REPUBLIC OF SLOVENIA
FISCAL COUNCIL

Assessment of budgetary documents for 2021 and 2022

(Fulfilment of conditions for the enforcement of exceptional circumstances and the assessments of draft Ordinance amending the Ordinance on a framework for the preparation of the general government budgets for the 2020–2022 period, of draft Amendments to the Budget of the Republic of Slovenia for 2021 and of draft Amendments to the Budget of the Republic of Slovenia for 2022)

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The assessment was drafted following a request submitted by the Government of the Republic of Slovenia to establish the occurrence of exceptional circumstances (received on 30 September 2020) and is based on the draft Amendments to the Budget of the Republic of Slovenia for 2021, the draft Budget of the Republic of Slovenia for 2022, the draft Ordinance amending the Ordinance on a framework for the preparation of the general government budgets for the 2020–2022 period and the Draft Budgetary Plan for 2021 (all received on 1 October 2020). Some forecast values in EUR were calculated indirectly from rounded shares of GDP presented in the 2021 Draft Budgetary Plan, wherefore certain items may not sum up. An extended version of Chapter 4.1 of this document was published separately as a Fiscal Council's assessment: Fulfilment of conditions for the enforcement of exceptional circumstances, which was supplied to the Government of the Republic of Slovenia by the Fiscal Council on 15 October 2020 in accordance with paragraph two of Article 12 of the Fiscal Rule Act (hereinafter: FRA). Data available up to and including 11 October 2020 were used.

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List of abbreviations

ACP5 – Anti-Corona Package No. 5

AF – Autumn forecast by IMAD

BoS – Bank of Slovenia

CF – Cohesion Fund

CSR – Country Specific Recommendations

DBP – Draft Budgetary Plan

DPP – Development Programmes Plan

EBRD – European Bank for Reconstruction and Development

EC – European Commission

ECB – European Central Bank

ECDC – European Centre for Disease Prevention and Control

EPUI – Economic Policy Uncertainty

ERDF – European Regional Development Fund

ESA – European System of Accounts

ESF – European Social Fund

EU – European Union

FC – Fiscal Council

FRA – Zakon o fiskalnem pravilu (Fiscal Rule Act)

GDP – Gross Domestic Product

IMAD – Institute of Macroeconomic Analysis and Development of the Republic of Slovenia

IMF – International Monetary Fund

MoF – Ministry of Finance

MGRT – Ministry of Economic Development and Technology

OECD – Organization for Economic Cooperation and Development

OG – The Official Gazette of the Republic of Slovenia

OxCGRT – Oxford COVID-19 Government Response Tracker

PEPP – Pandemic Emergency Purchase Programme

RRF – Recovery and Resilience Facility

RS – Republic of Slovenia

SORS – Statistical Office of the Republic of Slovenia

SURE – The European instrument for temporary Support to mitigate Unemployment Risks in an Emergency

SVRK – Government Office for Development and European Cohesion Policy

USA – United States of America

WB – World Bank

WIIW – Vienna Institute for International Economic Studies

WUI – World Uncertainty Index

YEI – Youth Employment Initiative

ZIUOOPE – Zakon o interventnih ukrepih za omilitev in odpravo posledic epidemije COVID-19 (Act Determining the Intervention Measures to Mitigate and Remedy the Consequences of the COVID-19 Epidemic)

ZIUZEOP – Zakon o interventnih ukrepih za zajezitev epidemije COVID-19 in omilitev njenih posledic za državljane in gospodarstvo (Act Determining the Intervention Measures to Contain the COVID-19 Epidemic and Mitigate its Consequences for Citizens and the Economy)

ZPIZ – Pension and Disability Insurance Institute

ZZZS – Health Insurance Institute

EXECUTIVE SUMMARY

In an uncertain environment, when deviations from the medium-term fiscal balance under the FRA are permitted due to exceptional circumstances, expansionary fiscal policy is counter-cyclical and, as such, appropriate in the light of currently available forecasts. However, according to the Fiscal Council, the projected expenditure of the general government in the coming years is high and therefore exposed to significant risks, especially related to their effectiveness. At the same time, the current situation should not be exploited for implementing measures that structurally worsen the position of public finances. The envisaged accelerated investment activity for promoting economic growth should strengthen long-term economic potential as much as possible. This would ensure that the burden of significantly increased government debt during the crisis will not be too heavy in the future. Otherwise, when the crisis is over, the room for manoeuvre in the context of future reversals of the business cycle will be reduced and it will be difficult to ensure the medium-term fiscal balance and thus the long-term sustainability of public finances.

The Fiscal Council notes that the conditions set out in the Fiscal Rule Act enable the enforcement of exceptional circumstances, given the available data at the time of drafting this assessment, this year and next, while for 2022 this cannot be unequivocally confirmed at this time. The European Commission has extended the enforcement of the general escape clause from 2020 to 2021, while guidelines at EU level concerning the course of fiscal policy for 2022 have not yet been made public. Uncertainty regarding the future course of the epidemic and its impact on economic activity are crucial in deciding on the eligibility of the enforcement of exceptional circumstances in the current situation. According to the currently available information, it is not possible to unequivocally confirm that exceptional circumstances will still exist in 2022. This finding is not static and will be regularly examined by the Fiscal Council.

The fiscal projections in the proposed budget documents continue to be significantly marked by the effects of measures to limit the consequences of the COVID-19 epidemic. With the projected relatively rapid recovery of economic activity, which will reach the pre-crisis level of GDP in 2022, the state budget deficit is expected to gradually shrink over the next two years after this year's sharp deterioration, given the projected lower impact of COVID-19 measures. Due to the uncertain assessment of the realisation in 2020, which the Fiscal Council pointed out when preparing the assessment of the revised budget, it is rather difficult to assess the projections for the next two years. According to the Fiscal Council's assessment, the planned realisation for 2020 is not in line with the currently valid measures and actual data on state budget up to September.

As early as in March 2020, the Fiscal Council noted that the conditions stipulated by the Fiscal Rule Act for a temporary deviation from achieving medium-term fiscal sustainability were met, and that, in these circumstances, it would pay special attention to fiscal developments without considering the direct effects of COVID-19 measures. Such an analysis of the given fiscal projections shows that the general government deficit will increase significantly next year due to expenditure growth almost doubling. The increase in investment expenditure is expected to be particularly pronounced and the growth in other expenditure is also expected to be much higher than the growth of the long-term economic potential. The indicative calculations of the compliance of general government expenditure with the

Fiscal Rule Act as set out in the Framework Proposal indicate that although the deviation from the medium-term balance is allowed on a temporary basis, the expenditure is too high. This finding also applies when a wide range of alternative values of input variables is considered, on the basis of which the maximum allowed expenditure is determined in accordance with the Fiscal Rule Act.

Given the expected conditions, the expansionary fiscal policy is justified next year; however, the proposed scope and structure of fiscal incentives are optimistic and their actual implementation could entail a number of risks. In the event of a projected significant increase in investments that are expected to be financed by loans and grants, the risks are related to their efficiency and to the actual short-term and especially long-term effect on economic activity. Despite being supportive of investment as a major factor in restarting the economy in the current circumstances, international institutions also draw attention to these risks. With such a rapid and extensive increase in investment activity, there are also risks regarding the actual absorption capacity and governance concerning the management, supervision and implementation of projects, while restrictions may also appear on the supply side, including the labour market. The projected high growth of other expenditure not related to COVID-19 measures poses a risk to the structural position of public finances. According to the Fiscal Council, the planned expenditure is not entirely based on the measures currently in force, which is especially true for projections of labour cost growth.

In addition to the uncertainties associated with the forecasts of macroeconomic and fiscal aggregates, the given assessment by the Fiscal Council also explicitly highlights the numerous risks arising from economic policy measures. The structural position of public finances may deteriorate, in particular due to discretionary measures already adopted and announced that are not directly related to the epidemic. This is inappropriate in the current adverse economic and fiscal conditions according to the assessment of the Fiscal Council. It is necessary to be aware that the political cycle is already in a mature phase, which is why solutions should be sought that will solve problems not only in the short term, but also systemically, and that will be sustainable in the long run.

As in most other countries, the general government debt is expected to increase significantly in the crisis and temporarily exceed 80% of GDP in the baseline scenario. An increase in debt during a period of low interest rates and the expected recovery in economic growth may still be acceptable. However, it becomes risky if debt is not used mainly to increase economic potential before the interest rate normalisation period begins. It is therefore essential that all funds earmarked for financing the projected expenditure, both grants and loans, are spent effectively in finding solutions that will have the greatest multiplier effect and enable the sustainable growth and development of the economy.

After the end of the current crisis, Slovenia will face many long-term challenges for which it had not found appropriate systemic solutions even before the crisis. This applies especially to the challenges of demographic change and their impact on public finances. Many analyses show that long-term sustainable public finances can only be ensured through broader policies that address not only the reform of social security system parameters but also a wide range of areas that would comprehensively tackle the challenges of a long-lived society.

