REPUBLIC OF SLOVENIA
FISCAL COUNCIL

Assessment of compliance of the general government budgets with the fiscal rules in 2018

April 2018

Document no.: 30-2/2019/5

Account was taken of data available up to and including 31 May 2019.

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SUMMARY

Pursuant to the provisions of the Fiscal Rule Act, the Fiscal Council produced an assessment of compliance of the implemented budgets of the general government sector with the fiscal rules in 2018. According to the Fiscal Council's assessment, in 2018 the budgetary policy was neutral, but given the cyclical position of the economy it should have been restrictive. The fiscal rules were predominantly complied with, which was primarily made possible by high revenues driven by favourable cyclical conditions and partly by an increase in certain non-tax categories. Taking into account the deviation permitted, the medium-term budgetary objective under EU rules was attained in 2018. The relevant national rule was not complied with as the general government expenditure exceeded the level set in the adopted medium-term Framework. The ex-post analysis indicates that the general government sector expenditure did not exceed that ceiling set by taking into account the currently available revenue data and the output gap estimates. Compliance with the expenditure ceiling set by the Framework is in principle a form of formal guidance for conducting countercyclical fiscal policy; last year, compliance with this rule would have resulted in a higher than recorded surplus of the general government balance. Thus, more manoeuvring room would have been created for the fiscal policy in the subsequent years in which economic growth is expected to slow and negative risks are simultaneously increasing. A decrease in the share of general government debt in GDP was appropriate.

A favourable macroeconomic situation in 2018 – with economic growth close to 5% for the second consecutive year – was reflected in a further significant and broadly-based increase in general government revenue. The general government sector balance increased and amounted to 0.7% of GDP, as revenue increases exceeded those in expenditures, which, in fact, rose above the level set in the Framework. An important role was played by a reduction in interest expenditure as the primary balance surplus increase was lower. Last year, the structural balance continued to be close to equilibrium. The share of gross debt in GDP was further reduced; the Government took advantage of the favourable situation in the financial markets and continued to actively manage the debt.

The Fiscal Council is of the view that in 2018 the potential for a more sustainable improvement of public finance remained untapped. In addition to favourable macroeconomic conditions, the nearly full compliance with the fiscal rules was also due to the fact that certain measures with unfavourable structural fiscal implications were postponed to future years because of political uncertainty. According to current Fiscal Council's estimates, the annual achievement of the medium-term budgetary objective under EU rules, which is defined as a slight structural deficit for the 2020-2022 period, will not suffice to attain balanced position over the medium-term and that structural surpluses will need to be generated in the future. In order to ensure balance over the economic cycle, these surpluses will be required because of structural deficits in years past. The increased risks associated in particular with the anticipated negative fiscal implications of demographic change narrow the timeframe for adopting the measures to contribute to a more sustained improvement of public finance. In the current favourable cyclical conditions the state budget already transfers approximately 2% of GDP to the pension fund. If the measures to ensure long-term sustainability are not adopted, the implications for public finances will be far more extensive than that of a deviation from fiscal rules in a single year. Experience shows that the adoption of structural measures is more feasible in the first part of the policy cycle; in addition, Slovenia is still experiencing favourable economic conditions.

Tabela 1: Compliance with fiscal rules

		2018
A	Medium term objective (MTO)	✓
B	Expenditure rule	✓
C	Change in gross public debt	✓
D	Domestic fiscal rule	✗
A	Structural balance (in % of GDP)	0.1
	Medium term objective	*0.25*
	Change in structural balance (in % of GDP)	*0.0*
	Required change in structural balance (in % of GDP)	*0.0*
B	Growth in net expenditure (in %)	3.5
	Reference rate to be applied - nominal (in %)	*4.3*
C	Gross public debt (in % GDP)	70.1
	Reference level of debt (in % GDP)	*76.5*
D	Level of public expenditure (EUR million)	19,464
	Maximum level of public expenditure - Framework December 2018 (EUR million)	*19,290*

Source: SORS, MoF, FC estimates and calculations.

Legislative Basis

Pursuant to point 4 of Article 7(2) and point 3 Article 7(3) of the Fiscal Rule Act (the ZFisP), the Fiscal Council is required to produce an assessment of compliance of the implemented budgets of the general government sector with fiscal rules by 30 June of the current year for the previous year. On 29 March 2019, the Statistical Office of the Republic of Slovenia published the data on the Main Aggregates of the General Government 2015–2018 according to ESA methodology and on 19 April 2019 the Report on the Excessive Deficit and Debt 2015–2018. The Fiscal Council also acquired data from the consolidated public finance balance sheet from the Ministry of Finance compiled under the cash flow methodology.

In accordance with the ZFisP, in periods when approaching the medium-term budgetary objective, general government budgets are deemed balanced in the medium term if the structural balance of the general government sector approaches the medium-term budgetary objective in accordance with the dynamics determined according to the Stability and Growth Pact (SGP). Pursuant to the SGP rules, the relevant medium-term budgetary objective for Slovenia in 2018 is a structural balance of 0.25% of GDP. After the medium-term budgetary objective is attained, the focus is shifted on assessing compliance with the national fiscal rules on the medium-term balance and general government expenditure thresholds set in the frameworks for the preparation of the budgets. In the present assessment the Fiscal Council verifies (i) the achievement of the medium-term budgetary objective under the SGP referred to in Article 15 of the ZFisP and (ii) the compliance with the national fiscal rule referred to in Article 3 of the ZFisP.

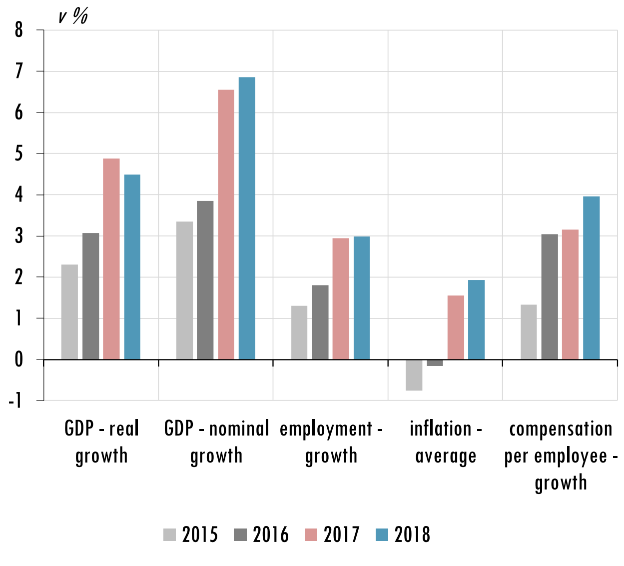
1. Macroeconomic and Fiscal Trends in 2018

1.1 Macroeconomic situation and assessment of the cyclical position of the economy

Economic growth remained high and contributed significantly to the increase in the general government sector surplus in 2018. Real GDP growth slowed down somewhat in comparison to 2017 (4.5%), while nominal growth increased to 6.9%, the highest since 2008. The structure of economic growth changed as the exports slowed down following 2017's exceptionally high growth; domestic consumption growth increased. Favourable conditions in the labour market prompted growth that was higher than the previous year's in disposable income, which stimulated the continued growth of private consumption. A high level of production capacity utilisation, growth in demand and good business results contributed to a further increase in private investment. Compared to the previous year, government consumption and investment recorded a more significant increase – had that not been the case, economic growth would have been notably slower.[1] Such economic growth structure was accompanied by a more noticeable increase in tax bases. The increase in compensation of employees (7.5%) was higher than in the previous year and resulted mainly from higher growth in wages driven by similar growth in employment. In the context of enhanced business operations, yet another substantial increase in gross operating surplus was recorded, even though its average growth in 2018 was slightly below that in the previous year due to a slowdown in the last quarter. Accompanied by higher domestic demand and commodity prices, inflation increased slightly but remained moderate.

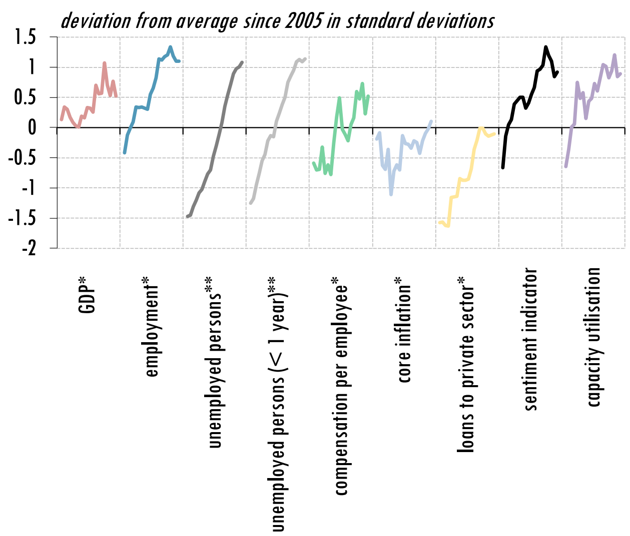
Based on various output gap estimates and an overview of a broader set of indicators that determine the state of the economic cycle, the Fiscal Council estimates that there were no major macroeconomic imbalances in the Slovenian economy in 2018. According to most institutions that produce output gap estimates, Slovenia's GDP level in the previous year was above the potential output level. Hence, the output gap was positive and stood on average at approximately 1.5%.[2] It

Figure 1.1: Macroeconomic indicators



Sources: SORS, Eurostat, FC calculations.

Figure 1.2: Indicators of economic cycle dynamics 2014–2018

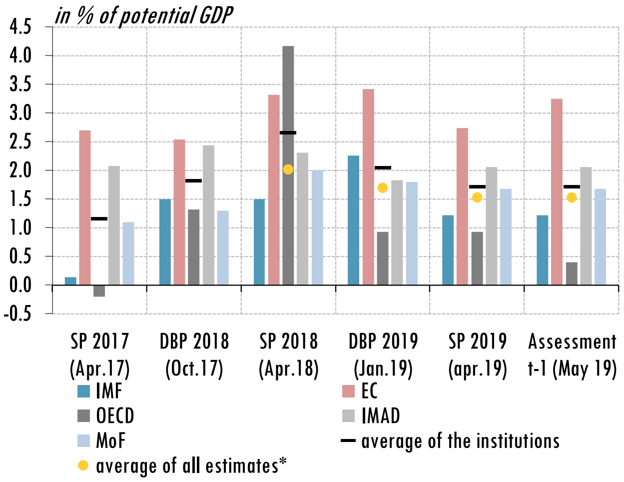


*Note: * y-o-y growth, ** inverted values*
Source: SORS, ECB, Eurostat, Employment Service of Slovenia, FC calculations.

