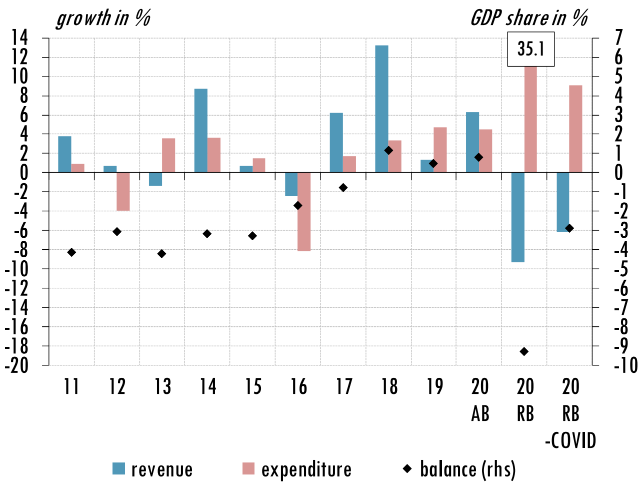
2. Assessment of projections in the Draft revised budget for 2020

Key findings

- The outbreak of the epidemic will be reflected in a large state budget deficit (9.3% of projected GDP) and a significant increase in debt, which increased by EUR 5.1 billion in the first seven months of the year.
- The deterioration of the situation due to the epidemic affects revenues mainly indirectly through the deterioration of macroeconomic bases, while expenditure is affected directly due to the operation of automatic stabilisers and measures to limit the consequences of the epidemic. According to the projections in the draft revised budget, the latter are expected to amount to EUR 2.6 billion this year, which, when the implementation in the first eight months of the year is taken into account, implies the creation of considerable room for manoeuver in the remaining months of the year.
- Excluding measures to limit the consequences of the epidemic, the projections indicate higher expenditure growth than last year and in the adopted budget, and, considering the implementation so far, also a significant acceleration of growth in the last five months of the year.

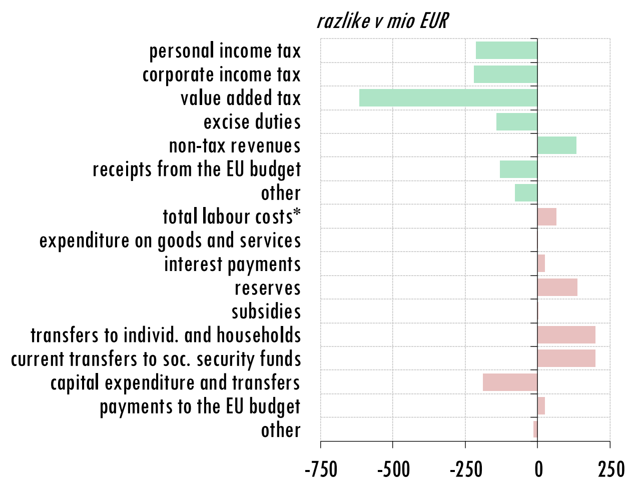
The state budget is expected to show a significant deficit this year due to the impact of the COVID-19 epidemic, but the projected growth of expenditure, even without taking into account the impact of measures related to the epidemic, is significantly higher than last year and in the adopted budget. According to the draft revised budget, the state budget deficit is expected to amount to EUR 4.2 billion or 9.3% of projected GDP this year. Excluding the direct impact of measures to limit the effects of the epidemic, the deficit is projected at EUR 1.3 billion or 2.9% of GDP this year. The deterioration of the balance compared to last year and according to the adopted budget is expected in view of the epidemic outbreak. This led to a significant deterioration in the macroeconomic bases

Figure 2.1: State budget revenue and expenditure



AB: adopted budget (Nov 19)
RB: revised budget proposal (Sep 2020)
RB-COVID: revised budget proposal excluding COVID-19 measures (Sep 2020)
Source: MoF, FC calculations.

Figure 2.2: Difference between revised and adopted state budget for 2020 excluding COVID-19 measures



**salaries and other expenditure for employees including employer's social contributions and transfers to public institutions for labour-cost related purposes.*
Revenue in green, expenditure in red.
Source: MoF, FC calculations.

and, consequently, to lower revenues, which are expected to be just under a tenth lower this year than last year. The deterioration in the balance is projected to be largely due to higher expenditure, which are expected to be more than a third higher than last year. Much of their increase is due to expenditure arising from measures to limit the effects of COVID-19, but expenditure growth without these measures is also expected to be about twice as high as last year and in the adopted budget, with growth particularly high in last months of the year. The assessment of projections is therefore divided as far as possible into projected trends directly related to one-off or temporary measures to limit the consequences of the COVID-19 epidemic and to trends that do not reflect these measures, thus allowing a more appropriate comparison with last year's outturn or in relation to the projections in the adopted budget.

Revenues of the state budget are expected to drop by 9.3% this year, mainly due to the deteriorating macroeconomic situation, while the direct effect of measures to limit the effects of the epidemic on the revenue side is expected to be relatively limited. In the first seven months of this year, revenues fell by 12.3% year-on-year due to a decrease in all key categories of tax revenues. According to the projections in the draft revised budget, the year-on-year decline in revenues is expected to slow down in the last five months of the year, with the exception of personal income tax revenues. The fall in personal income tax revenues this year is mainly due to a reduction in the compensation of employees, and to a lesser extent to the amended Personal Income Tax Act, which took effect in January and changed the personal income tax scale and increased the general relief amount.[7] In addition, the increase in the lump sum to municipalities[8] also has a negative impact on personal income tax revenues belonging to the state budget. Corporate income tax revenues are expected to fall the most among all key income categories this year, mainly due to poorer business results. Their decline is expected to slow down considerably over the last five months of the year. The latter also applies to revenues from VAT and excise duties, which are expected to fall by about a tenth on an annual basis, which is approximately in line with the forecast trends of their macroeconomic bases. The decline in VAT revenues is a result of a decline in final consumption, while the decline in

Table 2.1: State budget revenue

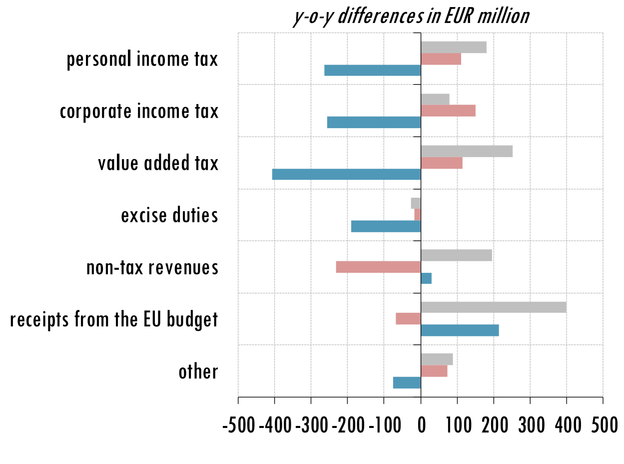
	EUR million					change in %				
			2020					2020		
	2018	2019	adopted (Nov.19)	revised (Sep.20)	revised excl. COVID	2018	2019	adopted (Nov.19)	revised (Sep.20)	revised excl. COVID
REVENUE	**10.001**	**10.136**	**10.773**	**9.189**	**9.510**	**13,3**	**1,4**	**6,3**	**-9,3**	**-6,2**
personal income tax	1.280	1.391	1.360	1.127	1.147	16,4	8,7	-2,2	-19,0	-17,5
corporate income tax	846	997	1.111	741	892	10,4	17,9	11,4	-25,7	-10,5
value added tax	3.757	3.872	4.188	3.466	3.572	7,2	3,1	8,2	-10,5	-7,7
excise duties	1.560	1.543	1.530	1.353	1.388	-1,6	-1,1	-0,8	-12,3	-10,1
non-tax revenues	867	636	532	665	665	29,2	-26,6	-16,3	4,6	4,6
receipts from the EU budget	794	727	1.071	941	941	101,0	-8,5	47,4	29,5	29,5
other	897	971	980	896	903	11,0	8,2	1,0	-7,7	-6,9

Sources: MoF, FC calculations.

