REPUBLIC OF SLOVENIA
FISCAL COUNCIL

Assessment by the Fiscal Council: Proposal for the Ordinance amending the Ordinance on the framework for the preparation of the general government budgets for the 2018–2020 period

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The Government of the Republic of Slovenia has submitted to the Fiscal Council for assessment the proposal for the Ordinance amending the Ordinance on the framework for the preparation of the general government budgets for the 2018–2020 period.

The Fiscal Council assesses that the proposal for the Ordinance does not comply with the provisions of the Fiscal Rules Act. Such an assessment is based on the fact that neither the political and macro-economic circumstances nor the situation in healthcare have further changed since the preparation of the Stability Programme 2018. Moreover, neither have other budget documents and consequently the adjustment of the overall framework been prepared on the basis of the changed circumstances since autumn 2017 nor have these changed circumstances been fully taken into consideration. Since the preparation of the Stability Programme 2018, risks that could undermine macro-economic and fiscal results have been increasing, which calls for greater precaution in planning processes. Furthermore, the proposal for the Ordinance does not explain the unchanged total level of expenditures of the general government while increasing the maximum level of expenditures of the Health Insurance Institute of Slovenia. The increase in the maximum level of expenditures by the Health Insurance Institute of Slovenia is not in line with the provisions of the Fiscal Rules Act on the possibilities of spending surpluses of general government institutional units.

When reviewing the Stability Programme – 2018 amendment (hereinafter: the Stability Programme 2018), the Fiscal Council established that the medium-term fiscal framework in the context of a favourable economic cycle does not provide a counter-cyclical fiscal policy which could contribute to preventing the emergence of macroeconomic imbalances or, consequently, preventing an overly rapid reversal of the economic cycle. In favourable economic conditions, higher revenues should not be allocated for increased spending by the individual institutional units by reallocating the cyclically created fiscal space within or between individual fund budgets, in particular because the risks that could lead to a deterioration in economic and thus fiscal results could accumulate in the international environment.

The Fiscal Council calls on the Government to consistently follow the principle of precaution in planning and assessing the amounts of revenues and expenditures imposed by the Fiscal Rules Act. Given the number of risks, the assessment that the half-yearly results ensure compliance with the budget plans of the health insurance fund and of the entire general government is too loose. **The common framework should be amended on the basis of updated macro-economic forecasts in September 2018, whereas the expenditure of the health insurance fund budget should be set together with the preparation of other budgetary documents.** This would provide a comprehensive expenditure framework for fiscal policy management instead of seeking partial or inconsistent solutions. The current problems in the healthcare system could already have been addressed if the Government had adjusted the framework of individual fund budgets of the general government to the then available macro-economic data and forecasts when preparing the Stability Programme 2018. **The Fiscal Council invites the Government to undertake a consistent review of the efficiency of operation of the healthcare system and to take effective action in the relevant areas.**

Any ad hoc amendment to the framework represented in this proposal creates a precedent for any further amendments to the framework in the future. By implementing the proposed amendments, the framework could entirely lose its medium-term function or it could be impossible to credibly determine the basis for the operation of fiscal policy in the short term. The Fiscal Council underlines that the framework for determining the maximum possible amount of expenditures *can* be changed, but only in a comprehensive manner or under regular procedures and with duly substantiated reasons.

The Fiscal Council expects that the Legislative Service of the National Assembly of the Republic of Slovenia will respond accordingly to the proposal for the Ordinance and its non-compliance with the Fiscal Rules Act.

Explanation of the assessment

On 27 July 2018, the Fiscal Council received for assessment the proposal for the Ordinance amending the Ordinance on the framework for the preparation of the general government budgets for the 2018–2020 period (hereinafter: the proposal for the Ordinance) adopted by the Government of the Republic of Slovenia at its session on 26 July 2018. The proposal Ordinance proposal provides for an increase in the maximum possible level of expenditure for the health insurance fund budget in 2018 by EUR 35 million, while the overall level of general government expenditure remains unchanged. In accordance with point 5 of paragraph two and point 4 of paragraph seven of Article 7 of the Fiscal Rules Act and paragraph four of Article 9f of the Act Amending the Public Finance Act (ZJF-H), the Fiscal Council is obliged to assess the appropriateness of the proposed amendments to the framework within 15 days of the receipt of said proposed amendments.