[1] This applies if the contributions of other economic growth factors remain unchanged. According to the estimate of the Fiscal Council, last year the total increase in government's consumption and investment contribution to real GDP growth increased compared to 2017 by 0.9 p.p. to reach 1.1 p.p. The contributions of private investment and net exports (external balance) decreased, while the contribution of private consumption maintained its previous level. The estimate was made on the assumption that the state and private investment deflator is the same as that published for total gross fixed capital formation.

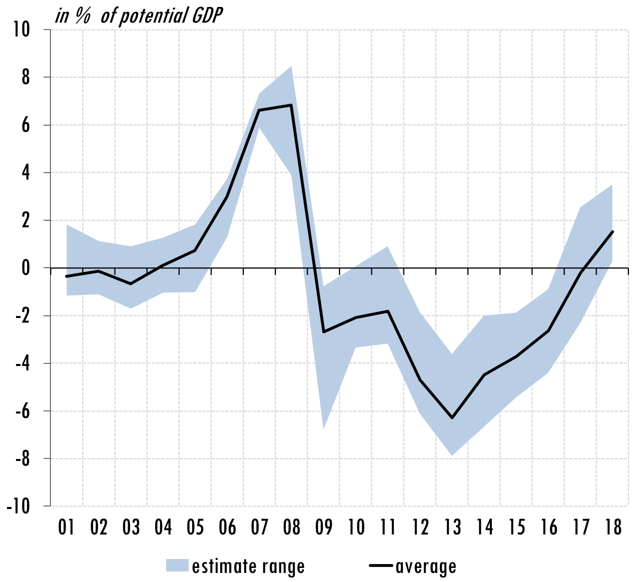
[2] In addition to the assessments of five institutions, the Fiscal Council also uses four statistical methods to estimate output gap. The Fiscal Council started to use the latter in April last year when it drew up its assessment of the 2018 stability programme. For more details on the output gap calculations used by the Fiscal Council, see the Report on the Fiscal Council's operations in 2017, pages 23-26 (May 2018).

Figure 1.3: Output gap estimates for 2018 available at time of preparation of budget documents



*Sources: IMAD, EC, OECD, IMF, MoF, FC. Note: *FC uses a wider set of output gap estimates since assessing SP2018.*

Figure 1.4: Output gap estimates



Sources: IMAD, EC, OECD, IMF, MoF, FC calculations.

should be noted that the output gap estimates differ because of different methodologies and input data; furthermore, they significantly change over time (see Figure 1.3). As regards the estimate for 2018, the OECD forecast stands out in terms of variability; the EC assessment – according to which the Slovenian economy was expected to significantly overheat – indicated the highest average output gap in the period from April 2017.[3] In view of the uncertainty and variability of the output gap estimates, the Fiscal Council monitors a broader set of indicators in order to determine the state of the economic cycle.[4] Last year the values of most indicators diverged from the peak values recorded in the period of economic recovery from the beginning of 2014; accordingly, we assess that the cyclical momentum is gradually slowing. This is primarily indicated by economic growth, employment and sentiment indicators and, to a lesser extent, also by production capacity utilisation rate. Last year, supply-side constraints intensified in the labour market, as indicated by the trend in the number of unemployed persons (total and short-term), and to some extent by wage trends.

1.2 Fiscal trends - general government sector (ESA)

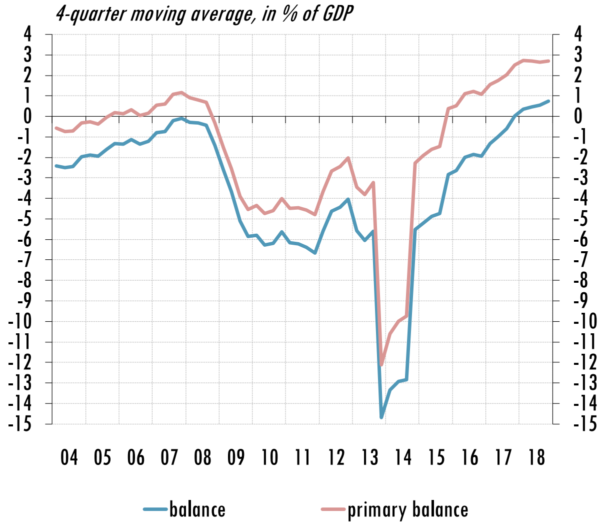
Last year, the general government balance surplus increased as a result of favourable economic conditions and further reduction in interest expenditure. The general government sector recorded a surplus of 0.7% of GDP and increased year-on-year by approximately EUR 300 million or 0.7 p. p. of GDP.[5] The increase in the primary balance surplus that excludes interest expenditure (by 0.2 p.p. to 2.7% of GDP) was lower, which points to the importance of further reducing interest expenditure in order to improve public finances. The improvement in the balance was the result of continued high revenue growth (6.6%) linked to a persistently high but more broadly based economic growth and improved labour market conditions. Last year, expenditure growth strengthened significantly (4.8%)

[3] The average of all EC estimates for 2018 produced in the period from April 2017 to May this year stands at 2.8%. The EC defines good times as the period in which the output gap is equal to or above 1.5%; this definition is used when determining the required structural effort expected from a country that falls short of the medium-term budgetary objective (Vade Mecum on the Stability and Growth Pact 2019, pp. 16-17, April 2019).

[4] This analysis does not include the prices of residential property. Errors detected in the process of calculation of the residential property price index led SURS to withdraw the data published for 2018; the correction is expected to be published on 21 June 2019.

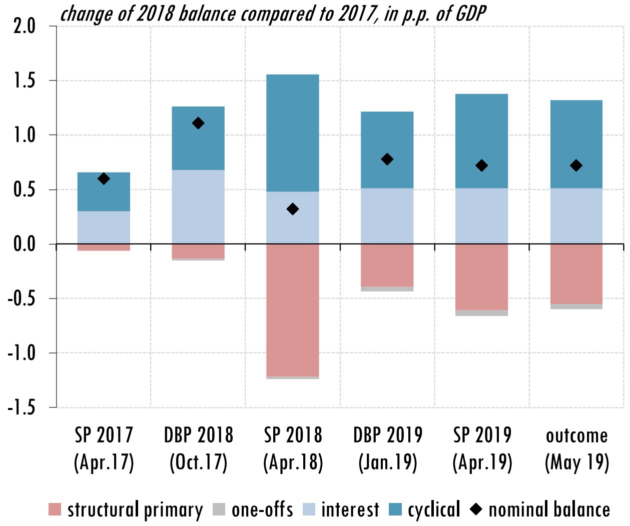
[5] This is approximately half of the improvement recorded in the general government balance in 2017 or in the 2015-2017 period average.

Figure 1.5: General government balance and primary balance



Source: SORS, FC calculations.

Figure 1.6: Changes to 2018 general governement balance forecast

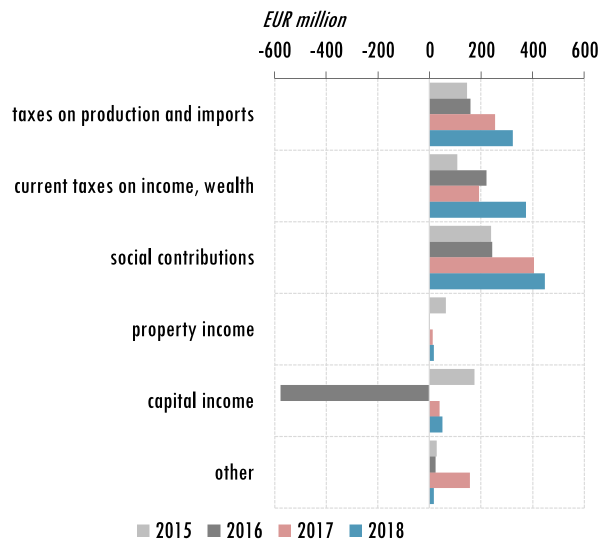


Source: forecasts: MoF, outcome: SORS. FC calculations. Note: decrease of interest expenditure is reflected in improved balance.

and was the highest since 2009.[6] A higher increase than in the previous year was primarily recorded in investment expenditure, intermediate consumption and subsidies. A review of the general government sub-balances indicates that the improvement of the general government balance in 2018 was mainly driven by the central government sector, which recorded the first surplus (0.9% BDP) to date. The local government balance deteriorated for the third consecutive year and moved into a slight deficit; the social security funds position also deteriorated slightly but was in balance.

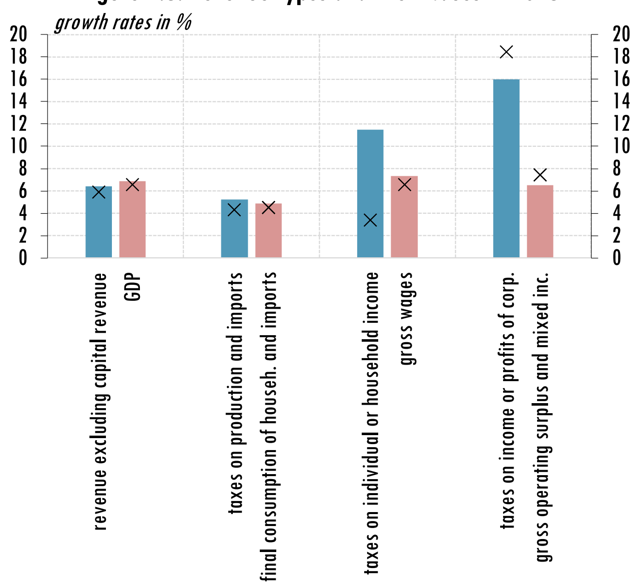
Favourable conditions in the economy and the labour market continued in 2018 and resulted in the general government revenue growth comparable to the previous year. Growth again stemmed primarily from revenue from taxes and social contributions. Compared to the previous year, a stronger increase was recorded particularly in revenues from taxes on individual or household income– which was linked to a stronger increase in wages coupled with continued increased employment – and

Figure 1.7: Year-on-year change of the components of general government revenue



Source: SORS, FC calculations.

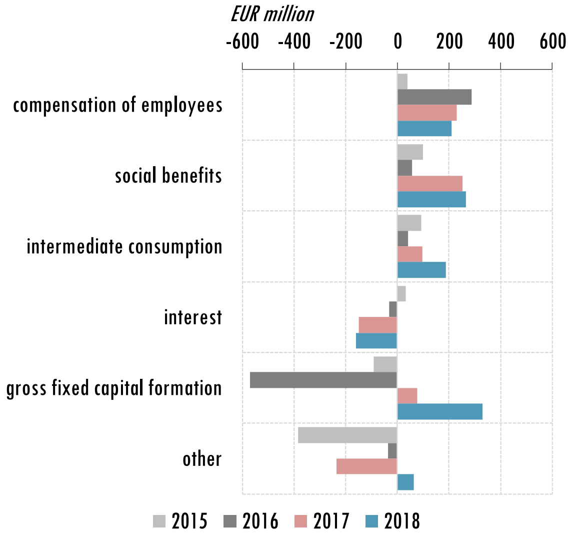
Figure 1.8: Revenue types and their bases in 2018



Note: Crosses denote growth rates in 2017.
Source: SORS, FC calculations.