Given the findings of the analysis and perceived risks, the Fiscal Council:

- considers that the assessment of the existence of exceptional circumstances and the assessment of budget documents should follow an appropriate chronological order, so that the preparation of budgetary documents is based on a preliminary assessment of the existence of exceptional circumstances;
- expects clarification of the projected budgetary developments for 2020, which also form the basis for assessing the adequacy of public finance projections in the coming years;
- calls for clarification of the difference between the change in general government expenditure and the change in the sum of expenditure of public finance accounts in the Framework Proposal;
- calls on economic policymakers that public spending, in the part that does not include necessary expenditure to mitigate the effects of the epidemic, should be effective and development-oriented and should not structurally worsen the state of public finances;
- draws attention to the risks associated with the feasibility of planning, managing, monitoring and implementing a rapid and extensive increase in investment projects and the need to observe the related absorption capacity of the administration and the economy as a whole, including the labour market;
- highlights the need for transparency regarding the use of funds in the general budget reserve item, which may be used exclusively for measures related to the COVID-19 epidemic;
- warns of the risk that any over-planned funds of individual items in the draft budget documents will not be used efficiently;
- although it recognises that a stalemate in this area is partly understandable due to the crisis, the Fiscal Council reiterates its call for the implementation of changes which will enable decent aging and sustainable public finances in the long run as soon as possible.

Legal framework

On 30 September 2020, in accordance with paragraph two of Article 12 of the FRA the Government of the Republic of Slovenia communicated a decision requesting the Fiscal Council to assess the the occurrence of exceptional circumstances referred to in paragraph one of Article 12 of the Fiscal Rule Act. On 1 October 2020, the Ministry of Finance submitted the draft Amendments to the Budget of the Republic of Slovenia for 2021 and draft Budget of the Republic of Slovenia for 2022 and related documents (hereinafter: Budget Proposals), the draft Ordinance amending the Ordinance on a framework for the preparation of the general government budgets for the 2020–2022 period (hereinafter: Framework Proposal) and the 2021 Draft Budgetary Plan (hereinafter: DBP21) under the ESA 2010 methodology to the Fiscal Council for the assessment of compliance with fiscal rules. Pursuant to Articles 2 and 3 of the FRA, compliance with fiscal rules is assessed for the whole general government sector, so that the projections under the ESA 2010 methodology are a prerequisite for the Fiscal Council to fully assess compliance with fiscal rules in the Budget Proposals. The Ministry of Finance and the Fiscal Council have co-operate under the Memorandum of Understanding which sets out the additional documentation that the Ministry of Finance must send to the Fiscal Council when sending budget documents. Thus, on 1 October 2020, the Fiscal Council called on the Ministry of Finance to provide additional documents and data. These were sent by the Ministry of Finance to the Fiscal Council between 1 October 2020 and 7 October 2020.

Pursuant to Article 28 of the Public Finance Act, the Government is required to submit a budget proposal to the National Assembly of the Republic of Slovenia by 1 October. If, upon submitting budget documents or their amendments, the Government finds that the circumstances on the basis of which the budgetary framework was adopted have changed, it must also submit a framework amendment to the General Assembly and the Fiscal Council. In accordance with paragraph two of Article 9f of the Act Amending the Public Finance Act, the Fiscal Council must submit the assessments on the compliance of the aforementioned documents with fiscal rules to the National Assembly and the Government:

- no later than by 20 October for Budget Proposals and
- no later than within 15 days for Framework Proposal after receiving it.

In accordance with Article 12 of the FRA, the Government shall determine whether exceptional circumstances have arisen or have ceased to exist after obtaining the assessment of the Fiscal Council. In accordance with point 7 of paragraph two of Article 7 of the FRA, the assessment regarding the occurrence or cessation of exceptional circumstances shall be drafted and, in accordance with paragraph two of Article 12 of the FRA, provided in no later than 15 days, if the assessment is requested by the Government. The temporary deviation from the medium-term balance as permitted in March 2020 also means that, in the present document, the Fiscal Council assesses the compliance of fiscal developments presented in the Budget Proposals and in the Framework Proposal with fiscal rules in accordance with 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 in March 2020, the implementation of the medium-term balance, as specified in Article 3 of the FRA, is assessed merely indicatively.

Considering all the aforementioned circumstances, the Fiscal Council has therefore assessed the compliance of the submitted documents with the FRA in several steps:

I. it assessed the feasibility of the projections contained in the Budget Proposals;

II. It assessed the fulfilment of conditions for the enforcement of exceptional circumstances for the 2020 –2022 period;

III. It examined the compliance of the Framework Proposal's projected expenditure for the general government sector with the sum of the proposed expenditure of individual public finance budgets, including state budget, as specified in the Budget Proposals;

IV. It indicatively checked the compliance of fiscal trend projections with fiscal rules.

1. Macroeconomic conditions and forecasts

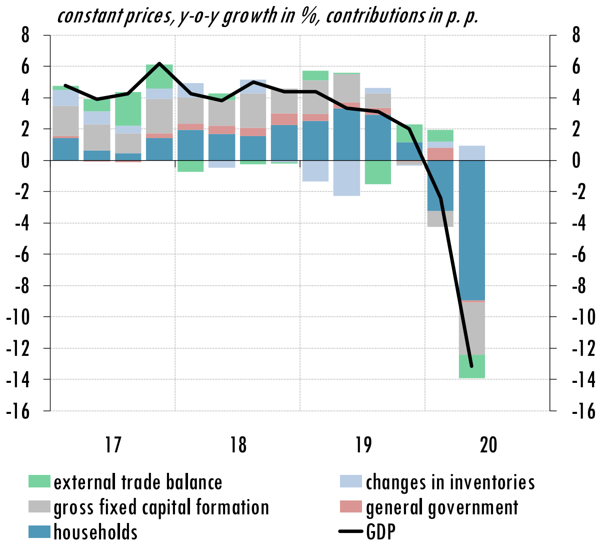
Key findings

- After significant shocks on both the supply and demand side that were caused by restrictive measures implemented to contain the COVID-19 epidemic and have contributed to a substantial decline in economic activity in Slovenia and abroad, activity has started to recover in the second half of the year considering the available data. However, some indicators show that the recovery slowed down in the beginning of autumn.
- Economic activity is expected to recover quickly in the following two years, while its pre-crisis level is projected to be achieved in 2022.
- After this year's considerable reduction, tax bases are expected to rise just slightly less compared to the 2017–2019 average.
- According to currently available estimates, the output gap in the entire 2021–2022 period will be negative, but will eventually narrow, while GDP will not attain the level of long-term economic potential by the end of the period observed.

1.1 An overview of macroeconomic conditions and forecasts

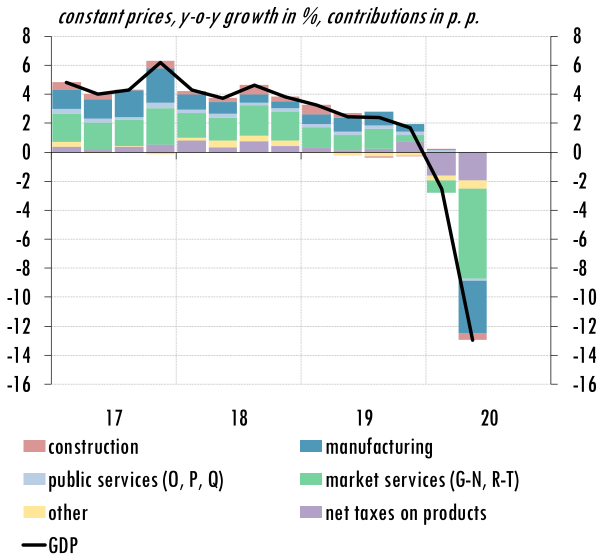
This year, economic activity is expected to decrease significantly under the current conditions of high uncertainty, however, short-term indicators suggest an improvement in the second half of the year. According to IMAD's autumn forecast,[1] real GDP is projected to decrease by 6.7%, while the

Figure 1.1: Gross domestic product - expenditure structure



Source: SORS, FC calculations.

Figure 1.2: Gross domestic product - production structure



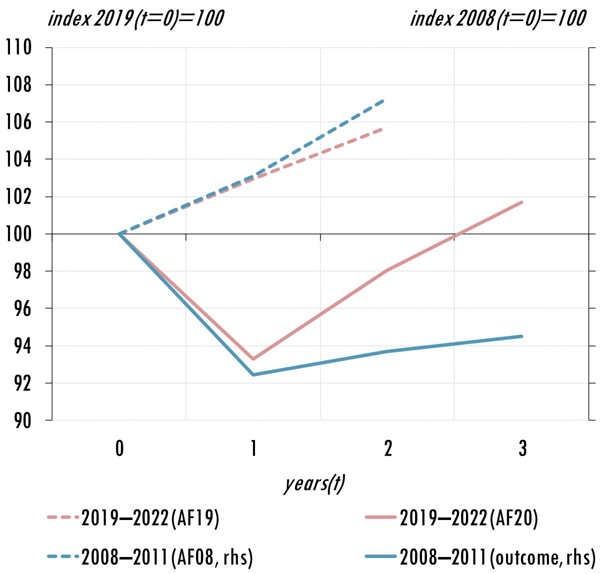
Sources: SORS, FC calculations.