[7] The Fiscal Council already drew attention to the risk that the proposed tax changes would not be fiscally neutral when adopting the state budget for 2020 last autumn. For more see The Fiscal Council: Assessment of compliance of the Proposal of budgets of the Republic of Slovenia for 2020 and 2021 with the fiscal rules, October 2019 (pp. 22–24).
Available at: - http://www.fs-rs.si/assessment-of-compliance-of-the-supplemented-proposal-of-budgets-of-the-republic-of-slovenia-for-2020-and-2021-with-the-fiscal-rules/

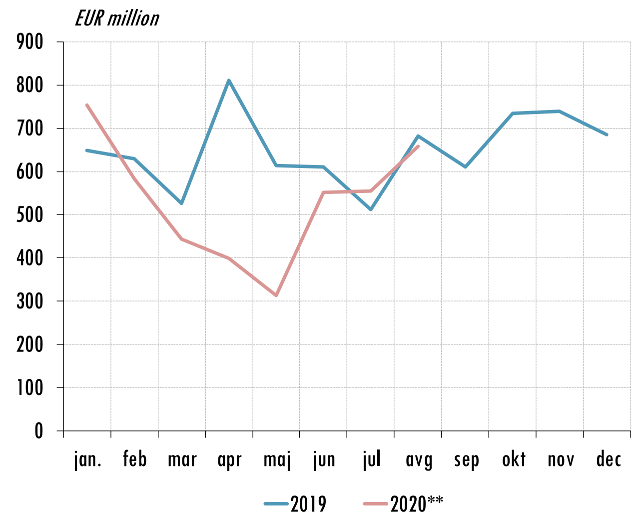
[8] Article 32 of the Act on Additional Liquidity to the Economy to Mitigate the Effects of the COVID-19 increased the lump sum expenditure for municipalities from EUR 589.11 to EUR 623.96.

Figure 2.3: State budget revenue



*Source: MoF, FC calcualtions. *revised budget proposal (Sep 2020).*

Figure 2.4: Selected tax revenue*

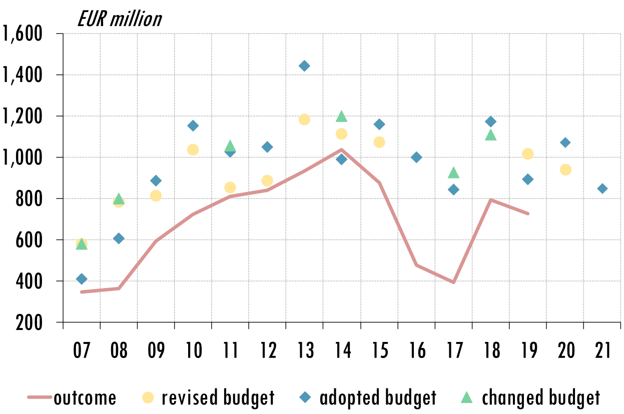


**personal income tax, corporate income tax, value added tax, excise duties.*
***August 2020 based on daily data.*
Source: MoF.

excise revenues stems from a decline in the quantities of sold goods subject to excise duties. Within the measures to limit the consequences of the epidemic, the revenue side of the state budget is mainly affected by tax measures. Among measures with the greatest effect are the possibility of deferral or instalment payment of tax liabilities and unaccounted and unpaid advance payments of corporate income tax and personal income tax on income from activity. According to the available information from the Ministry of Finance, their effect will total around EUR 300 million this year.

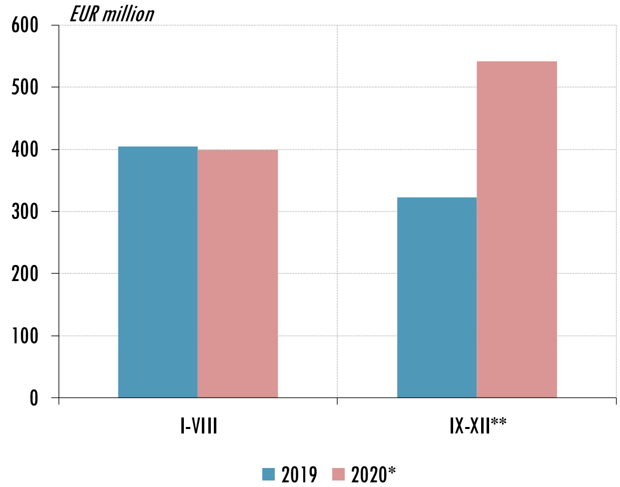
The overall decline in revenues will be somewhat mitigated by the growth of non-tax revenues and revenues from EU funds, but the projections of the latter are, in our opinion, again rather optimistic. Among non-tax revenues, revenues from profit sharing and dividends will fall by almost half this year, but other non-tax revenues will more than double this year due to treasury operations. The projection of revenues from EU funds has decreased by EUR 130 million compared to the adopted

Figure 2.5: Receipts from the EU budget - plan and outturn



Note: Markers for "revised budget", "changed budget" and "adopted budget" refer to specific budget documents for a specific year. For example, marker "revised budget" in 2015 refers to "78 Receipts from the EU budget" in the revised budget for 2015. There were no revised budgets for 2016, 2017 in 2018, therefore no marker "revised budget" is shown for those years.
Sources: MoF, FC calculations..

Figure 2.6: Receipts from the EU budget



**August 2020 based on daily data.*
***2020 implicitly based on projections in proposed revised state budget (Sep. 20).*
Source: MoF, FC calculation.

budget, but this year is still expected to grow by almost 30% compared to 2019. As these revenues were down 6.2% year-on-year in the first seven months of this year, they should increase by more than 70% year-on-year over the last five months of the year. The Fiscal Council regularly draws attention to the optimistic projections of revenues from EU funds[9], for which it found in the ex-post evaluation of deviations in macroeconomic and fiscal forecasts to be consistently overestimated and to contribute the most to deviations from the fiscal projections[10]. Taking into account the fact that a significant amount of EU funds will be available in the coming years, which, if effectively drawn, can make a significant contribution to the successful exit from the current crisis and also to an increase in long-term economic potential, the Fiscal Council reiterates its call for the better preparation of projects partly funded by the EU, which could contribute to more realistic projections of revenue under this title in the budget documents.

Expenditure will increase the most this year, i.e. as much as by 35.1%, mainly due to measures to mitigate the effects of the epidemic. Over the first seven months of the year, total expenditure increased by 25.2% year-on-year and, taking into account the projections in the draft revised budget, growth is expected to intensify over the last five months of the year, averaging almost 50%. According to the MoF, the direct impact of measures to limit the impact of COVID-19 on the expenditure side over the whole of 2020 will amount to EUR 2.6 billion. According to the MoF, more than half of this amount (EUR 1.4 billion) was implemented in the first eight months of the year, when most of the existing measures with the highest expected fiscal impact expired (see also Chapter 3). Of the remaining EUR 1.2 billion envisaged by the draft revised budget for COVID-19 measures in the last four months of the year, the large majority constitutes the reserve (EUR 953 million). According to the data available, we estimate that around EUR 350 million will be implemented from the latter under the currently applicable measures (see the table in Box 4.1). In our estimation, at least part of

Table 2.2: State budget expenditure

	EUR million					change in %				
			2020					2020		
	2018	2019	adopted (Nov.19)	revised (Sep.20)	revised excl. COVID	2018	2019	adopted (Nov.19)	revised (Sep.20)	revised excl. COVID
EXPENDITURE	**9.463**	**9.912**	**10.358**	**13.391**	**10.811**	**3,4**	**4,7**	**4,5**	**35,1**	**9,1**
total labour costs*	2.841	3.052	3.297	3.555	3.361	5,9	7,4	8,0	16,5	10,2
expenditure on goods and services	785	812	904	921	902	7,8	3,5	11,4	13,5	11,2
interest payments	861	785	752	776	776	-11,9	-8,8	-4,2	-1,1	-1,1
reserves	265	199	152	1.245	292	68,4	-24,9	-23,6	524,8	46,4
subsidies	396	413	523	1.445	525	4,0	4,4	26,5	249,6	27,0
transfers to individ. and households	1.304	1.453	1.332	1.792	1.532	3,4	11,5	-8,4	23,3	5,4
current transfers to soc. security funds	1.145	1.079	1.106	1.374	1.307	-6,6	-5,8	2,5	27,3	21,1
capital expenditure and transfers	822	938	1.157	973	968	35,8	14,2	23,3	3,8	3,2
payments to the EU budget	433	510	501	526	526	14,5	17,6	-1,8	3,3	3,3
other	613	671	635	784	622	-19,2	9,5	-5,4	16,7	-7,3

*Sources: MoF, FC calculations. *salaries and other expenditure for employees including employer's social contributions and transfers to public institutions for labour-cost related purposes.*

[9] For more information, see assessments by the Fiscal Council from February 2019 and October 2019. Available at: - http://www.fs-rs.si/publications/assessments-of-compliance-with-fiscal-rules/.