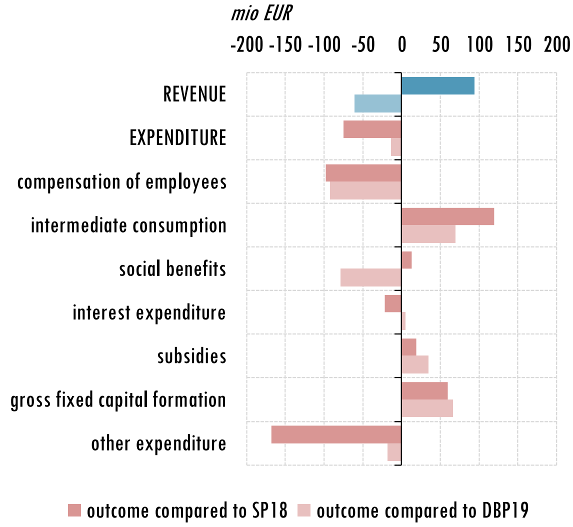
[6] Without taking into account other capital transfers that resulted in exceptionally high growth of total expenditure in the context of the recovery of the banking system in 2013.

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



Source: SORS.

Figure 1.10: Actual outcome compared to SP18 and DBP19



Source: SORS, forecast MoF: SP18 (Apr. 18) in DBP19 (Jan.19); FC calculations.

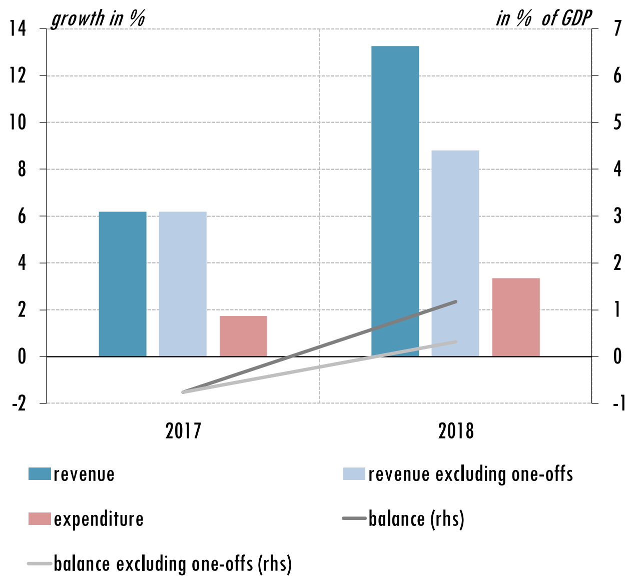
revenue from VAT. The growth in revenue from taxes on the income or profits of corporations continued to be high due to good business performance. In other revenue groups an increase was recorded in property income revenue resulting from major dividend payments by state-owned companies. The increase in revenue from other capital transfers was similar to that recorded in the previous year (by approximately 25%) and remained to be low.

Expenditure increase strengthened significantly last year in conjunction with accelerated growth in investment and also intermediate consumption. Investment expenditure increased by approximately one quarter, which is also linked to elections and slightly increased absorption of EU funds. Intermediate consumption increased by 7.0% last year to reach the highest growth since 2011 and the highest share in total expenditure to date. Coupled with the absorption of EU funds, expenditure on subsidies (8.6%) also increased significantly. The increase in social transfers and compensation of employees was similar to that recorded in the previous year. The general government sector saw a 1.9% increase in employment or 3,241 new employees; the highest increase was again recorded in health (3.2%) and education (2.4%). The increase in compensation of employees per employee was caused by regular promotions at the end of 2017 and the agreement to tackle wage anomalies up to the 26th wage grade. Although its growth slowed down further but mainly due to the resignation of the government in March last year that postponed the agreement with the trade unions to December. The increase in wages has thus been postponed to 2019 and subsequent years. Interest expenditure again recorded a significant decrease (-15.0%) triggered by favourable situation in the financial markets as well as effective debt management. Following its continued decrease, the share of interest expenditure in GDP fell to the 2012 level (2.0%).

1.3 Fiscal trends – public finance budgets (GFS)

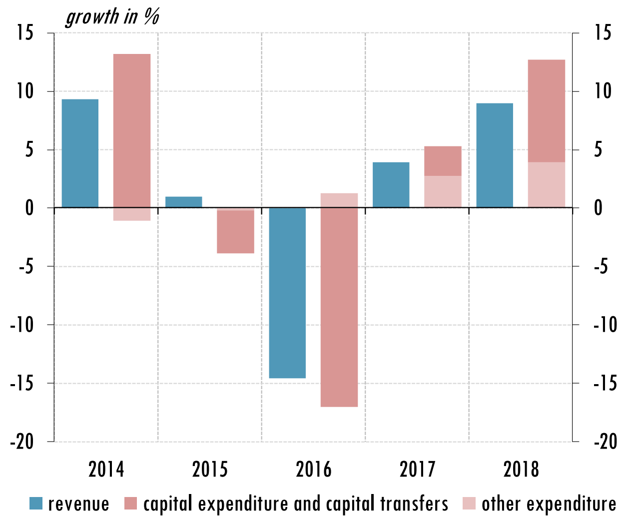
The state budget recorded a surplus of EUR 537 million (1.2% of GDP) in 2018, largely due to two one-offs and favourable economic conditions. Last year, the state budget received the outstanding EU funds under the previous financial perspective in the amount of EUR 205 million and NLB dividend

Figure 1.11: State budget revenue and expenditure



Source: MoF, FC calculations.

Figure 1.12: Revenue and expenditure of local government



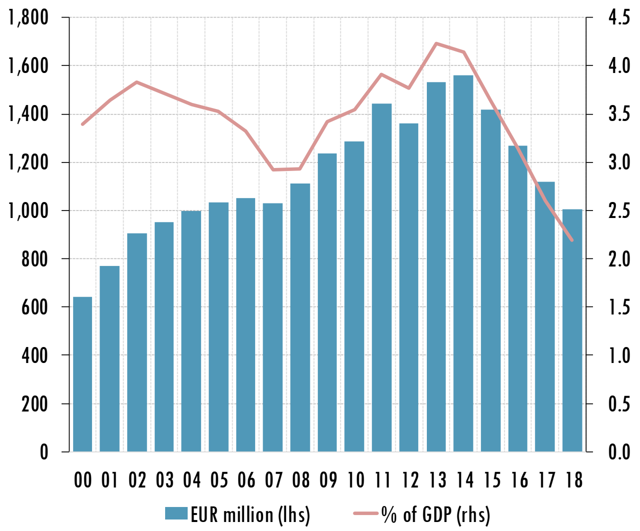
Source: MoF, FC calculations.

in the amount of EUR 260 million also linked to the retained earnings of the preceding year (EUR 189 million). If the two one-offs (in the case of NLB dividend including only retained earnings) are not taken into account, the state budget surplus would only amount to EUR 143 million or 0.3% of GDP. If the aforementioned one-offs are considered, revenue increased by 13.3%; if they are excluded, it increased by 8.8%, which is still higher than in the previous year. Continued favourable economic conditions resulted in a significant increase in all relevant tax revenues except in excise duties.[7] Favourable labour market situation led to a higher increase in revenue from personal income tax, while the increase in revenue from VAT remained similar to that of the previous year. The absorption of EU funds improved even if the one-off factor is not taken into account. Expenditure growth (3.4%) was twice that which was recorded in the previous year, mainly due to the trends at the end of the year. Investment expenditure and transfers increased by 35.8% and contributed most to the overall growth. As compared to the previous year, expenditure on goods and services recorded a substantial increase primarily attributable to the cost for the modernisation of military equipment. The increase in wages, transfers to individuals and households and subsidies was slightly lower than in the previous year; interest expenditure again decreased by approximately one tenth.

For the first time since 2014, local government budget balances recorded a deficit last year; in our view, this was also linked to local elections. Compared to the previous year, the balance deteriorated by EUR 70 million and the deficit amounted to EUR 44 million. Expenditure growth strengthened significantly compared to the previous year (from 5.3% to 12.7%) due to accelerated investment activities of municipalities. Higher expenditure for new construction, reconstructions, alterations and routine maintenance contributed most to the increased expenditure growth. In addition, revenue growth exceeded that in the previous year (from 3.9% to 9.0%) which, over and above the increased revenue from personal income tax, was primarily due to higher revenues of one-off nature (revenue from the sales of buildings and premises, other extraordinary non-tax revenue, funds received from the national budget intended for investments).

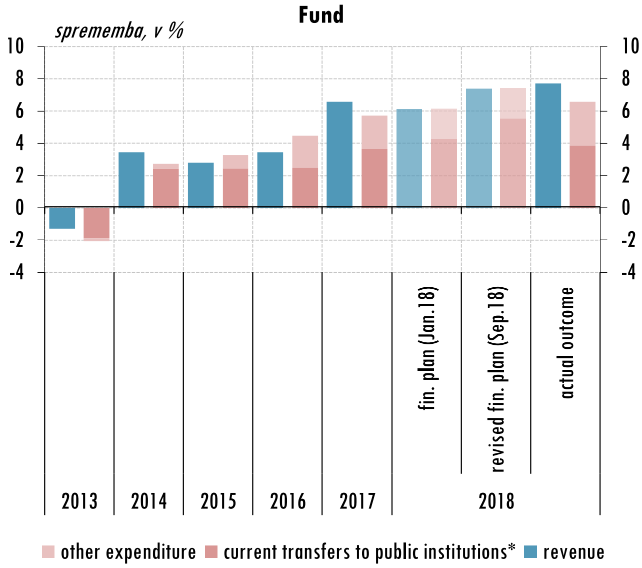
[7] In addition to the reduction in quantities sold, a further decrease in excise duty revenue was also affected by May's reduction in excise duties on energy products.

Figure 1.13: Pension Insurance Fund - state budget funding



Source: Pension Insurance Fund (ZPIZ), FC calculations.