[1] The macroeconomic forecasts of IMAD constitute the basis for the budgetary planning in accordance with the Decree on development planning documents and procedures for the preparation of the central government budget and local government budgets (Official Gazette of the Republic of Slovenia *[Uradni list RS]*, Nos 44/07 and 54/10). The current budget documents assessed by the Fiscal Council are based on the Autumn Forecast of Economic Trends 2020 from September 2020. Available at: https://www.umar.gov.si/fileadmin/user_upload/napovedi/jesen/2020/angleski/Autumn_forecast_2020.pdf

decline of nominal GDP will be smaller (−4,7 %). This fall on an annual level may primarily be attributed to the considerable decline in the second quarter, which was on par with the average decline in the EU. Economic activity is expected to start recovering in the second half of the year. In the summer months, short-term activity and economic sentiment indicators started to improve, although recovery has slowed down in recent months. Among consumption components, gross fixed capital formation (−13.0%) is expected to decrease the most this year, which mainly reflects the delaying of investment decisions in uncertain conditions. The drop in household consumption is expected to be half as pronounced, which is related to the greater willingness of consumers to spend after the end of quarantine, although spending decisions taken by households are also limited due to the measures in place. The volume of foreign trade is expected to shrink by around ten per cent on both the export and import side. Due to the increasing number of confirmed cases of COVID-19 (see Chapter 3), a major risk exists that the fall of GDP will be steeper than expected in the baseline scenario. According to IMAD, any repeated extensive measures to contain the epidemic could even entail a two per cent greater GDP decline this year and a slower recovery in the coming years.

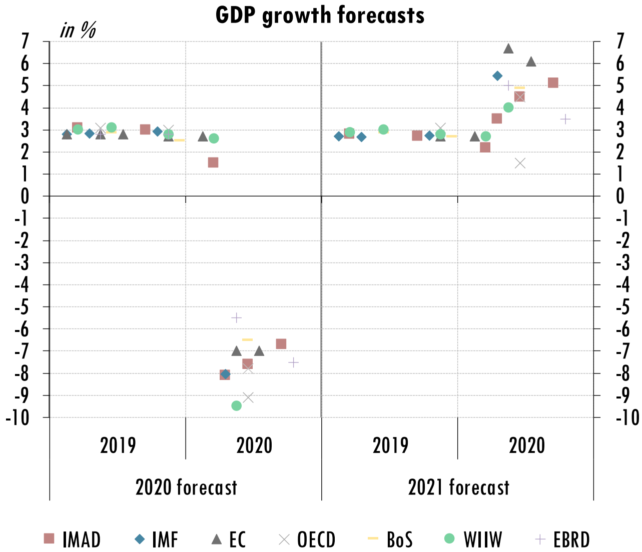
Given the last available forecasts, the economic growth in 2020 will be lower compared to the growth rate from the forecast that served as a basis for the state budget revision. According to IMAD's autumn forecast, real GDP decline is projected to be smaller by nearly one per cent compared to the June forecast that was used as a basis for this year's state budget revision. The forecasted changes of all key macroeconomic bases for this year that serve as a basis for fiscal revenue projections are less favourable compared to the June forecast. The draft revised budget was drawn up by the Government on the last day of the legal deadline of 1 September,[2] while the autumn forecast is prepared by IMAD after the statistical data on national accounts in the second quarter of the current year is published, which was 31 August.[3] On the basis of this year's less unfavourable forecast, we still assess that the actual annual realisation of public revenue could be higher compared to the projections from the revised budget (see Chapter 3.1).

Figure 1.3: Real GDP 2019–2022 and 2008–2011



Sources: SORS, IMAD, FC calculations.

Figure 1.4: Changes to 2020 and 2021 real GDP growth forecasts



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

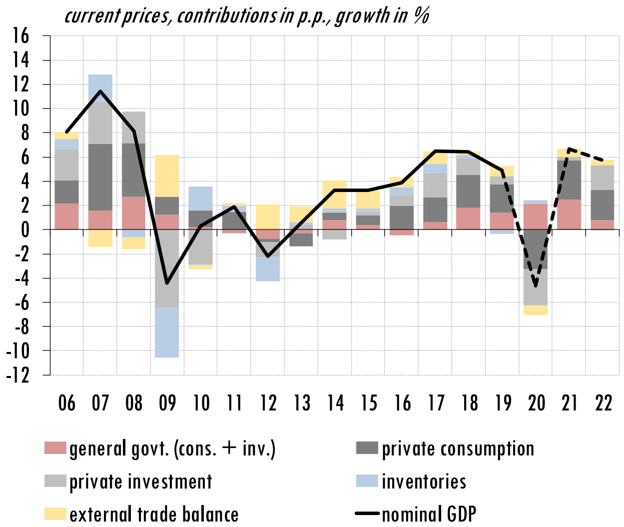
[2] Paragraph two of Article 11 of the Fiscal Intervention Measures Act. Available at: http://www.pisrs.si/Pis.web/pregledPredpisa?id=ZAKO8186. Only in Slovene.

[3] Paragraph three of Article 9b of the Public Finance Act. Available at: http://pisrs.si/Pis.web/pregledPredpisa?id=ZAKO1227. Only in Slovene.

According to the IMAD's baseline scenario, economic activity is expected to recover in the following two years and reach pre-crisis levels in 2022. The baseline scenario is based on the assumption that the coronavirus could be controlled without an extensive shutdown of activities. Fiscal policy measures of individual countries and at the EU level as well as monetary policy measures and related relatively favourable financing conditions are expected to make a key contribution to the recovery. The revival of international trade is expected to boost exports and imports, for which a faster recovery of trade in goods is expected by IMAD, while a large part of trade in services is only expected to stabilise after finding a long-term solution for controlling the virus. Improving conditions in the international environment, while reducing uncertainty and maintaining favourable financing conditions should also aid the recovery of private investment. Next year's economic growth should be promoted by the state, especially with investments that will be further stimulated by new EU instruments (see Box 2.3). With the strengthened growth of disposable income and the assumed reduction in the propensity to save, private consumption is also expected to increase. After this year's deterioration of labour market conditions, which were largely limited by supporting measures, the situation is expected to improve in the next two years. Due to delayed effects of the crisis, a further rise in unemployment is expected after the cessation of the measures currently in force. With a projected gradual reduction of the negative output gap, economic growth in the next two years will primarily be the result of cyclical momentum (see Figure 1.6). The contribution of total factor productivity will remain significant, while nominal GDP growth will also be promoted by the expected higher inflation, which is expected to gradually approach 2% by 2022. The contribution of capital and labour is expected to be modest, but only slightly below the 2019 level.

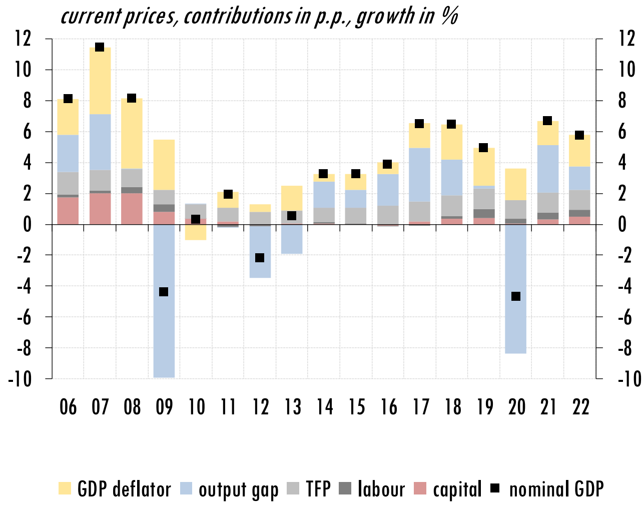
After this year's considerable reduction, the tax bases[4] are expected to rise just slightly less compared to the 2017–2019 average. The average annual growth of GDP in current prices is projected to reach 6.2% in the next two years, which corresponds to the three-year pre-crisis average. Up to and including 2022, nominal GDP is expected to rise by EUR 5.9 billion in total. The same developments are expected for domestic consumption in current prices, while the average growth in the net operating surplus in the next two years (7.7%) is expected to fall just slightly under

Figure 1.5: Demand factors and GDP



Source: SORS, IMAD, FC calculations.

Figure 1.6: Supply factors and GDP



Source: SORS, IMAD, FC calculations.