[10] For more information, see the Analysis of the forecast deviations of macroeconomic and fiscal aggregates in the 2016–2019 period. Available at: - http://www.fs-rs.si/an-expost-evaluation-of-forecasts-of-macroeconomics-aggregates-in-the-reference-period-2016-2019/.

Table 2.3: State budget expenditure - 2

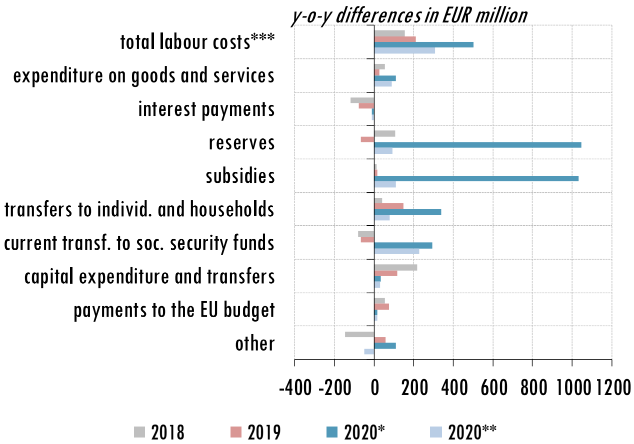
	EUR million						change in %			
	I-VII 20			VIII-XII 20 (implicit)			total		excl. COVID	
	total	COVID	excl. COVID	total	COVID	excl. COVID	I-VII 20	VIII-XII 20	I-VII 20	VIII-XII 20
EXPENDITURE	**7.258**	**1.258**	**6.000**	**6.133**	**1.322**	**4.812**	**25,2**	**49,0**	**3,5**	**16,9**
total labour costs*	2.058	153	1.904	1.498	41	1.457	15,9	17,3	7,3	14,2
expenditure on goods and services	436	2	434	485	17	468	0,7	28,2	0,2	23,7
interest payments	538	0	538	238	0	238	-5,5	10,6	-5,5	10,6
reserves	83	0	83	1.162	953	209	-8,8	973,9	-8,8	92,8
subsidies	1.081	818	263	363	102	262	302,5	151,4	-2,0	80,9
transfers to individ. and households	1.077	150	927	715	111	605	25,0	20,9	7,6	2,2
current transfers to soc. security funds	929	67	863	444	0	444	25,1	32,3	16,1	32,2
capital expenditure and transfers	311	0	311	662	5	657	-11,1	12,6	-11,2	11,8
payments to the EU budget	317	0	317	210	0	210	-8,1	27,1	-8,1	27,1
other	427	68	359	356	94	263	19,4	13,7	0,4	-16,2

*Sources: MoF, FC calculations. *salaries and other expenditure for employees including employer's social contributions and transfers to public institutions for labour-cost related purposes.*

this expected expenditure has already been allocated to individual expenditure items of the draft revised budget. Among other categories of expenditure, the draft revised budget envisages for COVID-19 measures a larger amount by the end of the year for subsidies (partial compensation for part-time work) and other current transfers, where the main part is constituted by expected further purchases of protective equipment. In light of the above, we assume that in the absence of a repeated general lockdown of the economy, which would require the adoption of similar measures as in spring, the growth of total expenditure this year could be slightly lower than projected in the draft revised budget.

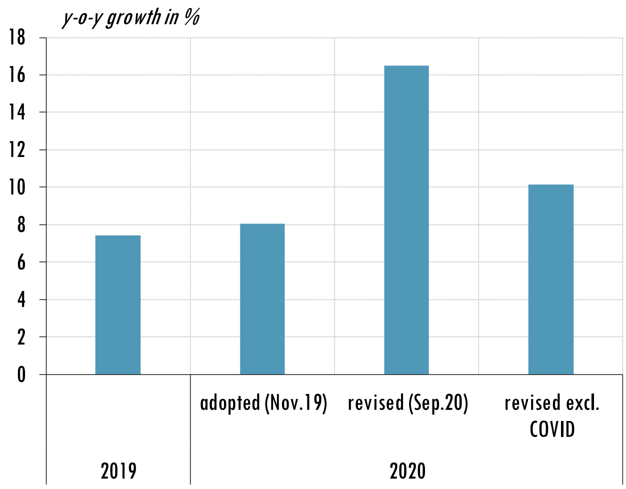
The projected growth of expenditure in the draft revised budget, even without taking into account the direct effect of COVID-19 measures, is about twice as high as last year and as in the adopted

Figure 2.7: State budget expenditure



**revised budget proposal (Sep 2020),*
***revised budget proposal excluding COVID-19 measures (Sep 2020)*
****salaries and other expenditure for employees including employer's social contributions and transfers to public institutions for labour-cost related purposes.*
Source: MoF, FC calcualtions.

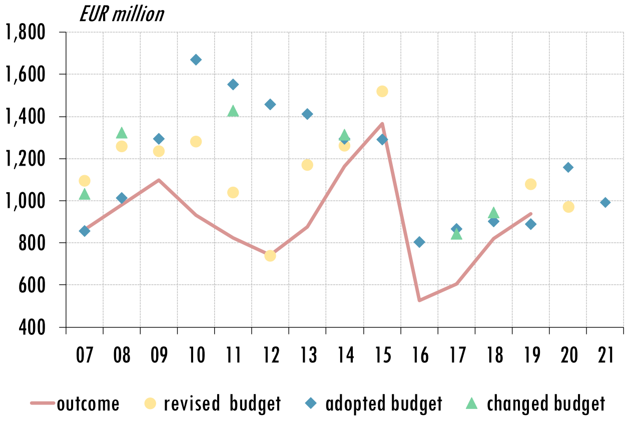
Figure 2.8: Labour costs*



**salaries and other expenditure for employees including employer's social contributions and transfers to public institutions for labour-cost related purposes.*
Source: MoF, FC calculations.

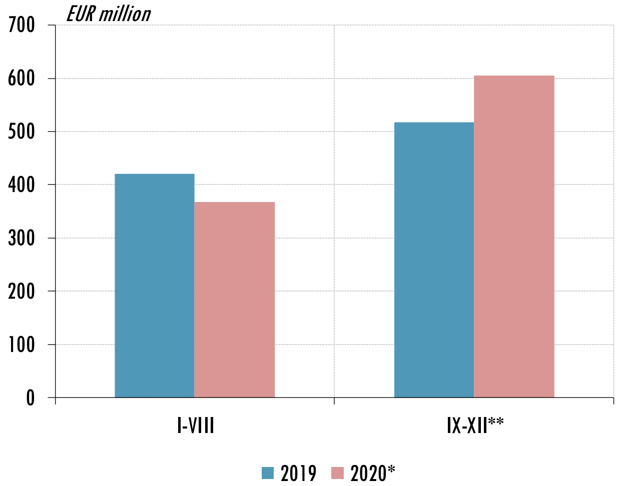
budget. In the first seven months of the year, expenditure growth was restrained (3.5%) without taking into account the direct effect of COVID-19, which is largely related to the suspension of the implementation of the state budget.[11] According to the draft revised budget, its growth in the last five months is expected to strengthen significantly (16.9%). Total labour costs[12] are expected to increase by 10.2% this year, thus contributing about a third to total expenditure. With employment growth similar to last year, such an increase is mainly due to the effect of regular promotions and the implementation of the Agreement on salaries and other payments of labour costs in the public sector concluded at the end of 2018.[13] Given that labour cost growth in the first seven months was similar to last year, it is difficult to explain the doubling of its growth over the last five months of this year as indirectly follows from the draft revised budget. A similar dynamic within the year is also expected for transfers to social insurance funds, which are expected to increase by a fifth this year, while they decreased last year, and the adopted budget envisaged only modest growth. Subsidies are also expected to increase significantly this year, but the growth according to the draft revised budget is similar to that in the adopted budget. Transfers to individuals and households are expected to increase by half less this year than last year, but growth is expected to significantly slow down in the last five months given the realisation over the first seven months. The adopted budget envisaged a drop in transfers to individuals and households this year, however the Fiscal Council warned last year when assessing the budget that the projections were exposed to underestimation risk.[14] The largest deviation downwards from last year's developments and from the projections in the adopted budget is for investment expenditure.[15] In our opinion, this is partly due to the lower expected absorption of EU funds, but mainly due to the fact that it is one of the few flexible expenditure categories that shrink during periods of high pressure on public finance expenditure. Despite the lower expected growth compared to the adopted budget, there is a risk that the realisation will be even lower, as investment

Figure 2.9: Capital expenditure and transfers - plans and outcome



Note: Markers for "revised budget", "changed budget" and "adopted budget" refer to budget documents for a specific year. For example, marker "revised budget" in 2015 refers to "42 Capital expenditure" and "43 Capital transfers" in the revised budget for 2015. There were no revised budgets for 2016, 2017 in 2018, therefore no marker "revised budget" is shown for those years.
Source: MoF, FC calculations.