Figure 1.14: Revenue and expenditure of the Health Insurance Fund



*Note: *salaries, wages and other personnel expenditure, goods and services, medicinal products. Source: MoF, Health Insurance Fund (ZZZS), FC calculations.*

Last year's growth in revenue and expenditure of the pension insurance fund has been the highest since 2009. The increased growth in revenue of the pension insurance fund (3.5%) was mainly due to the favourable labour market situation and the associated higher revenue from social contributions, which exceeded the financial plan forecast.[8] Funds received from the state budget decreased again (-9.7%), but less than the previous year given that the increase in pensions triggered a double increase in the pension insurance fund expenditure compared to 2017. The year-on-year increase in pensions was 3.0% [9] and the total amount of pension payments increased by 3.6% – the highest growth since 2010. Lower than expected growth resulted from the lower growth of the average number of pension beneficiaries (0.4%). The continued relatively high increase in the number of insured persons resulted in a more favourable ratio between insured persons and pensioners, standing at 1.52 as compared to the lowest ratio of 1.38 in 2013. It should be noted that despite last year's further decrease in the amounts received by the pension insurance fund from the state budget to cover the difference[10] between the fund's revenue and expenditure, the aforementioned amounts stood at approximately EUR 840 million or one quarter more than in the pre-crisis years.[11]

Given a more substantial increase in revenue over expenditure growth, the health insurance fund recorded a surplus of EUR 31 million. Revenue growth increased from 6.6% in 2017 to 7.7% and was the highest since the onset of the crisis and slightly exceeded the revenue projected in the revised financial plan adopted last September.[12] The growth primarily stemmed from an increase in revenue from social contributions triggered by favourable labour market situation; transfer revenues from other

[8] The 2018 financial plan of the pension insurance fund was adopted on 21 December 2017; revenue projection was based on the 2017 autumn forecast by IMAD. The actual employment growth in 2018 was higher than expected at that time and was instrumental in increasing contributions above those projected in the financial plan.

[9] In accordance with the provisions of the ZPIZ-2, February pension indexation by 2.2% was made with effect from 1 January 2018; according to Article 65(1) of the ZIPRS1819, an extraordinary indexation of pensions and other benefits by 1.1% was made in April 2018.

[10] According to Article 162 of the ZPIZ-2, the Republic of Slovenia provides funds from the state budget and other sources to cover the differences between the revenue of the pension insurance fund from contributions and other sources and its expenditure.

[11] Last year, the state budget transfers under Article 162 of the ZPIZ-2 amounted to 1.8% of GDP and represented one of the smallest shares in the past two decades. Article 161 of the ZPIZ-2 also lays down that the national budget is required to fund particular types of pension; last year, that funding amounted to 0.4% of GDP.

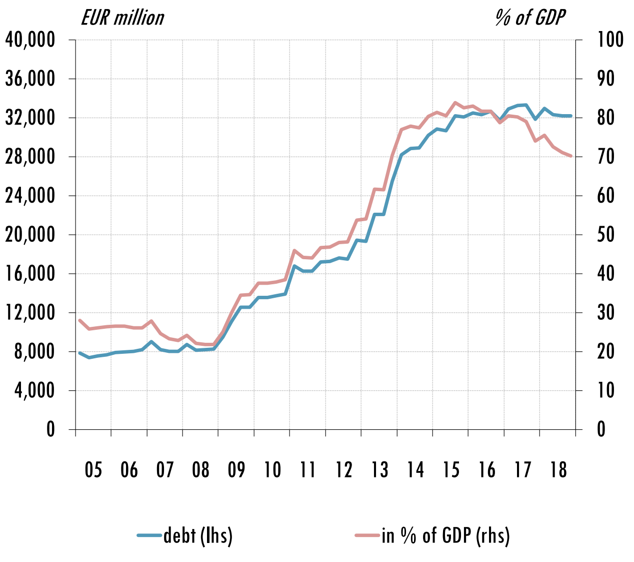
[12] The revised financial plan of the health insurance fund was adopted in September 2018, after the Government of the Republic of Slovenia proposed the Amendment to the framework for drafting the general government sector budgets for the 2018-2020 period and its adoption by the National Assembly in August. Compared to the financial plan adopted in January 2018, EUR 35 million increase in revenue was envisaged.

public financial institutions also recorded a slight increase. Expenditure increased by 6.6% (5.7% in 2017). The higher growth than in the previous year was due to higher transfers to public institutions for salaries and other staff remuneration; the increase in transfers to public institutions for goods and services and for medicinal products was lower than in 2017. Total expenditure was below the level foreseen in the revised financial plan, according to which higher revenue were to be primarily used to reduce waiting periods. It should be noted that at the time of amending the Framework for drafting the budgets for the 2017-2019 period and the revising of the budget, the data about the waiting periods were already unreliable.[13]

1.4 General government debt

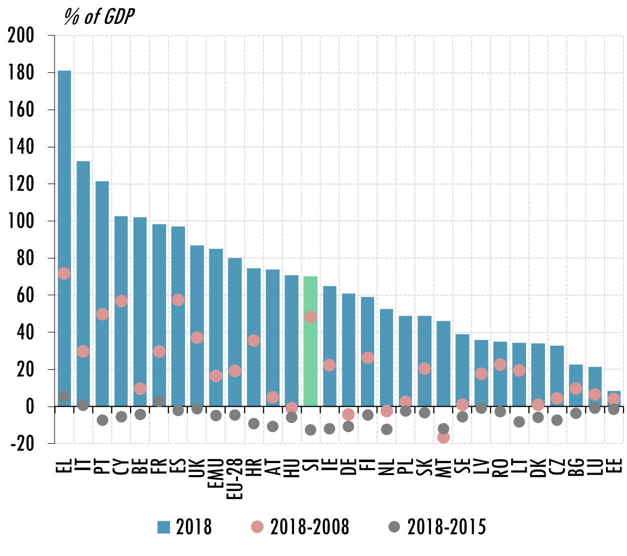
Gross general government debt increased by approximately EUR 370 million last year, while its share in GDP declined due to the high economic growth. At the end of last year, gross debt amounted to EUR 32.2 billion and constituted 70.1% of GDP, which is 4.0 percentage points less than in the previous year.[14] Despite its reduction, debt exceeded 60% of GDP, which implies more stringent requirements applicable to structural deficit reduction under the European budgetary rule when a country fails to achieve medium-term budgetary objective.[15] Following its highest level in 2015, debt reduction was the sharpest in the EU; but given its substantial increase in the initial years of the crisis, its level remains among the highest in the EU (ranked 12th).[16] Last year, total extent of borrowing amounted to EUR 3.3 billion, of which EUR 2.8 billion were earmarked to fund the budget or intended for pre-funding; the remainder was used for continued active debt management. The latter is linked to exchange of high return bonds issued in US dollars in the 2012-2014 period. Last year's borrowing

Figure 1.15: Consolidated gross debt of the general government



Source: SORS, FC calculations.

Figure 1.16: General government gross debt - EU countries



Sources: Eurostat, FC calculations.

[13] Analysis by D. Marušič, M. Kuhar, B. Simčič indicated that last August less than one-third of data on waiting periods was accurate (https://www.zdravstveniportal.si/zdravstvo/sistem/198/podatki-o-cakalnih-dobah).

[14] After three years of maintaining a similar level, the net government debt declined last year (gross debt minus financial assets invested in the form of cash and deposits, debt securities and loans) by EUR 1.2 billion to 46.0% of GDP. This was mainly due to the increase in financial assets invested in the form of cash and deposits.

[15] In line with the requirements of the Stability and Growth Pact and given the same cyclical position, the countries with debt above 60% of GDP are required to make a greater structural effort (Vade Mecum on the Stability and Growth Pact 2019, p. 17, April 2019).

[16] Between 2008 and 2018, Slovenia experienced the fifth highest increase of the share of debt in GDP in the EU (Greece, Spain, Cyprus and Portugal).

was made in favourable financial market situation. The required yield on Slovenia's 10-year bonds lowered further (from 1.14% average in 2017 to 1.09%), as was the case with the implicit interest rate on total debt that declined by an additional 0.5 percentage points to stand at 2.9% last year. The average term to maturity remained similar to the previous year (9.2 years); the average for developed countries stands at 7.6 years.[17]

[17] IMF Fiscal Monitor 2019, p. 105, April 2019.

2. Compliance with the fiscal rules in 2018

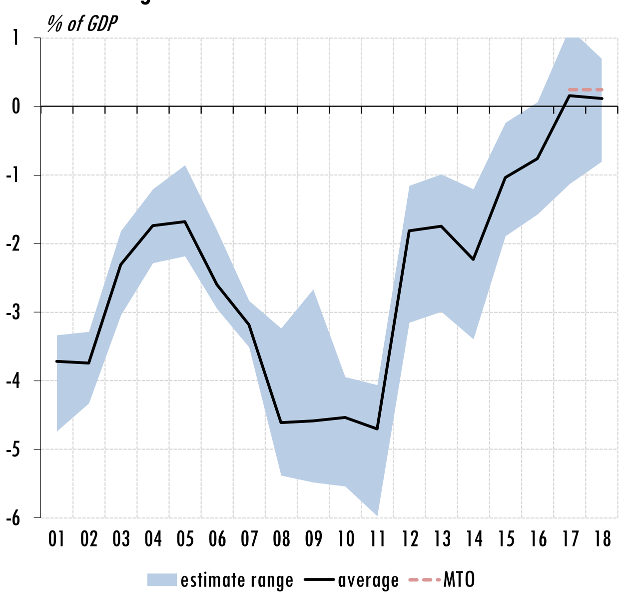
In its Assessment of compliance of the implemented budgets of the general government sector with the fiscal rules in 2018, the Fiscal Council verifies whether: (i) the medium-term budgetary objective was achieved and other requirements under the EU complied with; (ii) the medium-term balance of public finance as defined by the ZFisP was ensured; and (iii) the implementation of the national fiscal rule defined in Article 3 of the ZFisP regarding the maximum level of expenditures was achieved. In 2018, Slovenia had to continue to comply with the rule on the reduction of the general government debt applicable for three years after the general government deficit falls below 3% of GDP, which happened in Slovenia in 2015.

The Fiscal Council assesses that the medium-term budgetary objective was achieved in 2018, but only if the permitted deviation is considered. The Fiscal Council is of the view that it is not yet possible to determine whether in 2018 the two conditions regarding the medium-term balance were met. The national rule applicable to general government expenditure was not complied with in the previous year, given that the level of total general government expenditure exceeded the ceiling set in the Framework. Expenditure was nevertheless below the maximum level calculated on the basis of currently known revenue data and estimates of the cyclical position of the economy. Expenditures of individual public finance budgets calculated using the cash flow methodology were below the maximum permitted level of expenditure, except for local government budget expenditures. Growth in net general government expenditure under the SGP expenditure rule did not diverge significantly from the projected; the permitted growth estimate increased, primarily because the current figures and estimates indicate that no structural effort was required last year. General government debt decrease was also appropriate.