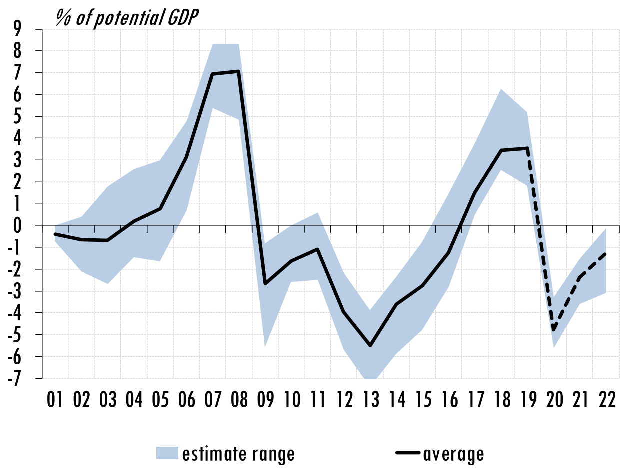
[4] Tax bases as listed in Priročnik za pripravo projekcij prihodkov sektorja država.
Available at: https://www.gov.si/assets/ministrstva/MF/ekonomska-in-fiskalna-poltika/Blagajne-JF/Pirocnik-za-napovedovanje-prihodkov-2019.pdf. Only in Slovene.

the pre-crisis level (2017–2019: 8.3%). The only tax base for which no decrease is projected this year is the compensation of employees. Nevertheless, their average growth in the 2020–2022 period will be more than halved compared to three years before the crisis, which is a result of lower growth in average gross salary and the stagnation in employment compared to the average employment of this period.

1.2 Assessment of the cyclical position of the economy

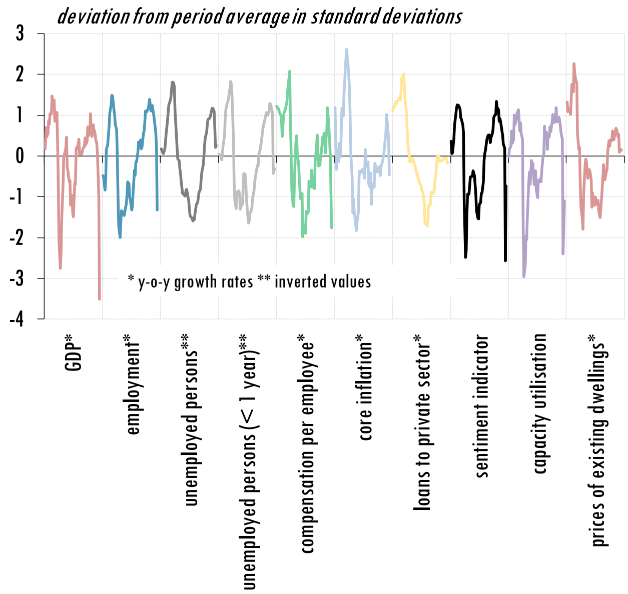
Considering the magnitude of the current crisis, the assessments of the cyclical position of the economy is surrounded by additional uncertainty.[5] As this epidemic has been accompanied by a

Figure 1.7: Output gap estimates



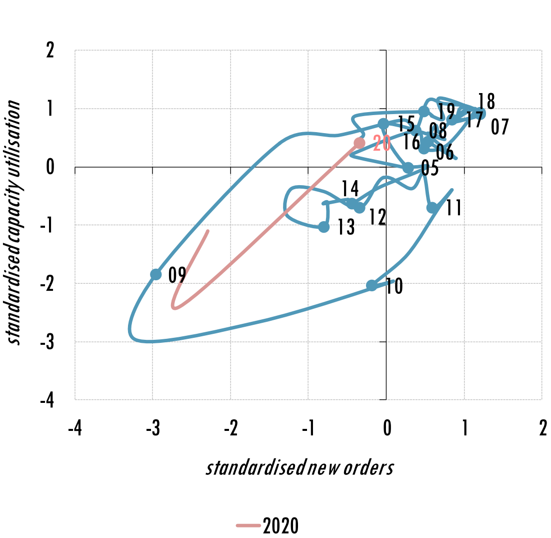
Note: For methodology regarding output gap calculation used by FC see notes under Table 4.3 in "Assessment of compliance of the Proposal of budgets of the Republic of Slovenia for 2020 and 2021 with the fiscal rules" (October 2019). Current calculation does not include certain institutions which produce estimates for Slovenia (EC, IMF, OECD), because their estimates have not yet been revised. Sources: MoF, IMAD, FC calculations.

Figure 1.8: Indicators of economic cycle dynamics 2005–2020



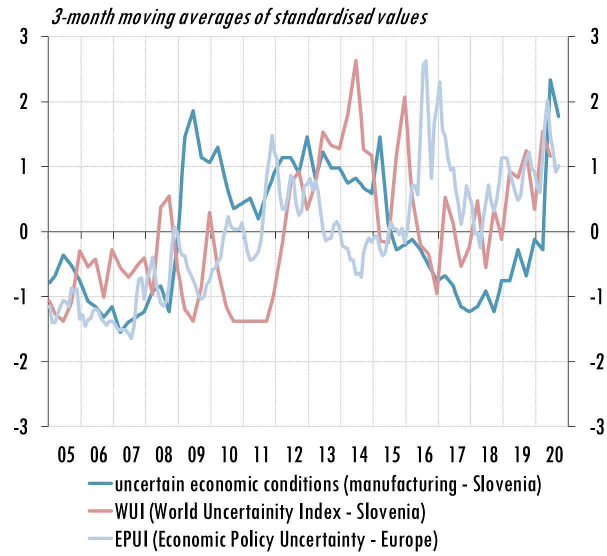
Sources: SORS, ECB, Eurostat, Employment Service of Slovenia, FC calculations.

Figure 1.9: New orders and capacity utilisation



Source: SORS; FC calculations. Circles denote first quarters.

Figure 1.10: Measures of uncertainty



Sources: www.policyuncertainty.com, SORS, FC calculations.

[5] See Fiscal Council (2020) for an analysis of the uncertainty of estimates of the output gap during the current crisis in Slovenia. Assessment of compliance of the general government budgets with the fiscal rules in 2019 (Box 1.1).

strong supply shock in addition to demand shock, it could affect—especially with extended duration or additional deepening—changes in the response and structure of production factors and the changed level and dynamics of the economy's potential. This impact largely depends on the structure and the flexibility of the economy and on the economic policy response.[6] Uncertainties regarding future economic developments suggest the need for caution in interpreting output gap[7] point estimates and the need to consider an additional set of indicators when assessing the cyclical position.

Available estimates support the assessment of the Fiscal Council that the output gap of the Slovenian economy in the 2021–2022 period will be negative. Given the currently available estimates, the negative output gap[8] is expected to narrow in the next two years, as GDP growth is expected to surpass the currently estimated growth of economic potential. According to currently available calculations, compared to the average output gap for the period that the Budget Proposals refer to, the negative output gap is expected to drop below the −1.5% threshold, which according to the EC methodology delimits the range of bad times from normal times.[9] The output gap is expected to fall below this threshold in 2022, which mirrors an expected relatively rapid economy recovery after the 2020 shock.

Having examined a wide range of indicators monitored by the Fiscal Council in order to determine the position of the economic cycle, the Fiscal Council assesses that following a significant shock in the first half of 2020, the economy is recovering amid great uncertainty. After a rapid but partial recovery of economic activity in the beginning of the second half of the year, most indicators available in the early autumn show signs of a further recovery. The persistence of high uncertainty could slow down the recovery at the end of the year, especially if the epidemic conditions continue to deteriorate. Although most indicators' values are gradually returning to their long-term average levels after a steep fall in the first half of the year and the lifting of restrictive measures, but still lag these considerably. This primarily applies to indicators of economic growth, employment, economic sentiment and production capacity utilisation. The supply side limitations that were arising in the labour market before the crisis have been reduced due to the restrictive measures to contain the epidemic and a severe economic downturn. According to IMAD's autumn forecast, no significant pressures on salary growth are expected in the period of gradual economic recovery in the next two years. The same applies to inflation, which is expected to stay moderate, while the surplus on the current account of the balance of payments is expected to remain high considering high private sector savings in the coming years. According to the currently available indicators, the crisis had the least impact on real estate and financial markets. Growth in real estate prices has slowed down in light of the crisis, but it still exceeds its long-term average. By contrast, the growth of private sector loans, which has already been below the long-term average before the crisis, has remained virtually unchanged during the crisis.

[6] European Commission (2009). Impact of the current economic and financial crisis on potential output. European Economy Occasional Papers 49.

[7] The output gap represents the difference between the actual economic activity (in terms of GDP) and the estimated economic activity made possible by the economy's available capacities, without causing inflationary pressures (potential output). In its output gap estimates the Fiscal Council uses the calculations of five institutions and four statistical methods. For more details on the output gap calculations used by the Fiscal Council, see Fiscal Council (2018). Report on the Fiscal Council's operation in 2017, p. 23–26.

[8] Determining the stage of the economic cycle has an impact on the choice of the FRA formula that is used to determine the ceiling for general government expenditure (see Chapter 4).

[9] The EC defines normal times as a period in which the output gap estimate is between −1.5% and 1.5% of potential GDP, while bad times are defined as a period in which the output gap estimate is between −1.5% and −3.0% of potential GDP (European Commission (2019). Vade Mecum on the Stability and Growth Pact 2019 Edition, p. 16–17). The requirements for structural efforts and the achievement of the medium-term fiscal objective as determined by the EC also depend on the definition of the economic cycle.