Figure 2.10: Capital expenditure and transfers



**August 2020 based on daily data.*
***2020 implicitly based on projections in proposed revised state budget (Sep. 20).*
Source: MoF, FC calculation.

[11] Paragraph one of Article 11 of the Fiscal Intervention Measures Act (the ZIUJP). Available at: http://www.pisrs.si/Pis.web/pregledPredpisa?id=ZAKO8186.

[12] Salaries and other expenditure on employees, employers' social security contributions and transfers to public institutions for salaries and other expenditure on employees and employers' social security contributions. This comparison does not include allowances under Article 71 of the ZIUZEOP and KPJS.

[13] Pursuant to the agreement, some allowances for special working conditions were increased in September 2019 and, in November 2019, an increase in the value of jobs for the second pay grade was introduced.

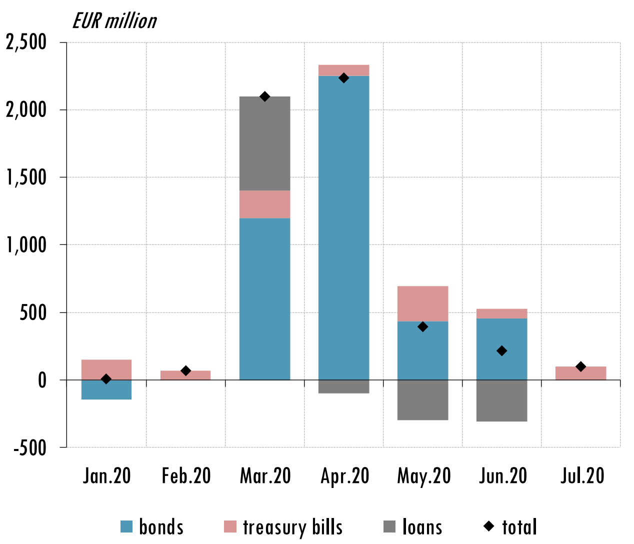
[14] For more see The Fiscal Council, Assessment of compliance of the Proposal of budgets of the Republic of Slovenia for 2020 and 2021 with fiscal rules, October 2019 (pp. 22–24).

[15] This is also one of the key findings of the Analysis of the forecast deviations of macroeconomic and fiscal aggregates in the 2016–2019 period (see footnote 10).

expenditure in the first seven months of the year were lower by about a tenth year-on-year, and in the last five months, given the draft revised budget, their growth is expected implicitly.

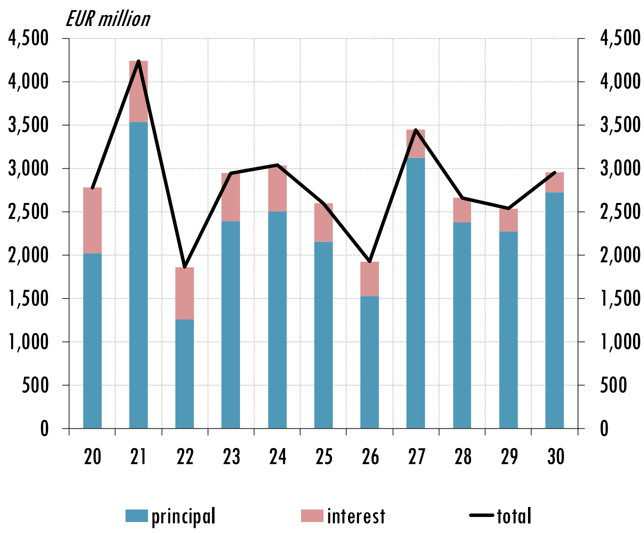
The debt of the state budget[16] increased by net EUR 5.1 billion in the first seven months of this year, and following the government's proposal it could increase by as much as EUR 7.3 billion over the year. The majority of net borrowing is represented by bonds issued at the outbreak of the epidemic, whose net issue in the period of March-May amounted to EUR 4.3 billion. The required yields increased temporary for all EU Member States in spring, but financing conditions remained relatively favourable.[17] The introduction of new ECB measures, in particular the Pandemic Emergency Purchase Programme (PEPP), made an important contribution. Under the latter, the ECB repurchased

Figure 2.11: State budget net borrowing, January - July 2020



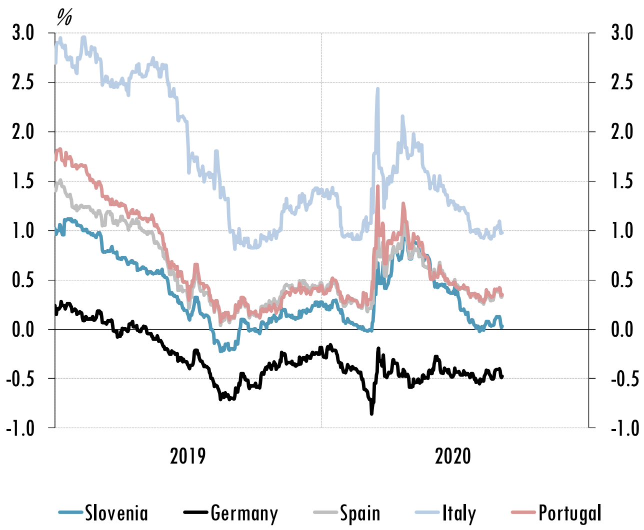
Source: MoF, FC calculations.

Figure 2.12: State budget debt repayment schedule



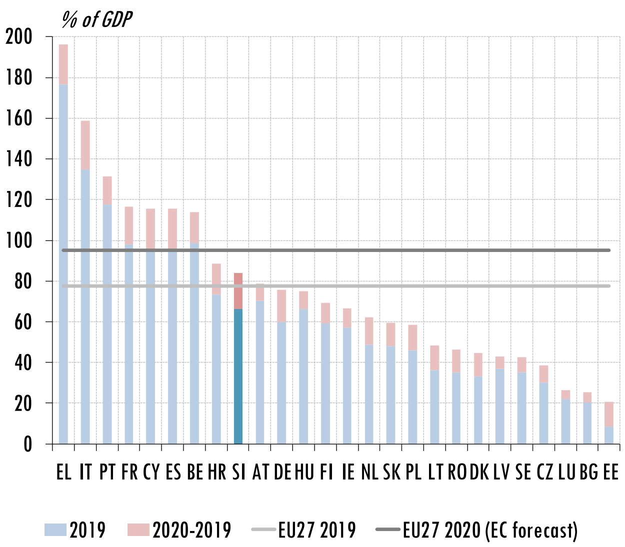
Source: MoF.

Figure 2.13: Yields on 10-year government EUR reference bonds



Source: Bloomberg.

Figure 2.14: General government debt in 2019 and EC spring forecast for 2020



Source: Eurostat, EC (European Economic Forecast. Spring 2020).

[16] The state budget debt is not equal to the debt of the general government sector, although it represents the largest part of it.

[17] The April issue of the 10-year bond had an interest rate of 0.875%, which is the second lowest interest rate on the bond with this maturity so far. Only the interest rate on bond issued in January this year was lower (0.2%).

EUR 1.9 billion of Slovenian government debt on the secondary market by July inclusive, which is the fifth largest share in the euro area in terms of total debt. At the same time, past treasury operations have not allowed the debt maturity distribution to deteriorate significantly.[18] In addition, the Single Treasury Account position has increased by EUR 2.2 billion since the end of last year to EUR 6.2 billion at the end of August. In the proposal of the Act Amending the Implementation of the Republic of Slovenia Budget for 2020 and 2021 Act, the Government proposes[19] for the second time this year an increase in the permitted volume of borrowing for this year to EUR 7.3 billion, which gives the possibility of additional net borrowing by the end of the year amounting to EUR 2.2 billion. This decision should take into account that EUR 3.5 billion in principal is to mature next year. On the other hand, the following factors should be considered: (i) the current liquidity position of the state budget is favourable; (ii) the EC approved EUR 1.1 billion in loans to Slovenia under the SURE instrument; (iii) according to the latest EC forecasts, this year's increase in general government debt in Slovenia is expected to be the sixth largest in the EU. In view of all the above, the Fiscal Council calls on the Government to be careful with additional borrowing, since the experience of the past significant increase in government debt in the period 2009-2013 shows that debt reduction is a demanding task. It is crucial to provide favourable conditions for sustainable economic growth after the end of the epidemic, which will make it possible to reduce the debt-to-GDP ratio and also to maintain, as far as possible, favourable financing conditions at the expected low interest rates in the coming years.