2.1. Achievement of medium-term budgetary objective

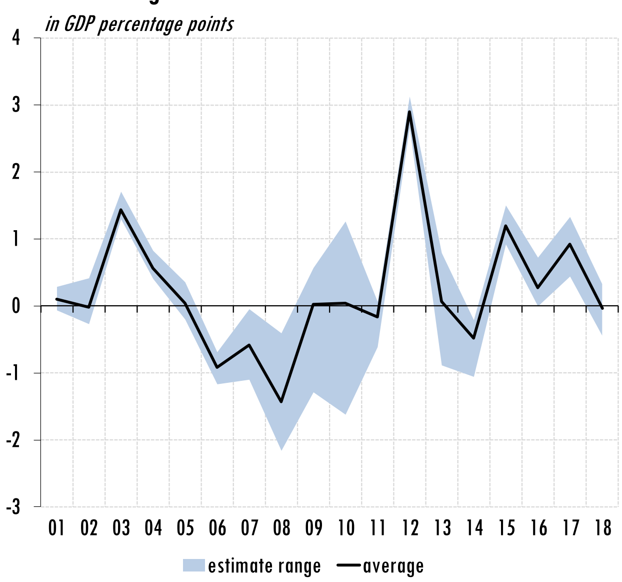
The Fiscal Council is of the view that within the deviations permitted Slovenia attained the medium-term budgetary objective under EU rules in 2018 – but only if the deviations permitted are taken into account. The medium-term budgetary objective (MTO) for Slovenia in the 2017-2019

Figure 2.1: Structural balance estimates



Sources: IMAD, EC, OECD, IMF, MoF, FC calculations.

Figure 2.2: Structural effort estimates



Source: IMAD, EC, OECD, IMF, MoF, FC calculations.

period set under EU rules[18] requires a structural surplus of at least 0.25% of GDP. The structural balance estimates may also diverge due to different output gap estimates. Current structural balance estimates that were considered in the production of assessments of compliance of the general government budgets with fiscal rules range from -0.8% of GDP to 0.7% of GDP for 2018.[19] Assessments based on the current average output gap calculation show that last year the structural balance was in surplus of approximately 0.1% of GDP for the second consecutive year. After three years of structural efforts, this means that last year the fiscal policy was neutral; account taken of the deviation permitted,[20] Slovenia complied with the MTO in 2018. Last year the surplus in the primary structural balance was recorded for the seventh consecutive year. Still, compared to 2017, currently assessed to stood at 2.7% of GDP, it fell by more than half a percentage point of GDP, i.e. to 2.1% of GDP.

2.2. Compliance with the national fiscal rule – medium-term balance

In addition to achieving the medium-term objective, the medium-term balance under the SGP rules also implies that at least a balanced structural position is achieved over the entire economic cycle. Article 3(1) of the ZFisP defines that the medium-term balance is achieved if the structural balance of the general government sector in an individual year is not lower than the minimum value as defined in the SGP and in the medium term is at least in balanced or in surplus position. Point 5 of Article 2 of the ZFisP defines medium term as a business cycle in which the actual level of GDP shifts from a level that is above the potential level of GDP to a level below and is on average equal to the potential level of GDP. Indeed, vice versa also applies: the medium term can also be defined as a period of business cycle in which the actual level of GDP shifts from a level that is below to a level above the potential level of GDP and is on average equal to the potential level of GDP.[21]

The Fiscal Council is of the view that it is not yet possible to determine whether in 2018 both conditions regarding the medium-term balance were met. The Fiscal Council assesses that, given a slight structural balance surplus of 0.1% of GDP in 2018, the minimum value of the MTO for 2018 defined by the SGP was reached within the permitted deviation. Considering the deviation permitted, the first condition required under the definition of the medium-term balance was met. On the other hand, the currently available output gap estimates do not enable medium term as defined by the ZFisP to be determined. Slovenia exited the excessive deficit procedure as late as in 2015. Bearing in mind the currently available output gap estimates, the economic cycle did not end by 2018. This was mainly due to a large decrease in GDP and consequent significant negative output gap in the double dip crisis. Taking into account an eight-year economic cycle up to and including 2018, the available estimates assess the cumulative sum of structural deficits of the general government to amount to approximately 12 p.p. of GDP. In each of the three years that follow the exit from the excessive deficit procedure, Slovenia would have had to decrease its structural deficit by 4 p.p. of GDP or generate a higher structural surplus in order for the structural balance to be deemed balanced in the

[18] Regulation EC 1466/97.

[19] In producing its estimates, the Fiscal Council uses the estimates of five institutions and four statistical methods of output gap assessment. The Fiscal Council started using these four methods in April last year when it drew up its assessment of the 2018 stability programme. For more details on the output gap calculations used by the Fiscal Council, see the Report on the Fiscal Council's operations in 2017, pages 23-26 (May 2018).

[20] Due to uncertainties linked with the output gap assessment, the EC allows a deviation of up to 0.25% of GDP in respect of the medium-term budgetary objective (see Vade Mecum on the Stability and Growth Pact, 2019, p. 15; April 19).

[21] For purposes of economic analysis, both definitions indicate the period in which the sum of the output gap estimate deviations from the balanced position in the sequence of the indicated two phases of the economic cycle to the selected year amounts to 0.

medium term already in 2018.[22] The period up to 2018 was thus too short to make it rational in economic terms to require the achievement of compliance with the medium-term balance rule.

2.3. Compliance with the national fiscal rule – maximum level of expenditure

The Framework relevant for the current assessment of compliance with the national fiscal rule and also referring to 2018 (the 2017-2019 period) was last amended in December 2018.[23] The Ordinance on a framework for the general government budgets sets a maximum permitted level of general government sector expenditure and a target balance. The level must be in accordance with ESA methodology; the maximum level of expenditure and the target balance for the state budget, the health insurance budget, the pension insurance budget, and the local government budgets are set according to GFS methodology. The Ordinance on a framework related to 2018 was adopted by the Government of the Republic of Slovenia in April 2016 and subsequently amended on four occasions, whereby the maximum permitted level of general government expenditure for 2018 was amended two times (in May and November 2017). On the proposal of the Government[24] and in spite of the negative opinion of the Fiscal Council[25] the Ordinance on a framework was further amended in August

Table 2.1: Adopted Frameworks for the preparation of general government budgets and expenditure outcome for 2018

	general government ESA, EUR million	state budget GFS, EUR million	local governments GFS, EUR million	pension fund (ZPIZ) GFS, EUR million	health fund (ZZZS) GFS, EUR million	*GDP (IMAD) EUR million*
Framework Apr. 2016, UL 30/2016	18,537	9,573	2,117	5,246	2,638	*41,880*
Framework, Nov. 2016, UL 74/2016	18,537	9,573	2,117	5,246	2,687	*42,885*
Framework May 2017, UL 21/2017	19,158	9,575	2,174	5,381	2,827	*43,696*
Framework, Nov. 2017, UL 65/2017	19,290	9,625	2,174	5,381	2,847	*45,265*
Framework, Aug. 2018, UL 57/2018	19,290	9,625	2,174	5,381	2,873	*46,588*
Framework, Dec. 2018, UL 82/2018	19,290	9,625	2,174	5,381	2,873	*45,742*
Actual outcome	19,464	9,463	2,198	5,295	2,859	*45,948*
Framework, Dec. 2018 - Framework, Apr. 2016	753	52	57	135	235	*3,862*
Actual outcome - Framework, Dec. 2018	**174**	**-162**	**24**	**-86**	**-14**	***205***

Note: Red denotes change to the Framework.

Source: Official Gazette of the Republic of Slovenia (UL), FC calculations.

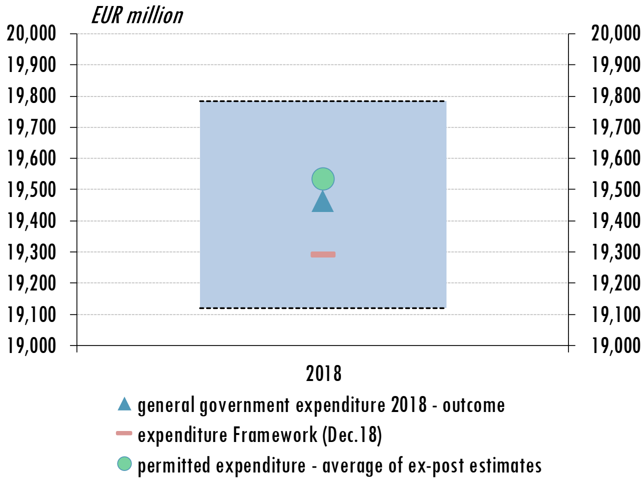
[22] If the assumption on the economic cycle duration is reduced to seven or six years, the corresponding reduction in the above-defined structural deficit or increase in the surplus would amount to 2.5 or 2 p.p. of GDP respectively.

[23] The Ordinance amending the Ordinance on a framework for the preparation of the general government budget for the 2018-2020 period (Official Gazette of the Republic of Slovenia [*Uradni list RS*] No. 82/2018). This Framework only amended the parameters for 2019.

[24] The Government of the Republic of Slovenia drafted the proposed amendment to the Framework on the basis of the disclosed semi-annual accounts of the Health Insurance Institute, the requirements of the Health Insurance Institute's management board and the wider professional public and in view of the health policy priorities, i.e. the reduction of patient waiting lists, though at the time the proposal was drafted no distribution of the additional funds was clearly defined. The proposed amendment to the Framework is available at: https://imss.dz-rs.si/imis/74a108cc8d0e4847b911.pdf

[25] Following the Government's proposed amendment to the Ordinance on the framework, the Fiscal Council responded in August 2018 and assessed that the proposal was not in compliance with the ZFisP. This assessment was based on the fact that neither the political and macroeconomic context nor the healthcare situation changed in the period between the drafting of the 2018 Stability Programme – that provides for the amendments to the Framework under the ZFisP – and the drafting of the proposed amendment to the Framework. The Fiscal Council noted that other budgetary documents – and resulting adjustment of the overall Framework – were not drafted based on circumstances that changed from autumn 2017, i.e. did not take these changed circumstances into account. The proposed amendment to the Ordinance on the framework failed to explain the unchanged total amount of general government expenditure given the increased maximum level of expenditure of the Health Insurance Institute; the Fiscal Council was of the opinion that the proposed increased maximum level of expenditure of the Health Insurance Institute was not in compliance with the provisions of the ZFisP referring to potential use of surpluses of the institutional units of the general government sector. The assessment of the Fiscal Council is available at:
http://www.fs-rs.si/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/

Figure 2.3: Maximum permitted expenditure general



Note: The blue field denotes the zone between the lowest and highest calculated maximum permitted expenditure based on currently available data.
Sources: SORS, MoF, FC calculations.

2018 to increase the maximum permitted expenditure level of the health insurance fund for 2018. In the five Frameworks that included 2018 and were adopted following that of April 2016, these levels changed most frequently and also most substantially in relative terms. Frequent changes of the Framework distort the medium-term budgetary planning purpose as compliance with the Framework is in principle a formal guidance for conducting countercyclical fiscal policy. Changes to the Framework of the health insurance fund budget may be driven by a number of factors, including uncertainties or planning errors arising from changed demographic and health situation, or the lack of health expenditure control.