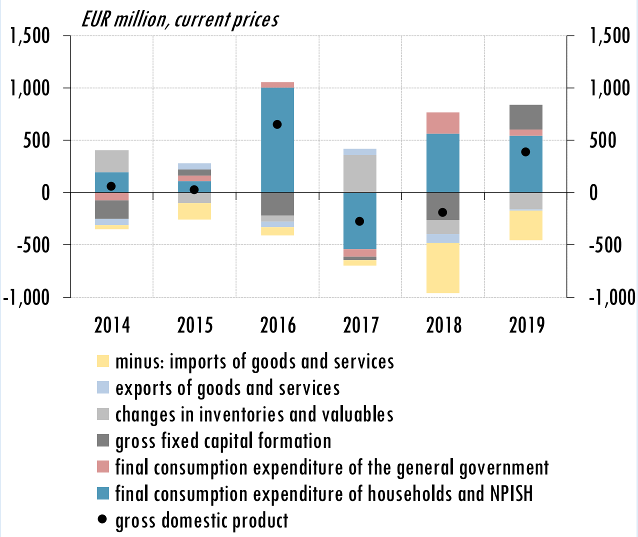
Box 1.1: Revised data on national accounts and forecasts of fiscal aggregates

The reliability of a forecast largely depends on reliable and timely input data. In addition to the assumptions on exogenous forecast factors and economic policy operation, this also includes statistical data available at the time of drafting the forecast. Although the developments in high-frequency data are particularly important in short-term forecasts, data published by statistical offices within national accounts plays a decisive role in macroeconomic projections. National accounts are a complex system of linked accounts used to assess economic activity and its components. Various sources, databases and estimates that may change over time serve as a basis for measuring economic activity. Therefore, the estimated outturn values of economic activity also change.[1]

Revisions to national accounts data are frequent and may also affect economic forecasts. In general, revisions to national accounts data are regular while a comparison shows that this year's revision of national accounts by SURS for the 2016–2019[2] period was one of the largest in the past few years. Because the revisions to national accounts data affect the levels of macroeconomic aggregates, the basis of the forecast also changes.[3] Given the published preliminary data, the estimated outturn of nominal GDP for 2019 increased by 0.8% or EUR 386 million, while revisions of other components were even more drastic. Gross fixed capital formation was altered by 2.6% and the estimated household consumption by 2.1%. Following data revision, the gross operating surplus in 2019 was 1.3% higher than the preliminary estimate. In its forecasts, which were, *inter alia*, based on quarterly data published at the end of August, IMAD could not observe this data, because, due to a delay in obtaining data from key data sources, SURS only published the revised data on 30 September 2020 instead of at the end of August. All national accounts data displays from Chapter 1.1 were prepared on the basis of data available to IMAD at the time of preparing the forecast.

The recent revisions to national accounts data could affect the realisation of forecasts of fiscal aggregates from the submitted budget documents and the feasibility of such realisation. In the latest forecasts issued by the Ministry of Finance, which served as a basis for the drafting of the submitted budget documents, IMAD's forecast that was prepared and published before the publication of revisions to national accounts served as an input. For example, with unchanged growth rates from macroeconomic projections, higher known input levels of realised data could also imply a higher level of forecasted fiscal aggregates. Because most values of national account components, which form the basis for making projections of fiscal aggregates, increased after the revision, it could be concluded that the projections of fiscal aggregates in the submitted budget documents have become somewhat

Figure: Change to GDP when first estimate based on annual data sources is released



Sources: SORS, FC calculations.

underestimated. The scope of underestimation depends, *ceteris paribus*, primarily on the elasticities applied by the Ministry of Finance in their revenue forecasts.[4]

[1] For instance, see analysis by Mazzi et al. (2019). Data uncertainties: their sources and consequences. 2019 edition. Statistical working papers. Eurostat.

[2] Published on 30 September 2020. See https://www.stat.si/StatWeb/en/News/Index/9102 (for modified data) and https://www.stat.si/StatWeb/en/News/Index/9128 (for reasons for revision).

[3] In its forecasts, the Bank of England thus includes uncertainties regarding past data revisions, which are observed on the basis of their probability distribution. See https://www.bankofengland.co.uk/-/media/boe/files/inflation-report/2007/november-2007.pdf?la=en&hash=03AA4FB7EE5CA613952B392EFB00411A7D10195A (box on p. 39).

[4] The macroeconomic bases used by the Ministry of Finance for preparing revenue projections are evident from Priročnik za pripravo projekcij prihodkov sektorja držav. Available at: https://www.gov.si/assets/ministrstva/MF/ekonomska-in-fiskalna-poltika/Blagajne-JF/Prirocnik-za-napovedovanje-prihodkov-2019.pdf. Only in Slovene.

2. Fiscal conditions and forecasts

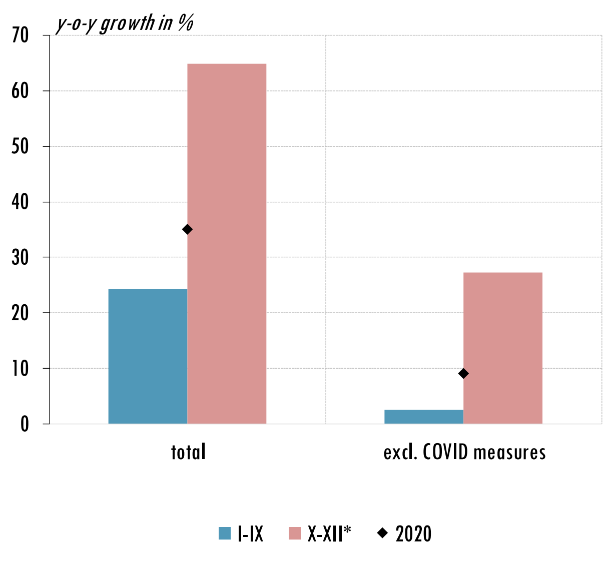
Key findings

- The revised state budget projections for 2020 do not necessarily provide a suitable basis for estimating the dynamics of fiscal aggregates in the projections for the next two years. According to the Fiscal Council's assessment, there is a high probability that, given the currently known measures, particularly this year's expenditure growth will be lower than expected. Thus, the projections for 2021 should imply a much higher growth than they currently do.
- Without considering the effects of COVID-19 measures, the state budget deficit is expected to grow from EUR 1.3 billion to EUR 2.0 billion next year. This will mainly be the result of an expected significant increase in investment expenditure, while the growth of other categories of expenditure is also expected to be relatively high.
- Following this year's considerable increase in the share of gross debt of the general government sector in GDP, the share is expected to be slightly reduced by the end of 2022 (to 79.3% of GDP), but it will nevertheless remain much higher than before the crisis.

2.1 Assessment of the projected revenue and expenditure in the Budget Proposals

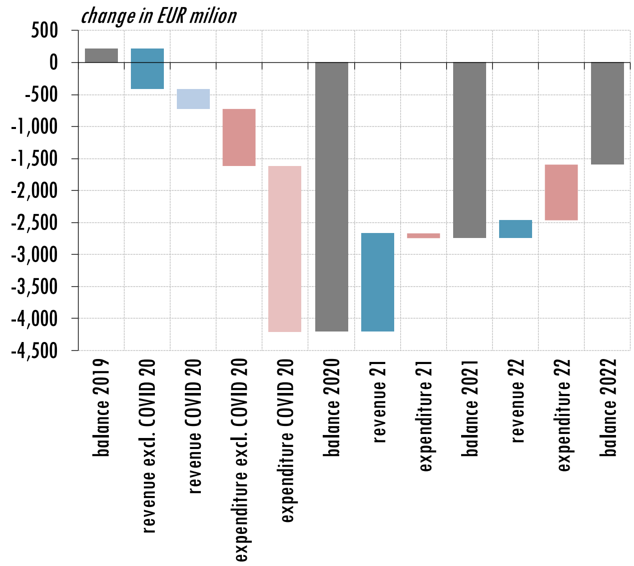
The revised state budget projections for 2020 do not necessarily provide a suitable basis for estimating the dynamics of fiscal aggregates in the Budget Proposals projections for the next two years. The adopted revised budget assumed a deficit of EUR 4.2 billion for the entire year of 2020, while the deficit, without considering the effects of COVID-19 measures, is estimated at EUR 1.3 billion. In the nine months of the current year,[10] the deficit amounted to EUR 2.6 billion and EUR 1 billion without taking into account the effects of COVID-19 measures. Based on the actual realisation in the aforementioned nine months and the adopted revised budget, the year-on-year

Figure 2.1: State budget expenditure in 2020



*Source: MoF, FC calculations. Note: *implicitly based on revised 2020 state budget.*

Figure 2.2: Factors of change to state budget balance 2019–2022



Source: MoF, FC calculations.

[10] Based on the data on daily realisation of the state budget. Available at: https://proracun.gov.si/#. Only in Slovene.