The Government has submitted the proposal for the Ordinance to the Fiscal Council for assessment and to the National Assembly for adoption in accordance with paragraph six of Article 6 of the Fiscal Rules Act (Official Gazette of the Republic of Slovenia No. 55/15) pursuant to which the Government may modify the framework if it finds by 15 September of the current year that the circumstances on the basis of which the framework was adopted have changed.

The Ordinance on the framework for the preparation of the general government budgets for the 2018–2020 period was last amended in the autumn of 2017. On 14 September 2017, the Government of the Republic of Slovenia concluded that the circumstances requiring an amendment to the framework had changed. Accordingly, the Ministry of Finance drew up an amendment to the Ordinance on the framework for the preparation of the general government budgets for the 2018–2020 period (Official Gazette of the Republic of Slovenia No 65/17), increasing the maximum level of expenditure from the state budget for the health insurance fund budge, the maximum possible level of general government expenditure and the target general government balance for 2018. Between the spring of 2016 and the autumn of 2017, the maximum possible level of expenditures for the health insurance fund budget specified in the frameworks for the preparation of the general government budgets was changed three times. In this period, it increased in total by over EUR 200 million, i.e. by 7.9%, while the estimated GDP for 2018 increased by more than 8%. Compared to the first medium-term expenditure framework of spring 2016, the proposed increase would amount to almost EUR 250 million or 9.2% in 2018 while the GDP forecast for 2018 increased by more than 11% in the period between the spring of 2016 and the autumn of 2017. This was not taken into account in the preparation of budget documents in the spring of this year.

In April 2018, the Government of the Republic of Slovenia drew up the Stability Programme for 2018, which did not change the existing common general government expenditure framework despite the changed circumstances. In this document, the Government indicated that the current political circumstances (i.e. the resignation of the government) and, consequently, the performance of only regular duties, did not allow changes in the frameworks for the preparation of budgets, although the macro-economic circumstances had changed or even improved since the autumn of 2017, as noted in the proposal for the Ordinance. The Fiscal Council agreed on an explanation of the tasks related to the current performance of regular duties while reviewing the compliance of the Stability Programme 2018 with the achievement of fiscal rules, but pointed out that the overall medium-term framework should have been changed under the improved macroeconomic conditions. When reviewing the Stability Programme 2018, the Fiscal Council established that, due to the high economic cycle, the total general government expenditure in 2018 should decrease by around EUR 200 million as compared with the framework from the autumn of 2017. This counter-cyclical operation of the fiscal policy would, in the circumstances of high economic growth, facilitate the respect of domestic fiscal rules and at the same time ensure a gradual convergence to the medium-term objective of fiscal policy.

The Fiscal Council estimates that the proposed Ordinance does not comply with the provisions of the Fiscal Rules Act because of the following:

a) **The Government proposes a change in the framework although political and macroeconomic circumstances and the situation in healthcare have not further changed since the preparation of the Stability Programme 2018.** Other budget documents too, including the government expenditure framework, were not prepared on the basis of the changed circumstances since autumn 2017, or these changed circumstances were not fully taken into consideration. The Government drew up the proposal for the Ordinance on the basis of paragraph six of Article 6 of the Fiscal Rules Act. This provides that the Government may propose amendments to the framework if, by 15 September of the current year, it finds that the circumstances have changed on the basis of which the framework was adopted, which in accordance with the Fiscal Rules Act is, as a rule, prepared and adopted by the National Assembly, together with the Stability Programme. In the light of the provisions of the same Article of the Fiscal Rules Act, the proposals for amendments to the framework must be sent to the National Assembly by the Government, together with the proposed budget or any proposed amendments to the budget. The National Assembly adopts amendments to the framework when adopting the state budget or amendments thereto. Despite the updated spring forecasts, the Government, when preparing the Stability Programme 2018, decided not to modify the framework due to the restrictions on the current operations. Since the preparation of the Stability Programme 2018, the circumstances that make it possible to amend the framework have not changed. The Government continues to perform regular duties as when preparing the Stability Programme 2018. Since the last amendment to the framework, the healthcare situation also has not changed, i.e. the waiting times existed already in autumn 2017 and therefore also in spring 2018. No new macroeconomic forecasts were presented since the preparation of the Stability Programme 2018 and the Institute of Macroeconomic Analysis and Development of the Republic of Slovenia (IMAD) is expected to prepare them in early September 2018.