In 2018, general government sector expenditure exceeded the maximum permitted level under the applicable Framework for the drafting of the budgets. In 2018, general government sector expenditure was EUR 174 million above the level permitted in the applicable Framework for 2018 as set in December 2018; due to macroeconomic results revenue was significantly higher. Thus, the surplus of 0.7% GDP was higher than the target surplus of 0.4% GDP set in the Framework. The state budget expenditure, expenditure of the pension and of the health fund budgets were lower, while the total expenditure of local government was slightly above the maximum level permitted in the Framework of December 2018. The sum of the expenditures of the abovementioned four budgets was below the maximum permitted level set for these four budgets. In part, these differences can be attributed to methodological differences and in part they result from revenue and expenditure trends in general government sector units not under a direct supervision of the Ministry of Finance or the Government.

In 2018, general government expenditure did not surpass the limit set subject to the currently available data, even if the ceiling set in the Framework was exceeded. This finding is based on an *ex post* assessment that takes into account the current figures on the 2018 revenue and the recent assessment of the cyclical position of the economy, which differ from those available at the time of drafting the Framework. The maximum level of expenditure is calculated on the basis of the formula referred to in Article 3(4) of the ZFisP, taking into account one-off effects of 0.1% of GDP. In 2018, the general government sector revenue exceeded the implicitly assumed amount[26] indicated in the last adopted Framework by approximately EUR 370 million. The assessments of the cyclical position of the

[26] Only the level of expenditure and the target balance share in GDP are explicitly defined in the Framework. This data provide for the calculation of assumed revenue level.

economy were obtained on the basis of a broader set of currently available output gap estimates, which have not changed significantly since December 2018, as the positive output gap estimate only decreased by 0.1 p.p. of GDP. Expenditure was below the average expenditure threshold (though in its close proximity) set on the basis of the currently available data on revenue in 2018 and the set of output gap estimates. It should be noted that the Framework adopted by in the National Assembly is in principle a mechanism for conducting countercyclical fiscal policy. If revenue growth is higher than expected at the time the Framework was drafted, the general government balance should be higher than that targeted in the Framework. If economic growth is lower, the opposite also applies: if revenue growth falls behind that expected at the time the Framework was drafted, the fiscal policy could act stimulatively and be countercyclical if expenditure set in the Framework is taken into account.

2.4. Compliance with the EU expenditure rule

According to the currently available data, the growth of net expenditure fell behind the permitted growth as well as behind the medium-term growth of potential output in 2018. In the framework of the expenditure rule some types of expenditure that are not directly impacted by the fiscal policy are excluded from the calculation of the relevant expenditure growth.[27] Net expenditure growth may not exceed the average 10-year potential output growth. For countries that do not meet the medium-term objective, expenditure growth must be even lower and adjusted by a convergence margin that ensures the expenditure rule is harmonised with the required adjustment of the structural balance. When determining the permitted expenditure growth in a particular year under the SGP expenditure rule, the assumptions available in the spring of the previous year are applied, i.e. data available in spring 2017 are used for 2018. In producing the assessment of compliance with the rule for 2018, we also made a calculation with the latest available data that are taken into account in the expenditure rule calculation. If the calculation is made with data available when the SPU 2018 estimate was produced, the growth of net expenditure exceeds that permitted by the rule, while in the case of calculation made with the currently available data, the growth is below that permitted by the rule. The actual growth in net expenditure did not deviate significantly from the SPU 2018 (it was 0.2 p.p. higher and stood at 3.5%), while the permitted growth increased considerably. The higher permitted growth was most strongly impacted by a different assessment of the level of the structural balance in 2017. According to the currently available data, no structural effort was required last year; according to the data available in spring 2017, the effort of 1.0% GDP was required because the structural balance in 2017 was assessed to deviate from the medium-term budgetary objective. Currently data on the GDP deflator and medium-term potential GDP growth estimates[28] are also slightly above the 2017 spring estimates.

[27] Interest payments, the cyclical component of unemployment benefits and expenditure resulting from EU funds are excluded. Given that government investments can vary considerably from year to year, the calculation takes into account the four-year average of investment expenditure, excluding received EU funds earmarked for investment spending. For more details on the expenditure rule see Vade Mecum on the Stability and Growth Pact 2018, p. 47-53 (March 2018).

[28] According to the expenditure rule, a 10-year average of the medium-term rate of potential GDP growth is used, taking into account the period of five years preceding the year of the analysis and four years following that year. IMAD's calculations of potential GDP growth are used as these are the only available estimates that cover the entire period to be taken into account in calculating the expenditure rule.

2.5. Compliance with the general government debt rule

Slovenia complied with the specific rules of the Fiscal Pact regarding debt reduction in 2018. These rules apply three years after the EDP for a state is abrogated. In Slovenia's case, the three-year transitional period covers 2016-2018, as the general government deficit fell below 3% of GDP in 2015. Debt reduction is to allow for a structural adjustment so that after the expiry of the transitional period the debt reduction rules under the preventive arm of the Stability and Growth Pact can be complied with. In the transitional period, the state must thus comply with the minimum linear structural adjustment.[29] This rule is defined on the basis of three indicators: (i) debt adjusted to the economic cycle; (ii) debt and its past trends; and (iii) debt and its future developments. The calculations show that Slovenia complied with the minimum structural adjustment in 2018, as its debt was below the maximum level of the three indicators used to assess the debt rule in the transitional period. After 2018, Slovenia is required to reduce general government debt following the yearly dynamics which in a three-year average corresponds to a 1/20 deviation in the debt level from the base-year level of 60% of GDP.

Table 2.2: Compliance with the debt rule in transition period for 2018

a) Maximum allowed cyclically adjusted debt	74.3
b) Maximum allowed debt (backward-looking benchmark)	76.5
c) Maximum allowed debt (forward-looking benchmark)	68.8
Maximum (a,b,c)	**76.5**
Debt in 2018	**70.1**

Source: SORS , FC calculations.

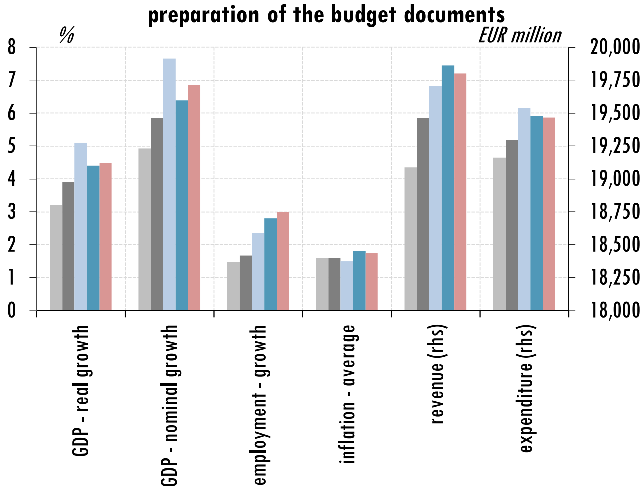
[29] Vade Mecum on the Stability and Growth Pact, 2019, Chapter 2.2.1.3, p. 49-50 (April 2019).

Annex 3.1: Changes in the macroeconomic and fiscal projections for 2018

Since spring 2017, the macroeconomic projections for 2018 have become more favourable, which has also been mirrored in the general government revenue projections. The macroeconomic projections required for the budgetary projections are independently produced by IMAD[30] in March and September following the publication of the national accounts statistics. Gradual improvements of the 2018 projections stemmed from a number of factors, primarily from a more significant increase in employment and higher growth in export and gross capital formation. A certain degree of deviation is noted in the last year's spring projection because of very favourable national accounts figures recorded in the last quarter of 2017 that led to a significant increase in export growth projections and consequent contribution of international trade balance; a significant improvement was also recorded in expected private consumption increase. The subsequent projection and data on turnover were slightly below that expected in spring last year. The higher macroeconomic projections were mirrored in general government sector revenue projections, primarily taxes and social contributions. Revenue projections were also increased last autumn on account of good business results of state-owned companies, also relaxed restrictions on the distribution of the NLB's retained earnings. On the contrary, other projections of revenue, primarily EU funds, reduced gradually and thus indicated their weak absorption more realistically.

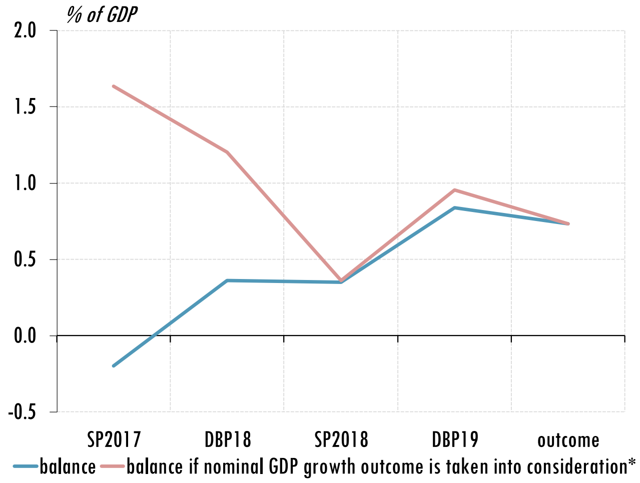
Improved general government revenue prospects were also mirrored in the higher expenditure projections; the actual growth structure differed considerably from what was projected. In 2018, the total expenditure growth did not significantly deviate from that foreseen in the budgetary documents adopted last year when the projection had increased significantly compared to documents adopted in 2017. Given the resignation of the government, last year's Stability Programme stands out because it was drawn up on a scenario that assumed unchanged policies. It envisaged that due to the planned relaxation of austerity measures increased compensation of employees would make a key contribution to total expenditure growth increase. The compensation of employees growth was in fact below the forecast, but the agreement signed with the trade unions in December only transferred the

Figure 3.1: Forecasts for 2018 available at the time of preparation of the budget documents



Sources: forecasts IMAD, MoF; actual outcome SORS.

Figure 3.2: General government balance in 2018 if budget documents took into account nominal GDP growth outcome



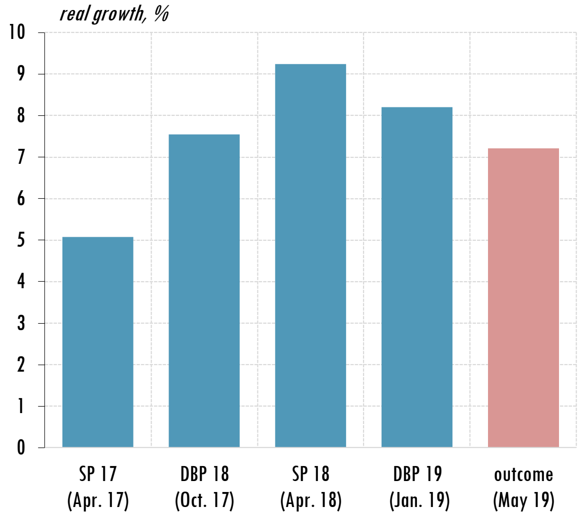
Note: Sum of actual general government balance in 2018 and the product of between elasticity of balance and the difference between forecast nd actual nominal GDP growth in 2018.
Source: SORS, forecasts MoF, IMAD; FC calculations.