With the proposed draft revised budget for 2020, the government did not prepare an updated forecast of general government debt. According to the ESA 2010 methodology, the general government debt is monitored in the context of compliance with fiscal rules and is also internationally comparable. At the time of drafting this estimate, only the outturn for the end of the first quarter is known, when the general government debt amounted to EUR 33.4 billion. The state budget debt amounted to EUR 30.7 billion in the same period, rising to EUR 33.6 billion by the end of the second quarter, representing 74.2% of projected GDP for this year. SORS will publish data on the amount of general government debt at the end of the second quarter on 30 September 2020. The Fiscal Council expects the government to prepare an updated forecast of general government debt for the 2020-2022 period when preparing the draft state budgets for 2021 and 2022 and the Draft Budgetary Plan 2021 in October this year.

[18] The weighted average maturity of debt decreased from 9 to 8.6 years from the end of last year to the end of July this year.

[19] For the first time, additional borrowing with regard to the Implementation of the Republic of Slovenia's Budget for 2020 and 2021 Act, adopted last year, was provided by the amendments included in the Act Governing the Intervention Measure of Providing Additional Liquidity to the Economy to Mitigate the Consequences of the COVID-19 Epidemic (PKP2), which was adopted at the end of April 2020. According to the PKP2, the maximum amount of additional indebtedness may not exceed the difference between the expenditure planned in the adopted state budget and the maximum state budget expenditure set by the National Assembly by adopting an amendment to the Framework for the state budget for 2020 (April 2020), amounting to just over EUR 2 billion.

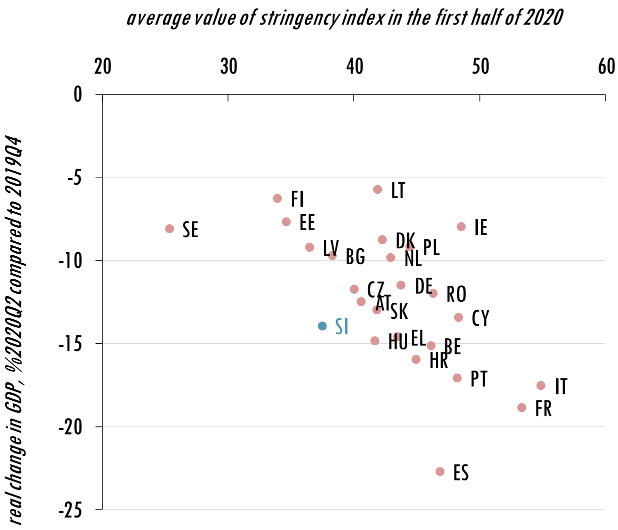
3. Review and impact assessment of measures to limit the effects of the COVID-19 epidemic

Key findings

- The measures taken to limit the consequences of the epidemic are largely in line with the recommendations of international institutions and similar to those in other countries, and are close to the average of the EU Member States in terms of the forecast volume.
- Measures to preserve jobs have, at least temporarily, made it possible to preserve the economic potential, while guarantee schemes to maintain the liquidity of the economy have so far been used to a lesser extent.
- Simulations show that the action taken so far has mitigated the fall in economic activity by just under a quarter of the fall from the baseline scenario.

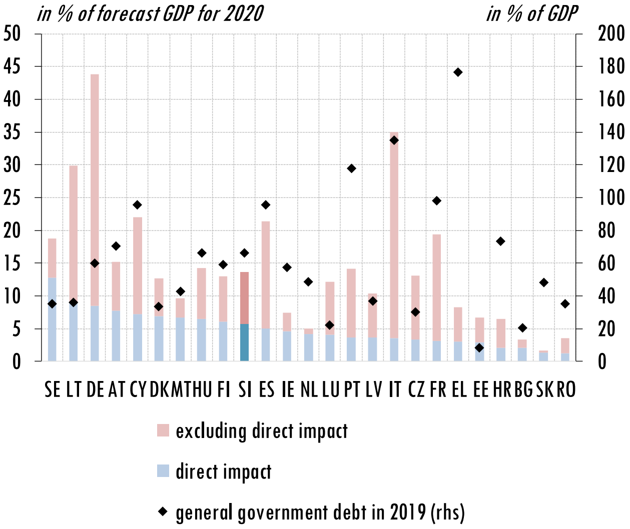
Due to measures to curb the spread of the virus, the outbreak of the COVID-19 epidemic has significant negative consequences for macroeconomic and fiscal developments in most countries. Countries have taken various measures to curb the spread of the virus, as illustrated by the stringency index.[20] In countries with more severe restrictions, the decline in economic activity has generally been greater in line with expectations. In Slovenia, after the outbreak of the epidemic, relatively strict restrictions were quickly adopted, which also began to be released earlier than in other countries. According to the average value of the stringency index in the first half of the year, Slovenia thus ranks among the EU member states in the lower half. Nevertheless, the fall in GDP between the end of 2019 and the second quarter of this year was among the largest in the EU. The epidemic has an indirect impact on public finances, in particular on revenues, through the deterioration of macroeconomic trends, and a direct one through the operation of automatic stabilisers and measures that mainly affect the increase in expenditure. According to available data for most EU Member States, Slovenia

Figure 3.1: Decline in GDP and stringency



Source: Eurostat, OxCGRT, FC calcualtions.

Figure 3.2: Estimates of fiscal effect of the measures



Source: EU IFIs Network, EC, FC calculations.

[20] For more on the index see the Oxford University Blavatnik School of Government https://www.bsg.ox.ac.uk/research/research-projects/coronavirus-government-response-tracker#data.

ranks in the middle in terms of the announced scope of measures with a direct impact on public finances. In this situation, countries that entered the crisis with high levels of debt and doubts about their long-term fiscal sustainability are mainly opting for measures with an indirect effect on the balance, while countries with more fiscal space are more likely to take direct measures. This confirms the need to provide sufficient room for manoeuver regarding public finances in more favourable times.

According to the MoF, by the end of August, COVID-19 measures were implemented in the amount of EUR 1.38 billion in expenditure, taking into account the implemented and already recorded measures. At the end of August, the Fiscal Council (FC) estimated their current value at EUR 1.54 billion on the basis of data acquired from the institutions responsible for implementing individual measures.[21] The FC obtained data showing higher spending or expenditure not yet recorded in the state budget. The biggest difference is in the purchase of protective equipment, where the FC included in its assessment data from the Commodity Reserves Institute on fulfilled and partly fulfilled contracts, while according to the Ministry of Finance, actual expenses for this purpose are lower by EUR 43 million. The FC included in its assessment data from FURS on redeemed tourist vouchers, and the MoF on the amounts actually reimbursed to tourist providers, which were EUR 45 million lower by the end of August. The last major difference between the FC estimate and the MoF data is the estimate of the payment to healthcare providers due to the failure to perform the activity that actually fell due in early September. On the other hand, according to the MoF, the allowances to employees were around EUR 30 million higher than according to the data obtained from the Ministry of Public Administration by the Fiscal Council.

Among individual groups of measures, the largest in terms of scope are the measures to preserve jobs, which, similarly to those in other European countries, have at least so far made an important contribution to maintaining the economic potential. These measures include a temporary layoff allowance, basic income for the self-employed and other eligible groups, exemption from social security contributions for these groups, exemption from pension contributions for employees who worked at the time of the epidemic, and sick pay compensation by the Health Insurance Institute of the Republic of Slovenia (ZZZS). According to the Employment Service of Slovenia, around 180,000 employees were included in the measure of temporary layoff for work in April, and around 150,000 in May. In the share of all employees by activities, the measure as was expected included the largest

Table 3.1: Overview of materialised COVID-19 measures

	EUR million
Measures for protecting jobs	980
Measures for normal functioning of public services	361
-of which employee bonuses	178
-of which purchases of protective equipment	67
Measures for supporting consumption	176
-of which tourist vouchers	80
Measures in agriculture	6
Measures for maintaining liquidity	460
-of which tax deferrals	213
-of which uncalculated and unpaid taxes	172
-of which issued guarantees	76

Source: MoF, Tax Authority, SID Bank, estimates and calculations FC.