b) **Since the preparation of the Stability Programme 2018, the risks that could impair macroeconomic and fiscal results have been increasing.** The Fiscal Council considers it necessary to take into account the fact that the spring round of forecasts was followed by a deterioration in the forecasts for the international environment. The forecasts for the global economy and for Slovenia's major trading partners, particularly the forecasts for 2018, have been slightly worsened by all international institutions (ECB, the European Commission and the IMF). In addition, risks in the international environment have increased significantly. This is reflected, inter alia, in the widespread stagnation of growth (by geographic areas and by industry) or in the gradual decline in the economic confidence indices. The realisation of risks could have a significantly negative effect on economic and, consequently, fiscal trends in Slovenia.

c) **The increase in the maximum level of expenditure by the Health Insurance Institute of Slovenia while at the same time not changing the total level of general government expenditure has not been sufficiently justified.** The proposal for the Ordinance does not provide sufficient justification for the proposal to raise the maximum possible amount of expenditures. The explanation of the increase relies solely on the revised spring forecast by IMAD, which should have been taken into account in the preparation of the renewed framework in submitting the Stability Programme 2018 in April this year, on the review of the semi-annual balance sheets of the Health Insurance Institute, on the assessments of the operations of the Health Insurance Institute of Slovenia until the end of the year, and on the requests of the Board of Directors of the Health Insurance Institute of Slovenia and the general expert public. At the same time, the proposal for the Ordinance does not sufficiently justify the fact that the maximum possible expenditure and the general government balance remain unchanged despite the change in the maximum amount of expenditure for health insurance fund budget in 2018. Given the unchanged value of the total general government expenditure, the achievement of the set fiscal frameworks and the path towards the achievement of a medium-term fiscal objective, the discrepancy, which had already been noticed during the assessment of the Stability Programme 2018, could not have been further aggravated. Assuming an unchanged cyclical position of the economy in the light of previous assessments, the output gap assessments for Slovenia with regard to the calculations of the Fiscal Council have not changed significantly from the Stability Programme 2018.

d) **The increase in the maximum level of expenditure of the Health Insurance Institute of Slovenia is not in accordance with Article 5 of the Fiscal Rules Act, which prescribes in which cases and for what purposes the surpluses of the institutional unit of the general government may be spent.** The surplus of the Health Insurance Institute of Slovenia amounted to slightly below EUR 35 million in the first six months of 2018. Article 5 of the Fiscal Rules Act provides that the surpluses of the budgets that each individual institutional unit of the general government generates in a given year are collected on a separate account. If the institutional unit is in debt, the surpluses may be used only for the repayment of the debt principal. According to the available information (Business Report of the Health Insurance Institute of Slovenia for 2017), the Health Insurance Institute of Slovenia is not in debt. If the institutional unit of the general government is not in debt, paragraph three of Article 5 of the Fiscal Rules Act provides that the surpluses generated in a given year can only be used for:

i) financing of deficits in periods of below-potential GDP level,

ii) financing of the loss of revenue,

iii) increasing expenditure in the case of exceptional circumstances of a severe economic downturn or an unusual event which is beyond control and has a significant impact on the financial situation of the general government, or

iv) financing investment in coming years.