[30] Article 9b of the Public Finance Act

increase to the current and subsequent years. The increases in intermediate consumption and subsidies were substantially higher than projected and thus contributed most to the fact that the total expenditure increase in 2018 did not deviate from the SPU 2018 projections.

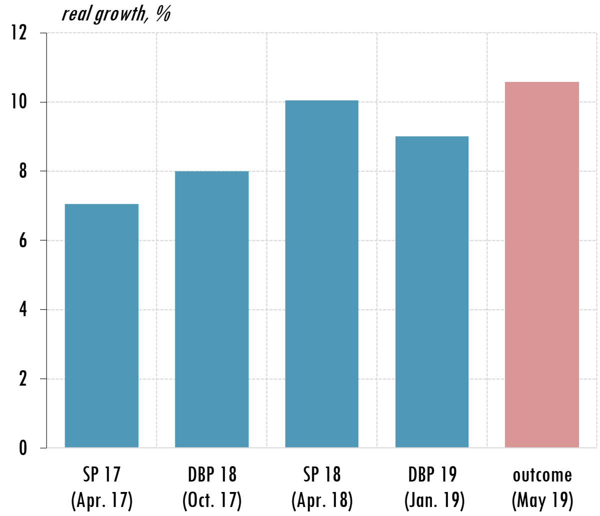
Fiscal policy was less restrictive than it would have been if no adjustment in expenditure to higher revenue had been made; nevertheless the general government balance improved. Even partial adjustments in expenditure to cyclically higher revenue were sufficient so that last year the balance of the general government sector was lower than it would have been in the absence of such adjustments. The Fiscal Council's calculations show that the general government surplus in 2018 would have been twice that actually generated if account had been taken of the difference between the currently available and projected increase in the nominal GDP for 2018, available when the SPU 2017 was drawn up. Replacement of certain increased expenditure – which was postponed to subsequent years – with concurrent increase in certain other expenditure that was substantially higher than projected, primarily intermediate consumption, is particularly controversial.

Figure 3.3: Changes in the 2018 forecast - exports of goods and services



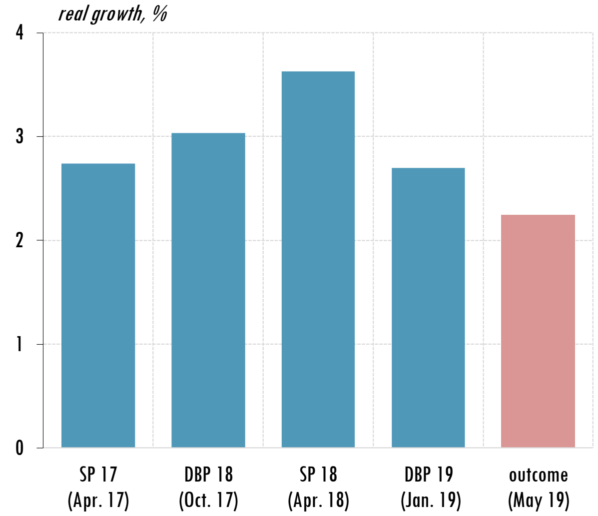
Source: SORS, forecasts IMAD.

Figure 3.4: Changes in the 2018 forecast - gross fixed capital formation



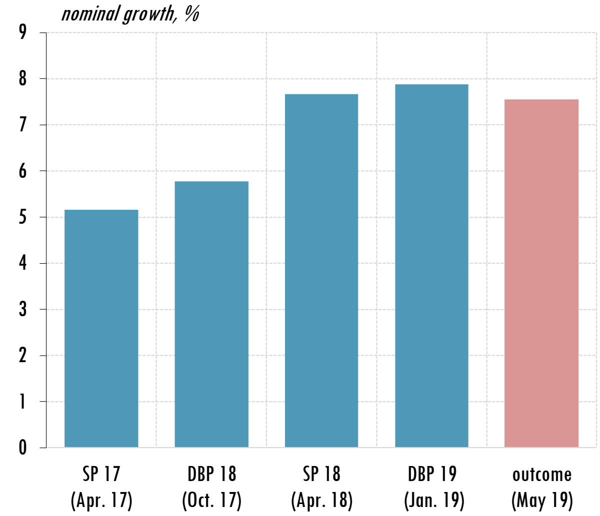
Source: SORS, forecasts IMAD.

Figure 3.5: Changes in the 2018 forecast - private consumption



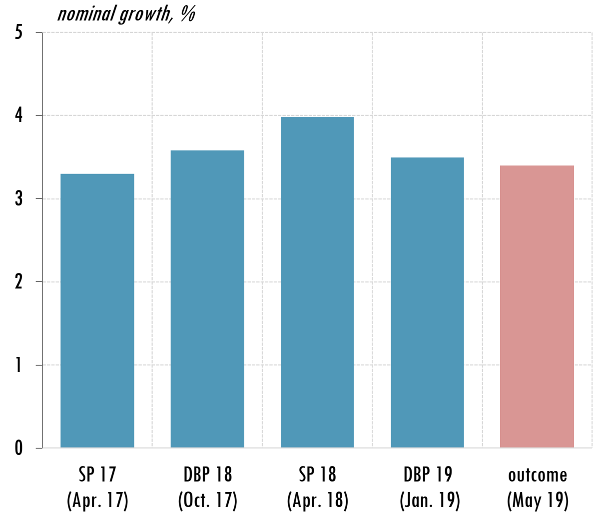
Source: SORS, forecasts IMAD.

Figure 3.6: Changes in the 2018 forecast - compensation of employees



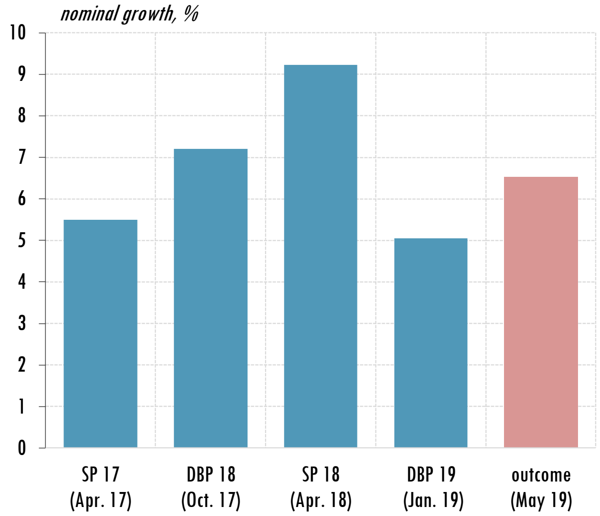
Source: SORS, forecasts IMAD.

Figure 3.7: Changes in the 2018 forecast - gross wages per employee



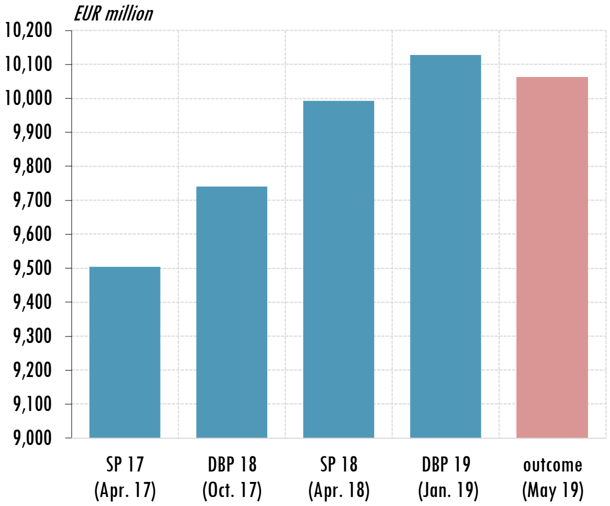
Source: SORS, forecasts IMAD.

Figure 3.8: Changes in the 2018 forecast - gross operating surplus/mixed income



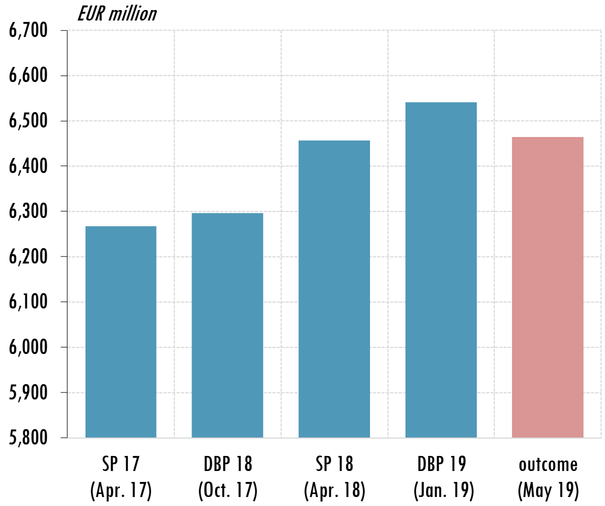
Source: SORS, forecasts IMAD.

Figure 3.9: Changes in the 2018 forecast - total taxes



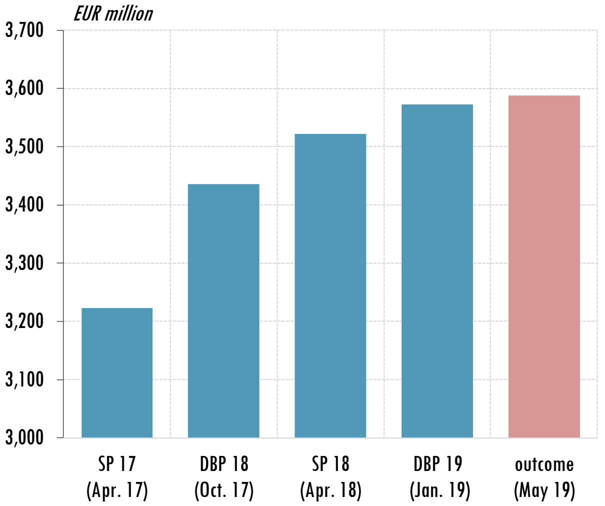
Source: SORS, forecasts MoF.

Figure 3.10: Changes in the 2018 forecast - taxes on production and imports



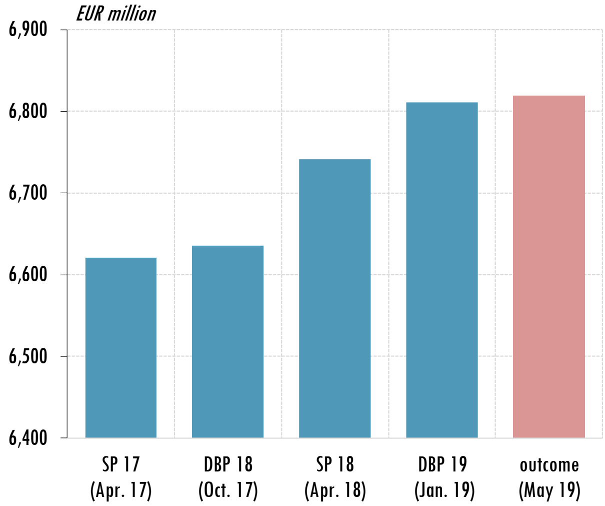
Source: SORS, forecasts MoF.