[21] The estimate is available at: - http://www.fs-rs.si/the-updated-assessment-of-the-actual-fiscal-impact-of-the-adopted-one-off-anti-crisis-measures-2/.

number of employees in cultural, entertainment and recreational activities and in catering (more than half), followed by manufacturing, trade and transport (about a quarter) and professional, scientific and technical activities and other miscellaneous business activities (about one fifth). With the cancellation of the epidemic in June, the number of temporarily laid off workers dropped significantly to around 40,000, but about a fifth of all employees were still involved in the measure in cultural, entertainment and recreational activities and in catering. Given that data by month and activity on partial subsidies for temporary layoff for work are not yet available, it is difficult at this time to estimate how many jobs remain at risk. Nevertheless, in the event of the need for further extension of the temporary layoff allowance, more targeted support should be considered in line with the recommendations of international institutions. According to our estimates, basic income was received by about half of the eligible self-employed and other eligible groups. Under the SURE instrument, the EC approved EUR 1.1 billion in the form of loans to Slovenia, which could be used to finance most of the expenditure for this purpose, based on data on current implementation and estimates of the remaining value of currently valid measures in this area.

Among the measures to ensure the smooth operation of public services, allowances to employees and purchases of protective equipment are the most prevalent. By the end of August, EUR 178 million had been earmarked for employee allowances[22], and according to available data from the MoF, another EUR 20 million is planned by the end of the year. Almost half of all allowances were paid to healthcare employees (EUR 82 million), more than EUR 40 million was paid to municipalities from the state budget and around EUR 30 million within the Ministry of Labour, Family, Social Affairs and Equal Opportunities (MDDSZ), most for social security employees. According to the MoF, EUR 67 million was earmarked for the purchase of protective equipment by the end of August, while according to the Commodity Reserves Institute, contracts in the amount of EUR 84 million were fulfilled, with an additional EUR 26 million in partly-fulfilled contracts. Based on this, we estimate that actual expenditure for this purpose will increase by the end of the year. Other measures in this area are mainly aimed at covering the loss of income in the field of education, where the largest part is represented by payments to kindergartens.

Slightly less than half of the measures for maintaining consumption is represented by tourist vouchers, while the rest are one-off payments to various groups of beneficiaries. The maximum volume of tourist vouchers was estimated at EUR 350 million, whereas the realisation so far shows that the their consumption will be significantly lower. They were mostly spent only in certain segments of the tourist offer, so that this sector will face significant challenges as the demanding epidemiological picture continues. One-off transfers to various groups of the population (pensioners, students, recipients of various social benefits, large families) were received by around 650,000 beneficiaries, in an average amount of around EUR 150 per person. At the time of the adoption of the legislation, the Fiscal Council assessed that this measure was primarily intended to reduce uncertainty, but from the point of view of stimulating consumption, its implementation would make more sense after the strict restrictive measures have been abolished.[23]

An important item among the measures to maintain the liquidity of the economy was the postponement or instalment payment of tax liabilities, while the guarantee schemes have not yet been fully implemented. However, all measures in this area have only indirect impact on the public finance balance. The deferred payment of tax liabilities was a quick and easy measure to maintain

[22] Allowances under Article 71 of the ZIUZEOP and under the KPJS, and allowances for members of the Civil Protection under Article 66 of the ZIUOOPE.

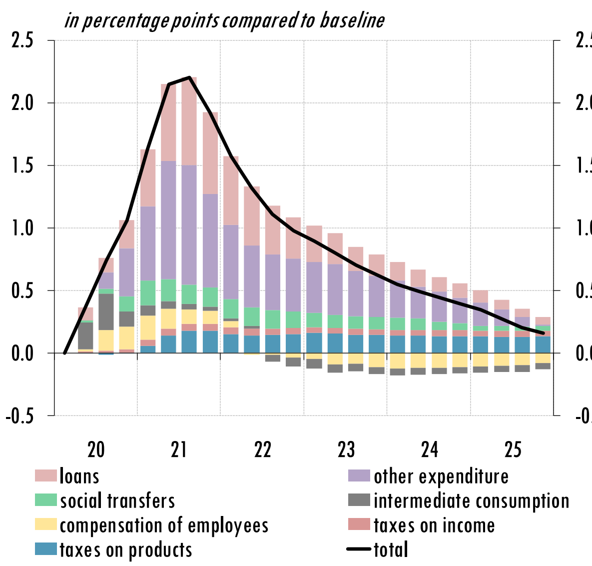
[23] Analyses show that during a pandemic, only a small share of one-off transfers to the population are actually spent. For more information on this, see https: //- https://www.stat.si/StatWeb/en/News/Index/8399.

liquidity. The largest part of deferred payments constitutes VAT and excise duties, which in the period of March–June cumulatively amounted to around 4% of last year's full-year realisation. A significant contribution to maintaining liquidity was made by the non-calculation and non-payment of advance payment of corporate income tax and personal income tax on income from activities, which according to the MoF amount to around EUR 170 million. On the other hand, guarantee schemes with a total value of available guarantees of EUR 2.2 billion have not yet been fully implemented. The adoption of a larger scheme under the ZDLGPE was particularly time-consuming, so that by the beginning of September a total of guarantees for only around EUR 75 million in loans had been issued.

For the model calculation of the macroeconomic effect of the measures involved, shocks were defined according to the findings on the implementation of measures so far, i.e. just under 3.5% of GDP. They were divided into taxes on products and income and social transfers, compensation of employees, intermediate consumption and other general government expenditure (mainly subsidies). These measures were added to by an exogenous increase in loans based on various measures (liquidity loans, SPS – Slovene Enterprise Fund – loans) in the amount of slightly less than 1% of GDP. All these variables were temporarily increased in appropriate proportions with regard to the introduction of measures in the second and third quarter of this year, after which the values of measures return to baseline or the relevant variables change endogenously. The model simulations therefore show only the consequences of the measures implemented so far and do not contain an estimate of the decline in general government revenues due to the reduction of economic activity – which has already been included in the baseline scenario, the results of which are not shown here.

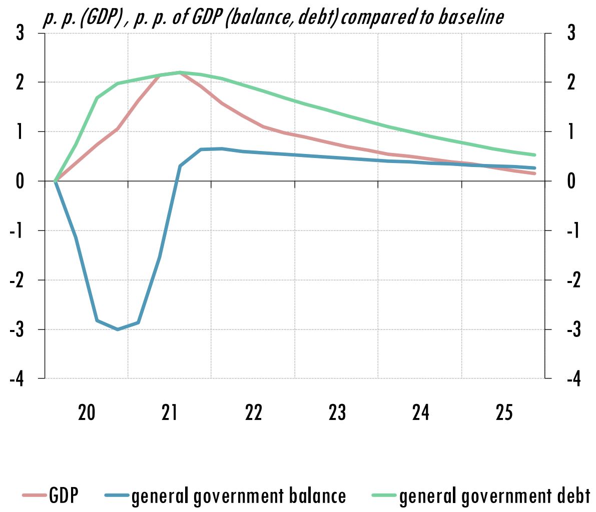
The simulations of the impact of fiscal measures show that, in 2020, measures would provide around a 1.5% increase in economic activity in comparison to economic activity in the scenario without government action. This mitigates the decline in economic activity by just under a quarter of the decline assumed in the baseline scenario; this is similar to the assessment of the impact of measures in the EU that was made by the European Commission. Simulations also show that the multiplicative effects of the measures are relatively small. This is to be expected as measures in the situation of high uncertainty were primarily intended to prevent a significant economic decline and excessive increase in unemployment.

Figure 3.3: Contributions of measures to change in GDP



Source: FC estimate.

Figure 3.4: Contributions of measures to change in GDP, general government balance and general government debt



Source: FC estimate.

Given the implemented model simulations, subsidies contribute the most to limiting the decline in economic growth, which is understandable, since this measure is the most extensive. In these circumstances, subsidies have a significant effect on employment, which is their primary purpose, with the characteristic that their effect in the long term is greater than in the actual period of the implementation of this measure. Measures in the field of social transfers and wages in the general government sector affect economic activity in a neutral way at best, and as a result they even reduce employment slightly in the short and medium term. Both measures, which increase the disposable income of the population, increase economic activity through spending only in the very short term, and at the same time, mainly due to the deterioration of competitiveness, contribute to the reduction of employment. Meanwhile, measures in the field of subsidies increase economic activity due to more persistent positive effects on employment in the medium term.