Table 2.1: State budget expenditure in 2020

	EUR million						change in %					
	I-IX 20			X-XII 20 (implicit)			total			excl. COVID		
	total	COVID	excl. COVID	total	COVID	excl. COVID	I-IX 20	X-XII 20	2020	I-IX 20	X-XII 20	2020
EXPENDITURE	**9,040**	**1,588**	**7,452**	**4,351**	**992**	**3,359**	**24.3**	**64.9**	**35.1**	**2.5**	**27.3**	**9.1**
Labour costs*	2,608	198	2,410	947	5	943	15.0	20.9	16.5	6.2	20.4	9.9
Expenditure on goods and services*	843	4	839	303	15	288	12.4	-17.1	2.7	11.9	-21.2	1.0
Interest	678	0	678	98	0	98	-2.7	11.8	-1.1	-2.7	11.8	-1.1
Reserves	99	0	99	1,146	781	364	-21.9	1,480.7	524.8	-21.9	402.7	132.6
Subsidies	1,155	864	291	290	71	218	292.6	143.6	249.6	-1.1	83.6	23.3
Transfers to individuals and households	1,472	284	1,187	321	24	296	35.9	-13.5	23.3	9.7	-20.0	2.1
Current transfers to social security funds	1,063	158	905	311	0	311	22.5	47.1	27.3	4.4	47.1	12.7
Investment	419	1	418	554	5	549	-15.4	25.1	3.8	-15.5	24.0	3.1
Payments to the EU budget	374	0	374	153	0	153	-12.5	85.3	3.3	-12.5	85.3	3.3
Other	329	80	250	230	90	140	25.1	119.9	52.1	-5.1	33.6	5.9

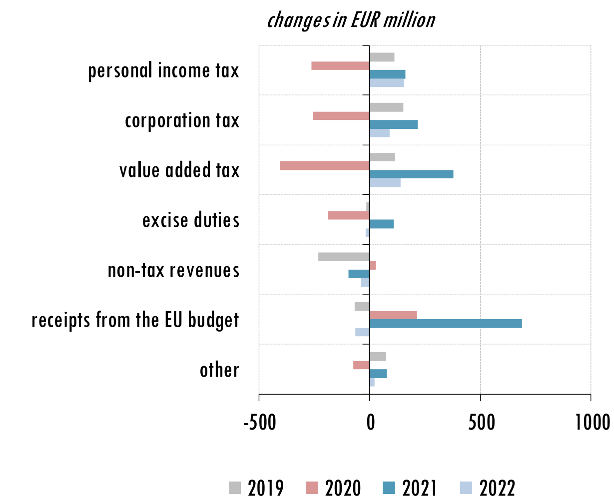
*Source: MoF, FC calculations. *Including transfers to public institutions for this purpose.*

expenditure growth is expected to accelerate significantly in the last three months of the year. Total expenditure growth is expected to rise from 24% in the first nine months to 65% in the last three months, while a rise from 2% to 27% is expected if the effects of COVID-19 measures are not taken into account. According to the Fiscal Council, this requires additional explanations from the Government in the case of realistic projections, which the Fiscal Council already pointed out when preparing the assessment of the revised budget for 2020,[11] or the projections in the revised budget may be unrealistic given the currently known data and as such do not represent a suitable basis for estimating the dynamics of fiscal aggregates in the Budget Proposals projections for the next two years. According to the Fiscal Council, there is a probability that revenue is underestimated and expenditure overestimated in the 2020 revised budget, while the state budget deficit, without considering the impact of COVID-19 measures, could be lower, observing currently available data and existing measures. In this case, particularly the projections of budgetary expenditure from the draft budget amendment for 2021 are predicted to exhibit a much higher growth than they currently do.

The total state budget deficit is forecasted to shrink next year, however, if the impact of COVID-19 measures is excluded, the deficit is expected to rise for slightly over EUR 700 million. While the total state budget deficit is expected to fall to EUR 2.7 billion next year, if the effects of COVID-19 measures are excluded it is expected to rise from EUR 1.3 billion to EUR 2.0 billion. In spite of the revival of tax revenue growth in connection with the forecasted economic growth and projected significant revenue increase fuelled by EU funds, the situation is expected to deteriorate, because expenditure is forecasted to rise by around 17% in 2021 without considering the impact of COVID-19 measures. The strengthening of expenditure growth will primarily be the result of the forecasted significantly higher investment spending, yet the growth of the remaining categories of expenditure is expected to be high as well. A continued, yet modest revenue growth in 2022 and a slight decrease in expenditure is expected to be followed by a reduction in deficit. Without considering the impact of COVID-19 measures, the expected deficit is EUR 1.4 billion, which is around EUR 100 million higher than the deficit estimated in this year's revised budget.

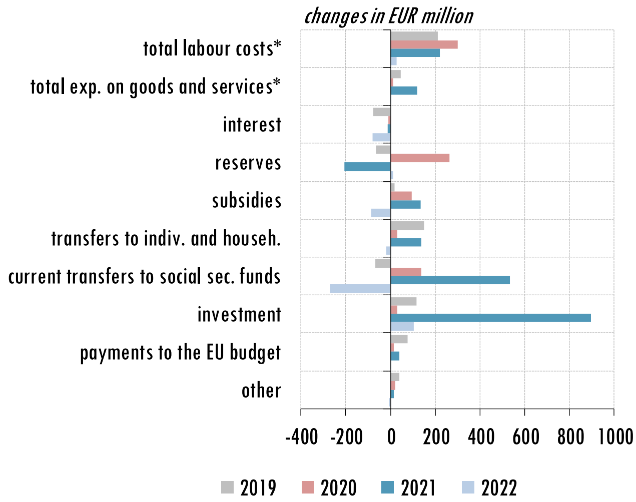
[11] Fiscal Council (2020). Assessment of compliance of the draft revised budget of the Republic of Slovenia for 2020 and of the proposal for the Ordinance amending the Ordinance on the framework for preparing the general government budgets for the 2020–2022 period with the fiscal rules. Available at: http://www.fs-rs.si/assessment-by-the-fiscal-council-compliance-of-the-draft-revised-budget-of-the-republic-of-slovenia-for-2020-and-of-the-draft-ordinance-amending-the-ordinance-on-the-framework-for-the-preparation-of/.

Figure 2.3: State budget revenue changes



Source: MoF, FC calculations.

Figure 2.4: Change in state budget expenditure excluding COVID-19 measures



*including transfers to public institutions for this purpose.
Source: MoF, FC calculations.

The state budget revenue is expected to grow in the next two years, primarily due to the forecasted marked growth of revenue from EU funds, while the risk for a weaker growth arises from the macroeconomic uncertainty together with the already adopted and potential new discretionary measures. Revenue is expected to fall by nearly a tenth in 2020, which is a result of a deterioration of economic conditions affecting the macroeconomic bases of tax revenue and a result of the COVID-19 measures, however, to a lesser extent than on the expenditure side. We assess that the projections for some categories of this year's tax revenue are underestimated considering the actual trends in the months after the end of the epidemic was declared. In 2021, tax revenue is expected to grow approximately in accordance with the forecasted developments of macroeconomic bases. Although the growth of revenue from corporate income tax is projected to be the highest, it is more in line with the developments of operating surplus as forecasted by IMAD when the effect of unaccounted advance tax payments during the epidemic is excluded. Further growth of tax revenue is expected in 2022, with the exception of excise revenue. The projections of funds received from the EU are a key factor of the expected strengthening of total revenue growth in the Budget Proposals. These funds are expected to increase to more than EUR 1.5 billion per year in the coming two years. This increase is partly a result of the projected utilisation rate of grants from the Recovery and Resilience Facility, which is relatively optimistic given the past pace of the utilisation of EU funds, and given the expected pace of utilisation of these funds at the level of the entire EU (for more information, see Box 2.3). The increase also partly stems from the faster drawing of funds from the Multiannual Financial Framework for 2014–2020, in which investment funds from the REACT-EU initiative are incorporated. The Fiscal Council estimates that, considering previous experience with drawing European funds, these projections of the scope of funds utilisation are subject to significant risk.