With the consent of the founder of the institutional unit, the surpluses generated may exceptionally be used to increase the assets of this institutional unit.

The Fiscal Council estimates that, at the moment, none of the above conditions is met which would enable the use of the surpluses generated by the Health Insurance Institute of Slovenia in 2018, since:

Ad i) the Health Insurance Institute of Slovenia has a surplus balance and the economy is in a period of above-potential level (this was also a finding of the Stability Programme 2018), Ad ii) in the proposal for the Ordinance, the Government establishes that the revenues of the Health Insurance Institute of Slovenia are above expectations, thus eliminating the need to finance the loss of revenues, and

Ad iii) currently, Slovenia is not exposed to exceptional circumstances – the existence (and termination) of exceptional circumstances is determined in accordance with Article 12 of the Fiscal Rules Act after obtaining the assessment of the Fiscal Council.

ANNEX: Tables and graphs

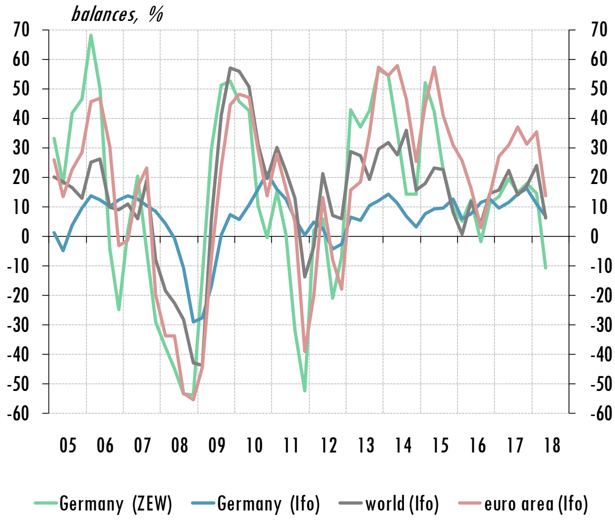
Table 1: Amendments to the framework

		Framework Apr. 2016 OG 30/2016			Framework, Nov. 2016 OG 74/2016			Framework, May 2017 OG 26/2017			Framework, May 2017 OG 21/2017			Framework, Nov. 2017 OG 65/2017			Proposed changes to the Framework, Jul. 2018		
		2017	2018	2019	2017	2018	2019	2017	2018	2019	2018	2019	2020	2018	2019	2020	2018	2019	2020
general government	target balance (GDP %)	-1.6	-1.0	-0.4	-1.6	-1.0	-0.4	**-0.8**	-1.0	-0.4	**-0.2**	**0.2**	0.4	**0.4**	0.2	0.4			
	max E (mio EUR)	18419	18537	18584	18419	18537	18584	**18460**	18537	18584	**19158**	**19512**	19952	**19290**	19512	19952			
Health Insurance Institute	target balance (GDP %)										0.0	0.0	0.0	0.0	0.0	0.0			
	max E (mio EUR)	2573	2638	2710	**2608**	**2687**	2710	**2685**	2687	2710	**2827**	**2944**	3087	**2847**	2944	3087	**2882**	2944	3087

Note: Numbers which have been changed compared to the previous Frameworks are marked in red. Max E: maximum expediture

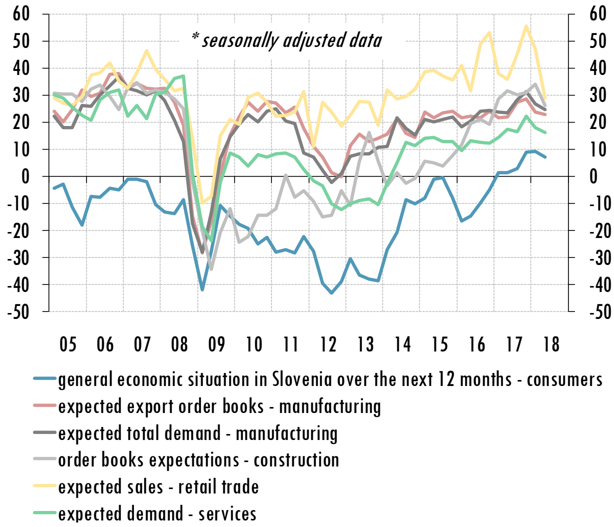
Source: Ministry of Finance, FC calculations.