The favourable macroeconomic impact of these measures could result in the deterioration of public finance aggregates. This is without considering the fact that due to the economic crisis the deficit and the general government debt strongly increase in the baseline scenario, and without considering the option that due to the reverse effect of the shock, caused by the fall in the economic activity, public finance aggregates would additionally deteriorate. Simulations show that as a result of these measures the general government deficit would increase in the first year by about 3 percentage points of GDP, while in the following years it is expected to return to the deficit level suggested in the baseline scenario. At the same time, in the year of introduction of measures the government debt would increase by about 2 pps of GDP, while five years later it would be about 0.5 pps of GDP higher than in the baseline scenario.

4. Assessment of compliance with fiscal rules

Key findings

- In exceptional circumstances, a temporary deviation from fiscal rules is allowed for, however, without endangering the medium-term fiscal sustainability.
- In line with previous calls from the Fiscal Council and despite many uncertainties, the government should establish a medium-term fiscal policy framework, while the proposed Framework should also indicate the possibility of gradually achieving medium-term fiscal balance after the end of exceptional circumstances.
- The assessments of fiscal policy orientations are also highly uncertain for the part of the expenditure not related to measures to remedy the effects of the epidemic.
- Nevertheless, the Fiscal Council estimates that the Framework draft contains, according to the available data from the draft revised budget and the Framework draft using the FRA mathematical formula, the relevant level of general government expenditure for 2020, but these could exceed the set limit.

Current exceptional circumstances allow for the temporary deviation from the fiscal rules. On 17 March 2020, the Fiscal Council estimated that the declaration of the epidemic in Slovenia was an unusual event which, according to Article 12 of the FRA, enables exceptional circumstances to be imposed for measures aimed at mitigating the impact of such an event, and thus a temporary deviation from medium-term public finance.[24] Despite the permitted temporary deviation from the medium-term balance, the Fiscal Council must, in accordance with the FRA, prepare assessments of compliance of public finance trends presented in the draft Framework and in the draft revised budget with fiscal rules. Estimates are associated with a high degree of uncertainty due to the risks related to the input variables (see Box 4.2).

Despite the possibility of a temporary deviation from the medium-term fiscal balance due to exceptional circumstances, the government must determine the permissible extent of expenditure. In accordance with Article 13 of the FRA, the government can do this by revising the framework for the preparation of general government budgets, which the government submitted to the Fiscal Council for assessment together with the draft revised budget. The Framework proposal only contains a revised estimate of the permitted maximum expenditure for 2020 without an adjustment for the following years, and as such does not underpin medium-term orientation. Article 13 of the FRA lays down that the scope of permissible deviations from the medium-term balance must be determined only for the period of exceptional circumstances, which, according to currently known public information, should refer only to 2020. In the given situation, we can only estimate what the maximum level of general government expenditure in 2020 would be if fiscal rules applied. In this context, the assessment focuses on whether the part of expenditure determined in the Framework proposal linked to the stage of economic cycle is adequate, since, in accordance with its competences, the Fiscal Council does not assess the suitability of expenditure related to the remedy of the effects of the epidemic. The volume

[24] http://www.fs-rs.si/wp-content/uploads/2020/03/Assessment_extraordinary-event-under-the-Fiscal-Rule-Act-_March-2020.pdf

Table 4.1: Comparison of the Framework proposal with previous frameworks for the preparation of general government budgets

	2020	gen. government		state budget		local governments		pension fund (ZPIZ)		health fund(ZZZS)	
		targ.balance	max E	targ.balance	max E	targ.balance	max E	targ.balance	max E	targ.balance	max E
		% of GDP	EUR million	% of GDP	EUR million	% of GDP	EUR million	% of GDP	EUR million	% of GDP	EUR million
A	Framework, Apr. 2019 (UL 26/19)	1,0	21.480	0,8	10.450	0,1	2.320	0,0	5.845	0,0	3.320
B	Framework, Apr. 2020 (UL 67/20)	-8,1	23.630	-8,1	12.525	...	2.340	...	5.930	...	3.320
C	Framework proposal, Sep. 2020	-8,6	24.650	-9,3	13.395	...	2.340	...	5.930	...	3.370
C-A	Difference	-9,6	3.170	-10,1	2.945	...	20	...	85	...	50
C-B	Difference	-0,5	1.020	-1,2	870		0		0		50

Sources: UL (Official Gazette of the Republic of Slovenia), the Framework proposal, Sep. 20 and FC calculations.

of these one-off expenditure, inter alia, has a very important impact on the assessment of the adequacy of the volume of expenditure that are not related to exceptional circumstances, and thus indicate the structural orientation of fiscal policy.

Despite the existing uncertainties, the government should prepare a plan for medium-term fiscal policy orientations and outline it in the proposed Framework. Due to the only one-year revision of the draft Framework and due to the current uncertainties related to input data determining the allowed maximum expenditure,[25] compliance of the draft Framework with fiscal rules cannot be assessed comprehensively. In the context of Article 6 of the FRA and from the point of view of medium-term budget planning, the revised framework should also reflect the gradual achievement of the medium-term fiscal balance expected after the period of exceptional circumstances. The design of medium-term orientations, despite the current uncertainties regarding future developments (these could be addressed e.g. by elaborating alternative scenarios) would be also desirable from the point of view of preparing the orientations of other economic and development policies.

The Framework proposal is in line with the draft revised budget for state budget expenditure, however, the difference between the change in state budget expenditure and the change in general government expenditure is not explained. Expenditure in the draft revised budget are equal to the maximum expenditure of the state budget in the draft framework. The change in the general government expenditure exceeds the total change in state budget expenditure and ZZZS expenditure in the draft Framework by EUR 100 million. The difference between two changes is normal due to the different involvement of institutional units and the consolidation of transactions between these units, however, in the current exceptional circumstances, which dictate the need for a revised budget, enhanced transparency of the government regarding this difference is required.

According to the basic Fiscal Council calculation, the volume of general government expenditure from the draft Framework in 2020 is in line with the maximum expenditure limit set by the FRA, but could exceed this limit with a more gentle decline in economic activity than expected or with a smaller volume of one-off expenditure. Considering the currently applicable Framework for the preparation of the 2020–2022 budgets, the revisions made to the draft Framework relate primarily to the state budget and, to a lesser extent, to the ZZZS (see Table 4.1). In the calculations of the baseline scenario shown in Box 4.2, in addition to the level of general government revenue, we took into account the estimate of the scope of one-off or temporary measures contained in the draft revised budget (see Box 4.1). We also considered the production gap estimate by the Fiscal Council.

[25] Variable input data that according to the provisions of Article 3 of the Fiscal Rule Act determine the maximum level of general government expenditure in an individual year are an estimate of the level of revenue of the general government sector, an estimate of the output gap and an estimate of the scope of one-off measures.

Considering the range of output gap estimates based on current information, and different estimates of the level of one-off expenditure, the level of the general government expenditure in 2020 could fall within so determined limits. The deviation from such a finding could be triggered by two factors. These are a less negative output gap and/or a smaller volume of one-off expenditure. In an extreme case and based on currently available information, the government expenditure could exceed the maximum expenditure limit from the draft Framework by around EUR 350 million or around 0.8% of projected GDP (see Table in Box 4.2). Nevertheless, the estimates show that the finding regarding the maximum expenditure limit is asymmetric in favour of meeting this criterion.

Box 4.1: One-off factors in the evaluation of the submitted budget documents

The level of one-off factors is particularly important in crisis situations, when it is necessary to ensure that a large part of the discretionary emergency expenditure to address the epidemic does not become permanent. This was pointed out by the Fiscal Council when establishing the existence of the conditions for the implementation of exceptional circumstances.[1] Since one-off factors are expected to be voluminous during a period of exceptional circumstances, a high degree of transparency is required in their definition. The requirement for transparency is largely conditioned by past experience, when the values of one-off measures were subsequently frequently revised and therefore only ex-post evaluations showed that fiscal policy was not oriented properly. For this reason, the Fiscal Council has indicated in its documents that it would use a conservative approach in assessing one-off factors.[2]

The EC laid down specific conditions under which measures can be dealt with as part of a general escape clause. The manual for implementing the provisions of the Stability and Growth Pact[3] places emphasis on the eligibility of such expenditure subject to the following principles: (i) additional spending should be directly linked to exceptional circumstances, (ii) deviations can only be permitted on a temporary basis; (iii) the permitted deviations should only reflect the additional costs related to tackling exceptional circumstances compared with the previous year; (iv) countries should present the deviations in a transparent manner. These principles also apply to justifying such expenditure in documents submitted to the EC by Member States within the framework of economic governance i.e. the European Semester. These include the Draft Budgetary Plan, which the government is to submit to the EC in October.