Figure 3.11: Changes in the 2018 forecast - current taxes on income and wealth



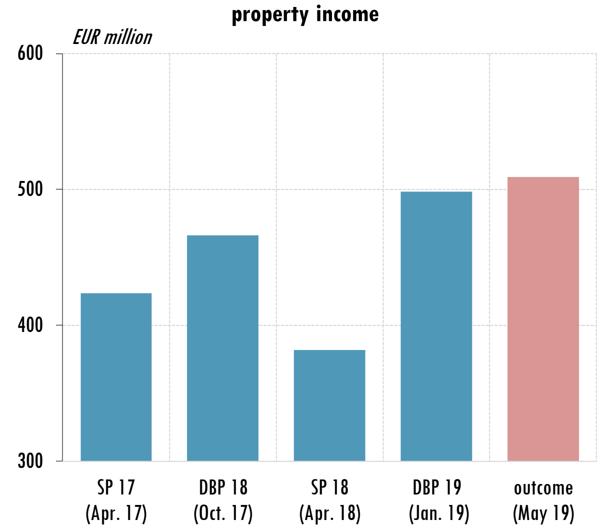
Source: SORS, forecasts MoF.

Figure 3.12: Changes in the 2018 forecast - social security contributions



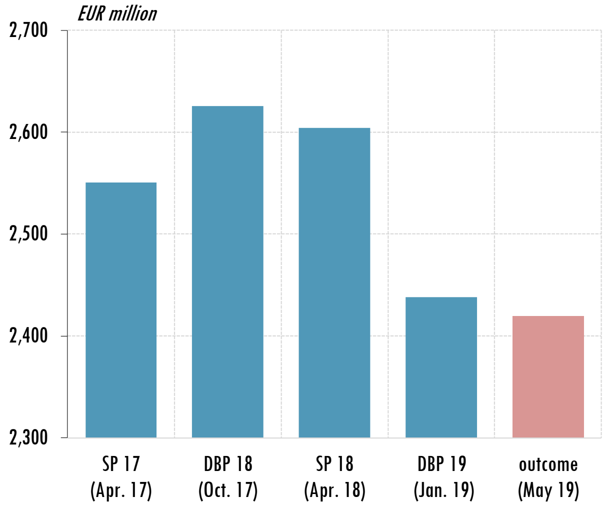
Source: SORS, forecasts MoF.

Figure 3.13: Changes in the 2018 forecast - property income



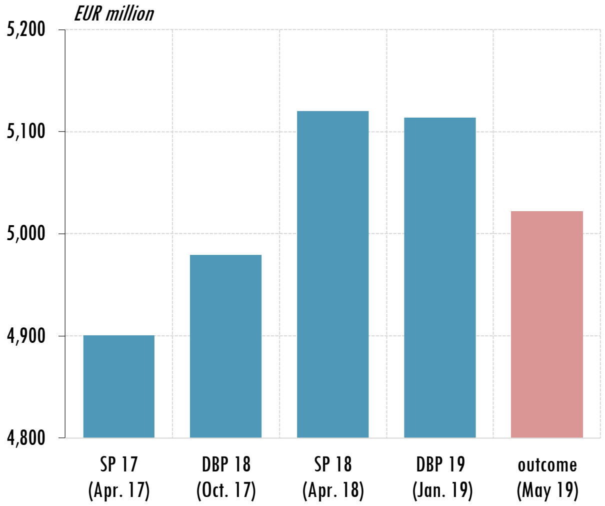
Source: SORS, forecasts MoF.

Figure 3.14: Changes in the 2018 forecast - other revenue



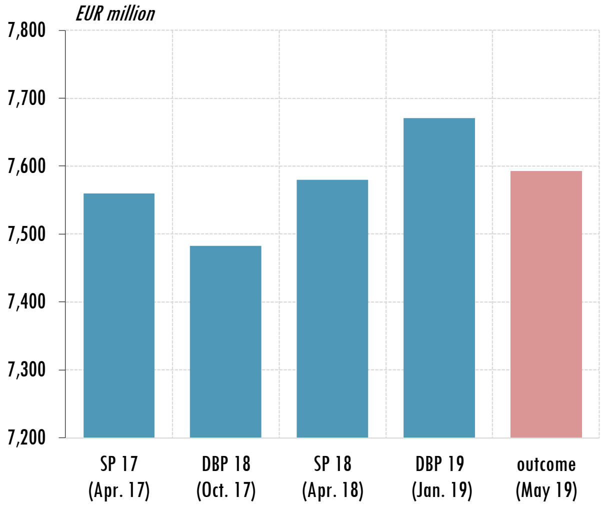
Source: SORS, forecasts MoF.

Figure 3.15: Changes in the 2018 forecast - compensation of employees



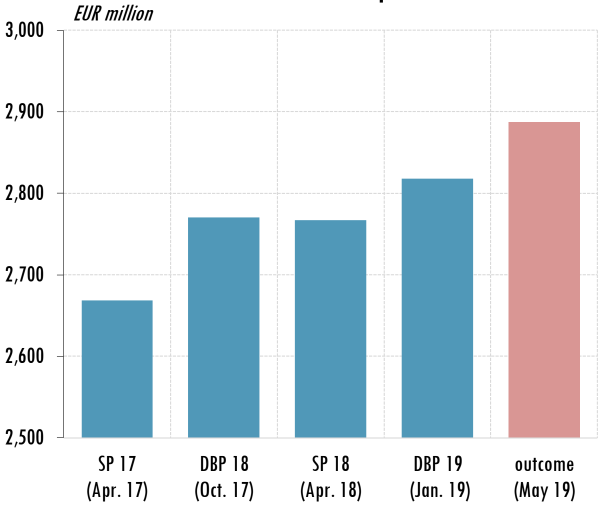
Source: SORS, forecasts MoF.

Figure 3.16: Changes in the 2018 forecast - social benefits



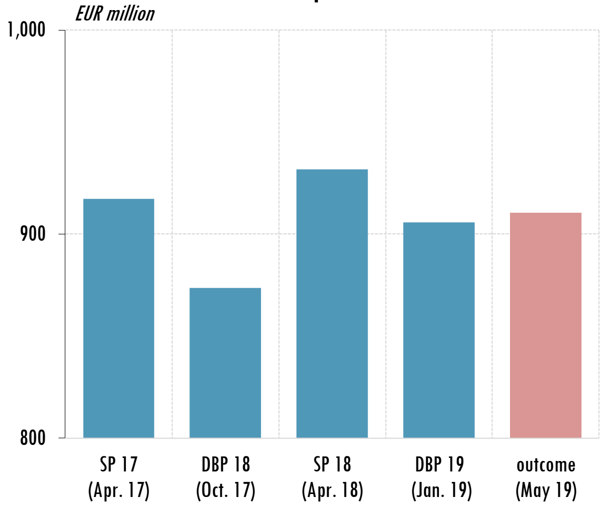
Source: SORS, forecasts MoF.

Figure 3.17: Changes in the 2018 forecast - intermediate consumption



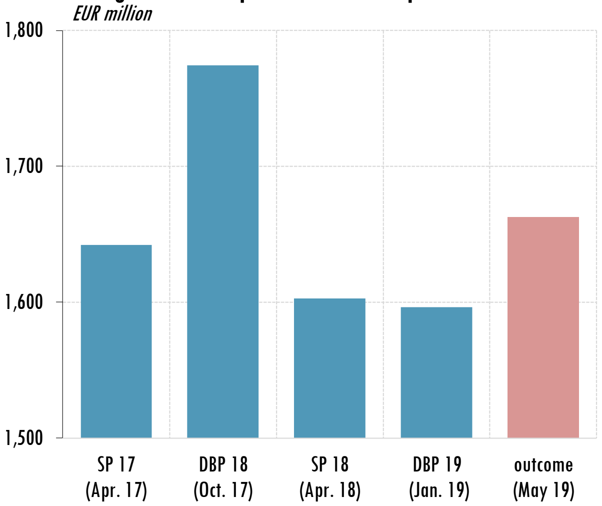
Source: SORS, forecasts MoF.

Figure 3.18: Changes in the 2018 forecast - interest expenditure



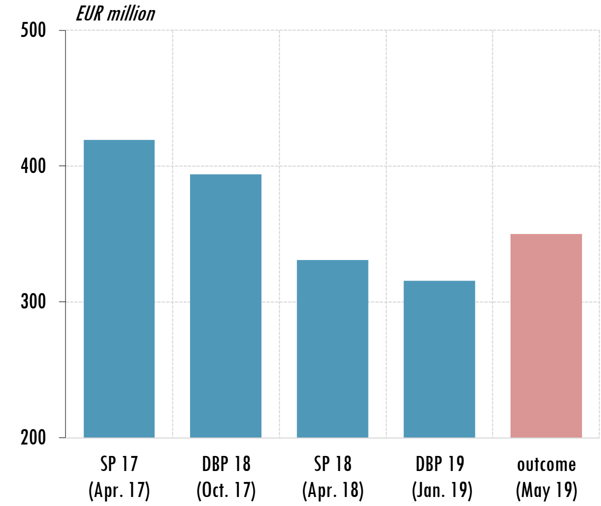
Source: SORS, forecasts MoF.

Figure 3.19: Changes in the 2018 forecast - gross fixed capital formation expenditure



Source: SORS, forecasts MoF.

Figure 3.20: Changes in the 2018 forecast - subsidies



Source: SORS, forecasts MoF.

Annex 3.2: Various output gap estimates and selected indicators of fiscal rules

Table 3.1: Structural balance and maximum permitted general government expenditure according to various output gap estimates

2018	Blanchard Quah (Apr. 19)	Factor (Apr. 19)	HP (Apr. 19)	Long-term average (Apr. 19)	IMF (Apr. 19)	EC (May 19)	OECD (May 19)	IMAD (Mar. 19)	MoF (Apr. 19)	average EC, MoF, IMAD*	average of institutions	**average of all**
Output gap	0.3	3.5	0.5	0.8	1.2	3.3	0.4	2.1	1.7	2.3	1.7	**1.5**
Structural balance	0.7	-0.8	0.6	0.4	0.3	-0.7	0.6	-0.1	0.0	-0.3	0.0	**0.1**
Permitted expenditure**	19,737	19,074	19,689	19,626	19,542	19,123	19,716	19,368	19,446	19,312	19,437	**19,478**

*Notes: * institutions that calculate output gap on the basis of commonly agreed methodology according to SGP,*

*** ex-post estimate*

Sources IMAD, EC, OECD, IMF, MoF, FC calculations.