International environment - expectations



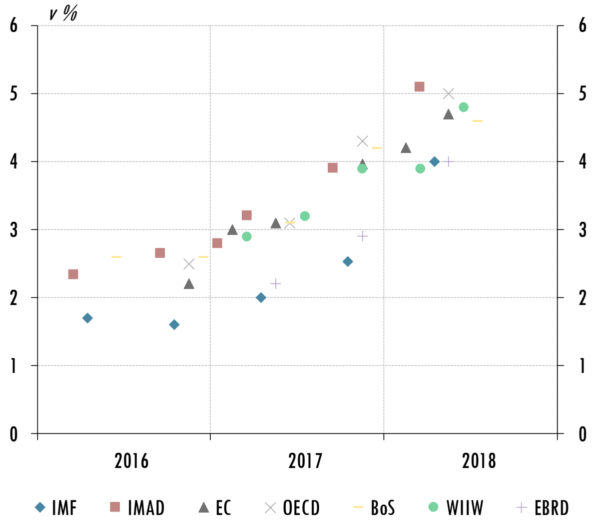
Sources: ZEW, Ifo.

Business tendency and consumer surveys - expectations*



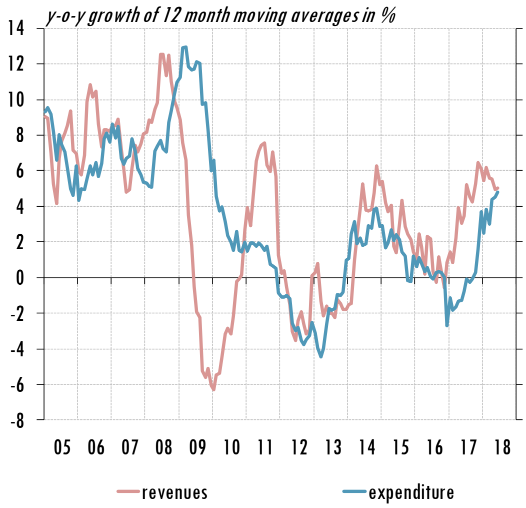
Source: SORS, FC calculations.

Real GDP growth forecasts for 2018



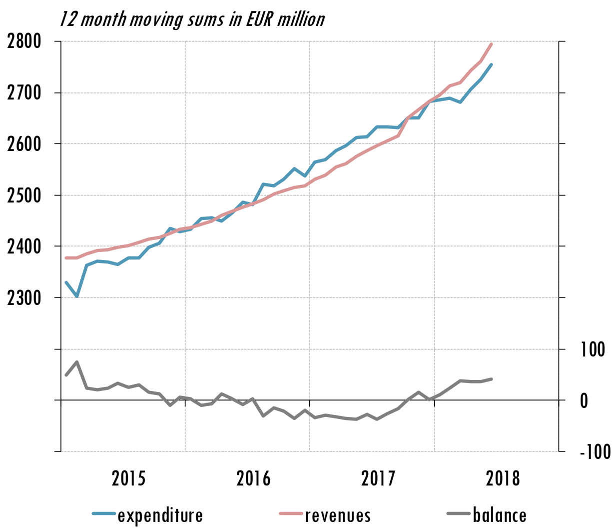
Sources: IMF, IMAD, European Commission (EC), OECD, Bank of Slovenia (BoS), WIIW, EBRD.

Revenues and expenditure of the consolidated general government budgetary accounts



Sources: Ministry of Finance (GFS), FC calculations.

Revenues, expenditure and balance of the Health Insurance Institute of Slovenia



Sources: Ministry of Finance (GFS), FC calculations.