Without considering the impact of COVID-19 measures, the state budget expenditure growth is expected to nearly double next year, particularly due to a pronounced investment expenditure being forecast, while the growth of other categories of expenditure is also predicted to strengthen. The developments in total expenditure are significantly impacted by the expenditure for COVID-19 measures, which is projected to fall from EUR 2.6 billion this year to EUR 0.8 billion next year (for more information, see Box 2.2). If this impact is not taken into account, the expenditure growth is

Table 2.2: State budget projections for 2021 and 2022

	EUR million				change in %			contributions in p.p.		
	2019	2020	2021	2022	2020	2021	2022	2020	2021	2022
Revenue	**10,136**	**9,189**	**10,722**	**11,005**	**-9.3**	**16.7**	**2.6**	**-9.3**	**16.7**	**2.6**
Value added tax	3,872	3,466	3,843	3,982	-10.5	10.9	3.6	-4.0	4.1	1.3
Excise duties	1,543	1,353	1,463	1,444	-12.3	8.1	-1.3	-1.9	1.2	-0.2
Personal income tax	1,391	1,127	1,288	1,443	-19.0	14.3	12.0	-2.6	1.8	1.4
Corporation tax	997	741	957	1,047	-25.7	29.1	9.5	-2.5	2.3	0.8
Receipts from the EU budget	727	941	1,631	1,565	29.5	73.2	-4.1	2.1	7.5	-0.6
Non-tax revenue	636	665	568	529	4.6	-14.6	-6.9	0.3	-1.1	-0.4
Other	971	896	973	996	-7.7	8.5	2.4	-0.7	0.8	0.2
Expenditure	**9,912**	**13,391**	**13,469**	**12,598**	**35.1**	**0.6**	**-6.5**	**35.1**	**0.6**	**-6.5**
Labour costs*	3,052	3,555	3,572	3,600	16.5	0.5	0.8	5.1	0.1	0.2
Expenditure on goods and services*	1,115	1,146	1,268	1,278	2.7	10.6	0.7	0.3	0.9	0.1
Interest	785	776	762	683	-1.1	-1.8	-10.4	-0.1	-0.1	-0.6
Reserves	199	1,245	759	272	524.8	-39.0	-64.1	10.5	-3.6	-3.6
Subsidies	413	1,445	661	560	249.6	-54.3	-15.3	10.4	-5.9	-0.8
Transfers to individuals and households	1,453	1,792	1,640	1,603	23.3	-8.5	-2.2	3.4	-1.1	-0.3
Current transfers to social security funds	1,079	1,374	1,750	1,481	27.3	27.4	-15.4	3.0	2.8	-2.0
Investment	938	973	1,974	2,075	3.8	102.8	5.1	0.4	7.5	0.7
Payments to the EU budget	510	526	565	569	3.3	7.3	0.7	0.2	0.3	0.0
Other	368	559	517	477	52.1	-7.5	-7.7	1.9	-0.3	-0.3
Balance	**225**	**-4,202**	**-2,747**	**-1,593**						

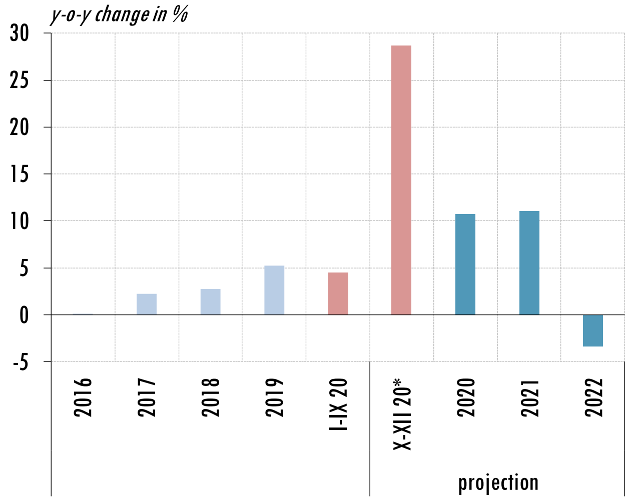
*Source: MoF, FC calculations. *Including transfers to public institutions for this purpose.*

Table 2.2: State budget projections for 2021 and 2022 (excluding the direct effect of COVID-19 measures)

	EUR million				change in %			contributions in p.p.		
	2019	2020	2021	2022	2020	2021	2022	2020	2021	2022
Revenue	**10,136**	**9,494**	**10,645**	**10,956**	**-6.3**	**12.1**	**2.9**	**-6.3**	**12.1**	**2.9**
Value added tax	3,872	3,548	3,796	3,946	-8.4	7.0	3.9	-3.2	2.6	1.4
Excise duties	1,543	1,372	1,446	1,442	-11.1	5.4	-0.3	-1.7	0.8	0.0
Personal income tax	1,391	1,153	1,285	1,441	-17.1	11.4	12.1	-2.3	1.4	1.5
Corporation tax	997	912	946	1,038	-8.5	3.7	9.8	-0.8	0.4	0.9
Receipts from the EU budget	727	941	1,631	1,565	29.5	73.2	-4.1	2.1	7.3	-0.6
Non-tax revenue	636	665	568	529	4.6	-14.6	-6.9	0.3	-1.0	-0.4
Other	971	903	973	996	-6.9	7.7	2.4	-0.7	0.7	0.2
Expenditure	**9,912**	**10,811**	**12,694**	**12,386**	**9.1**	**17.4**	**-2.4**	**9.1**	**17.4**	**-2.4**
Labour costs*	3,052	3,353	3,572	3,600	9.9	6.6	0.8	3.0	2.0	0.2
Expenditure on goods and services*	1,115	1,127	1,248	1,250	1.0	10.7	0.1	0.1	1.1	0.0
Interest	785	776	762	683	-1.1	-1.8	-10.4	-0.1	-0.1	-0.6
Reserves	199	463	259	272	132.6	-44.2	5.3	2.7	-1.9	0.1
Subsidies	413	510	646	558	23.3	26.8	-13.6	1.0	1.3	-0.7
Transfers to individuals and households	1,453	1,484	1,623	1,603	2.1	9.4	-1.2	0.3	1.3	-0.2
Current transfers to social security funds	1,079	1,216	1,750	1,481	12.7	44.0	-15.4	1.4	4.9	-2.1
Investment	938	968	1,863	1,968	3.1	92.6	5.7	0.3	8.3	0.8
Payments to the EU budget	510	526	565	569	3.3	7.3	0.7	0.2	0.4	0.0
Other	368	389	406	400	5.9	4.2	-1.3	0.2	0.2	0.0
Balance	**225**	**-1,317**	**-2,050**	**-1,430**						

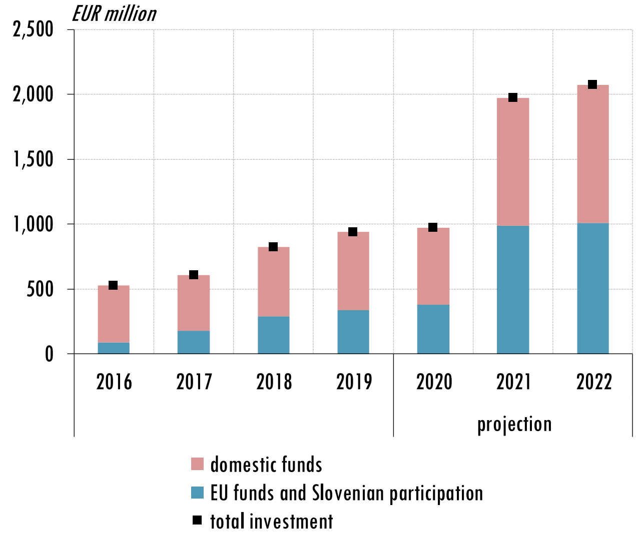
*Source: MoF, FC calculations. *Including transfers to public institutions for this purpose.*

Figure 2.5: State budget expenditure excluding interest, investment and the effect of COVID-19 measures



*Source: MoF, FC. *implicitly based on revised 2020 state budget.*

Figure 2.6: State budget investment expenditure



Source: MoF, FC calculations.

expected to nearly double following this year's growth, whose projection is not considered entirely credible by the Fiscal Council. The main growth factor should be total investment expenditure, which is expected to rise by EUR 1 billion in 2021. A major part of this growth is expected to be financed by EU funds, while around 40% of funding is expected to come from domestic sources. It should be highlighted that around a quarter of projected investment expenditure comprises transfers for units which are not budget users and whose transfers will not be recorded as general government sector investments. An increase in investment is otherwise in accordance with the recommendations by international institutions[12] and with the need for a counter-cyclical expansionary fiscal policy in the current situation. The Fiscal Council assesses that such a considerable increase in investment as projected although poses risks related to the feasibility, supervision and, in particular, to the efficiency of investments (for more information, see Box 2.4). According to the Budget Proposals, the growth of other categories of expenditure is also expected to strengthen next year without considering the impact of COVID-19 measures. Transfers to social insurance funds are projected to record the highest growth. The growth of transfers is also expected to be affected by an extraordinary indexation of pensions in December. An increase is also projected for transfers to ZZZS, of which EUR 200 million will be earmarked to stabilise the financing of healthcare. Furthermore, expenditure on subsidies, goods and services and on transfers to individuals and households is projected to increase. A relatively high growth of expenditure on labour costs,[13] which is expected to be a result of promotions and renewed payments for work performance, is expected to continue. With the projected growth of total expenditure, which is not directly linked to the COVID-19 measures, the Fiscal Council calls on economic policymakers to regulate this part of government spending within frameworks which will not endanger the medium-term sustainability of the public finances. Expenditure in 2022 is expected to fall or remain at the same level as in 2021, with the exception of investment expenditure.