We tried to divide the values of the components of the revised budget as much as possible between those that meet the definition of one-off factors and those that correspond to the normal functioning of the fiscal policy. In assessing the fiscal policy orientations, the Fiscal Council takes into account two values of one-off factors arising from the submitted budgetary documents. It included in the baseline scenario the volume of one-off factors, stated in the draft revised budget[4] as "direct Covid expenditure" in the amount of EUR 2,582 million or 5.7% of GDP.[5] In the simulations of the lower and upper limits of maximum expenditure (see Box 4.2) we also take into account the fact that a large share of envisaged budget expenditure is allocated to the item " reserves", for which there is no transparent explanation of the purpose of spending. Although at the same time we note that in some

Table: One-off measures taken into account

	Estimate of one-off measures (FC)		
		EUR mio	G
1.	Direct Covid-related expenditure (proposed supplementary budget)	2.582	5,7
2.	- of which: reserve	953	2,1
3.	Estimate of further Covid-related expenditure (FC)	340	0,8
1.-2.+3.	**One-off measures (estimate FC)**	**1.969**	**4,4**

The estimate of the fiscal effect of further Covid-related expenditure		
measure	estimated effect (EUR mio)	remark
Payments tourist voucher	94	FC estimate
Payments to the health sector due to the unability to perform the service	114	ZZZS estimate
Furlough simulation	67	FC estimate based on June outturn
Payments to the health sector regarding material costs	50	ZIPRS
Other	15	MoF estimate
TOTAL	**340**	

Sources: MoF, Health Insurance Institute (ZZZS),FC estimates.

items of state budget expenditure there is still some room for implementation by the end of the year (see Table 2.3), which in our estimates reduces the need for reserves, we also included among the one-off factors those where according to currently available information the fiscal effects of the measures would be visible by the end of the year (see lower part of the table). Among the one-off factors, the Fiscal Council does not take into account the "indirect Covid expenses" component. In our estimation, these do not meet the definition of one-off measures and are largely already covered by the cyclical component of the general government balance, which is already excluded from the calculation of the maximum general government expenditure limit.[6]

[1] http://www.fs-rs.si/wp-content/uploads/2020/03/Assessment_extraordinary-event-under-the-Fiscal-Rule-Act-_March-2020.pdf

[2] See the Report on the Fiscal Council's operation in 2017 (May, 2018).

[3] https://ec.europa.eu/info/sites/info/files/economy-finance/ip101_en.pdf (p. 26).

[4] Explanation of the general part of the revised budget of the Republic of Slovenia for 2020.

[5] When calculating the maximum permitted volume of general government expenditure, we neglected the fact that the draft revised budget was prepared for the state budget according to a different (GFS) methodology than the draft general government framework proposal (ESA methodology).

[6] Under the document "Explanation of the general part of the revised budget of the Republic of Slovenia for 2020" (p. 3) "indirect Covid expenses" include an increase in unemployment benefits, coverage of loss of income or increase in expenses for both social insurance funds, interest costs from borrowing and investments to support the restarting of the economy.

Box 4.2: Assessment of the permitted maximum level of expenditure, if fiscal rules were applicable

The expenditure ceiling for the general government sector, which allows for the medium-term balance, is determined in the Framework in view of the expected level of revenues and of the established cyclical position of the economy. The expenditure ceiling is calculated in accordance with the mathematical formula set out in paragraphs three and four of Article 3 of the FRA. The planned level of expenditure does not include temporary or one-off expenditure.

In setting the maximum possible expenditure ceiling, the following ambiguities arise due to the current situation:

- The forecasts of fiscal aggregates in the draft revised budget and in the draft Framework are prepared on the basis of the IMAD summer forecast from the end of June. Due to the process of preparing budgetary documents, the latest macroeconomic forecasts were not taken into consideration, but are expected to be available upon adopting the draft revised budget or the draft Framework in the National Assembly;

- The uncertainty about assessing the output gap is particularly high in the context of stronger fluctuations in economic activity. The Fiscal Council prepares its own output gap estimate on the basis of the average estimates of other institutions and statistical methods. The uncertainties related to the determination of the maximum volume of expenditure on the basis of the output gap point estimate are shown by two simulations, which take into account the current range of the output gap estimates according to known and available estimates (see the illustrations in this box).

- the Fiscal Council's assessment of the value of one-off or temporary measures slightly deviates from the estimate given in the draft revised budget (see Box 4.1) with both estimates being taken into account. The value of temporary or one-off measures is one of the main variables that influence the determination of the maximum volume of expenditure not depending on the cyclical factors.

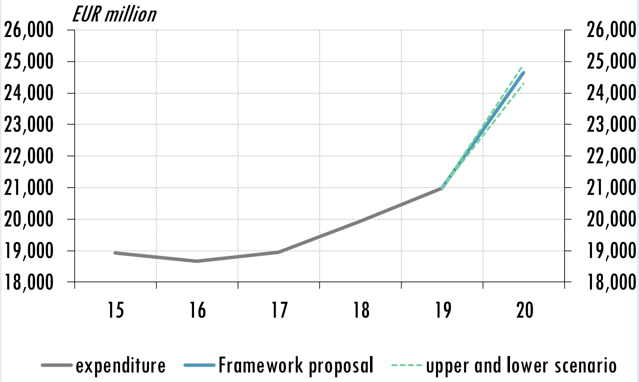
Table: Calculation of the permitted maximum level of expenditure

			2020 baseline scenario	2020 lower scenario max OG, min o	2020 higher scenario min OG, max o
Revenues (implicitly from Framework	*% of GDP*		45,9	45,9	45,9
Revenues (FC recalculation)	*EUR million*	R	20.761	20.761	20.761
Expenditures (Framework)	***EUR million***	**E**	**24.650**	**24.650**	**24.650**
GDP (IMAD)	*EUR million*	Y	45.241	45.241	45.241
Output gap (FC estimates)	*% of pot. output*	OG	-5,3	-4,7	-6,0
Potential output (FC estimates)	*EUR million*	YP	47.796	47.477	48.138
Elasticity of the balance to the output gap		á	0,468	0,468	0,468
Minimum structural balance	*% of pot. output*	mSS	-1,1	-1,1	-1,1
One-offs (FC)	*% of GDP*	o	5,7	4,4	5,7
Maximum expenditure (FC esti	***EUR million***	**E_max=R-(mSS+á*OG/100)*YP-o*Y/100**	**25.066**	**24.299**	**25.225**
Difference	*EUR million*	E-E_max	-416	351	-575

Note: The symbols in the third column reflect the markings from the mathematical notation of the formula for determining the ceiling of the general government expenditure in an individual year in Article 3 of the FRA. For the output gap, estimates of the average and of the maximum and minimum output gap were taken as used by the Fiscal Council. For one-off effects, see Box 4.1.

Source: Revised budget proposal (Sep. 20) and the Framework proposal (Sep. 20), FC calculations.

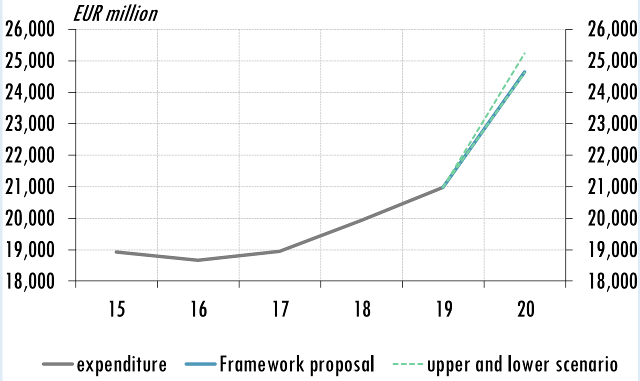
Figure 1: Simulation of maximum general government expenditure according to various assumptions on inputs



Note: Maximum value of output gap estimates used by FC in preparation of assessment is used. Border values of maximum general government expenditure level are set according to minimum and maximum value of one-off measures estimates (see Box 4.1).

Source: Proposed revised budget (Sep. 20) and Framework proposal (Sep. 20), FC calculations.

Figure 2: Simulation of maximum general government expenditure level according to various assumptions on inputs



Note: Minimum value of output gap estimates used by FC in preparation of assessment is used. Border values of maximum general government expenditure level are set according to minimum and maximum value of one-off measures estimates (see Box 4.1).

Source: Proposed revised budget (Sep. 20) and Framework proposal (Sep. 20), FC calculations.