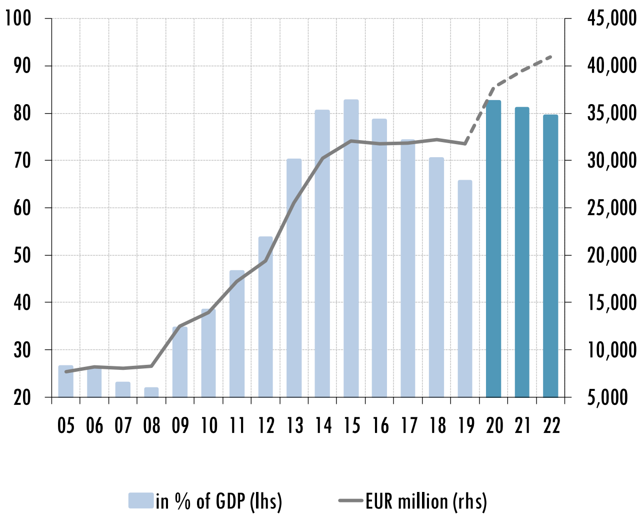
[12] For details on the role of public investment see IMF (2020). Fiscal Monitor: Policies for the Recovery. Available at: https://www.imf.org/en/Publications/FM/Issues/2020/09/30/october-2020-fiscal-monitor.

[13] Expenditure on salaries and employers' social contributions, including transfers to public institutions for salaries.

2.2 Gross general government debt

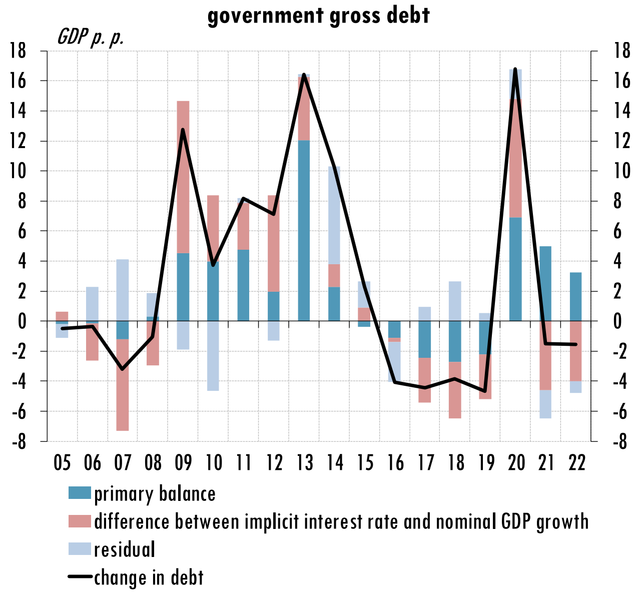
Following this year's considerable increase in the share of gross debt of the general government sector in GDP, the share is expected to be slightly reduced by the end of 2022, but it will nevertheless remain much higher than before the crisis. This year's increase of 16.8% in the share of gross debt of the general government sector in GDP will be the largest ever.[14] With the realisation of the forecasted nominal GDP growth, which is expected to be higher than the implicit interest rate, the share is predicted to be reduced by around three percent to 79.3% of GDP by the end of 2022. The nominal debt will increase cumulatively by EUR 9.2 billion to EUR 41 billion in all three years. After a transient yield increase for all EU Member States in spring, the required yield on Slovenian government bonds has decreased again in the past months and is currently around 0%. The

Figure 2.7: General government debt



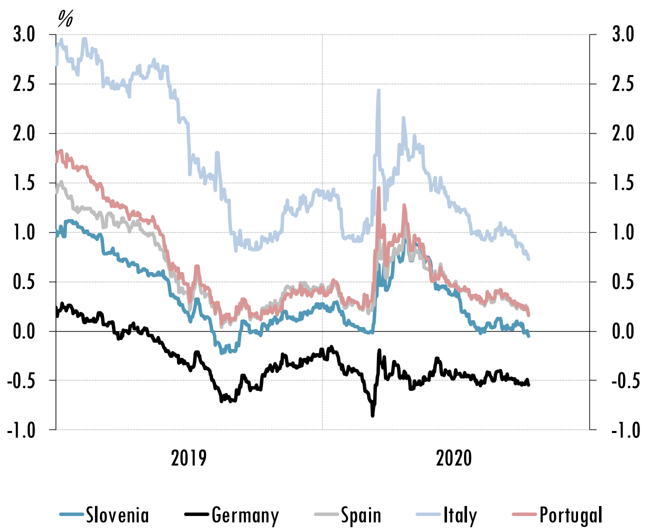
Source: SORS, MoF.

Figure 2.8: Contributions to change in general government gross debt



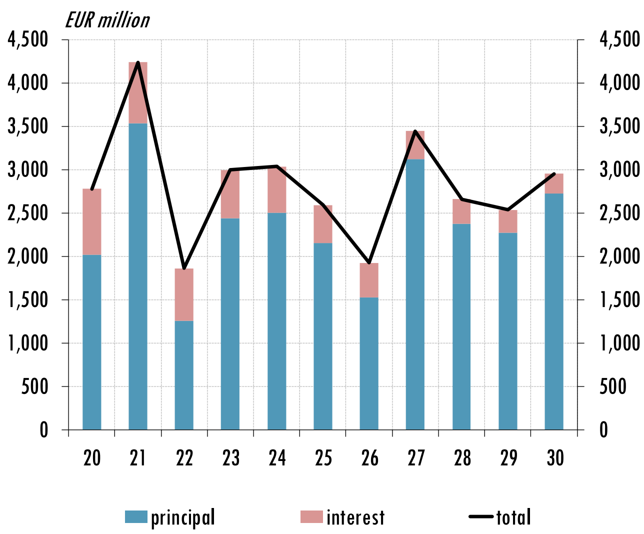
Source: SORS, MoF, IMAD, FC calculations.

Figure 2.9: Yields on 10-year government EUR reference bonds



Source: Bloomberg.

Figure 2.10: State budget debt repayment schedule



Source: MoF.

[14] The debt-to-GDP ratio grew by 12.7% in 2009 and by 16.4 % in 2013.

introduction of new ECB measures, in particular the Pandemic Emergency Purchase Programme (PEPP), made an important contribution. Under the latter, the ECB repurchased EUR 2.5 billion of Slovenian public debt on the secondary market up to September inclusive, which is the fourth largest share in the euro area in terms of total debt. Thus, the credit score of Slovenia has remained stable and has even improved.[15] In spite of debt increase, the share of interest expenditure in GDP is expected to decline in the absence of major unforeseen changes in financial markets. Until now, such decline was made possible through effective debt management and outstanding debt refinancing with favourable interest rates, which was largely the result of the ECB's accommodative policy. The current liquidity position of the state budget is favourable, because the Single Treasury Account has increased by EUR 2.2 billion since the end of last year to EUR 6.2 billion at the end of August.

The Fiscal Council calls on the Government to be careful with additional borrowing, since experience from the past significant increase in debt in the 2009–2013 period shows that debt reduction is a demanding task. In the DBP21, the Government maintains that increased liquidity reserves may be allocated for the repayment of the already issued debt when the economic situation stabilises. A total of EUR 3.5 billion in principal is to fall due next year, most of it in the beginning of the year. When taking decisions regarding any additional borrowing, the following should be considered according to the Fiscal Council: (i) the current liquidity position of the state budget is favourable; (ii) the EC already approved EUR 1.1 billion in loans to Slovenia under the SURE instrument; (iii) Slovenia has EUR 3.6 billion in loans from the Recovery and Resilience Facility at its disposal in the coming years; (iv) according to the latest EC forecast,[16] this year's increase in general government debt in Slovenia is expected to be the sixth largest in the EU. It is crucial to provide for 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 in the coming years.

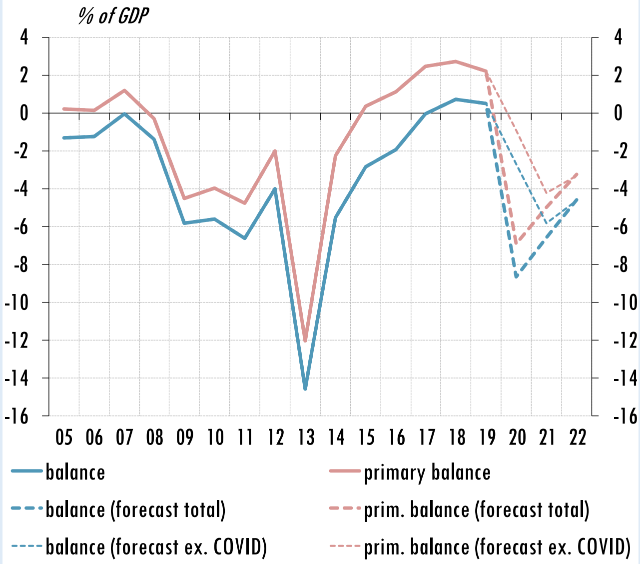
[15] In the beginning of October, Moody's raised Slovenia's credit rating with a positive outlook. For more information see https://www.gov.si/en/news/2020-10-03-moodys-upgrades-slovenias-credit-rating-in-uncertain-times/.

[16] The forecast was published in May 2020 and mainly observed, *inter alia*, the initially forecasted scope of COVID-19-epidemic-related measures, which was over-forecast according to the Fiscal Council. The EC forecast is available at: https://ec.europa.eu/info/sites/info/files/economy-finance/ip125_en.pdf

Box 2.1: The general government sector projections in the Draft Budgetary Plan for 2021 (without considering the direct effects of COVID-19 measures)

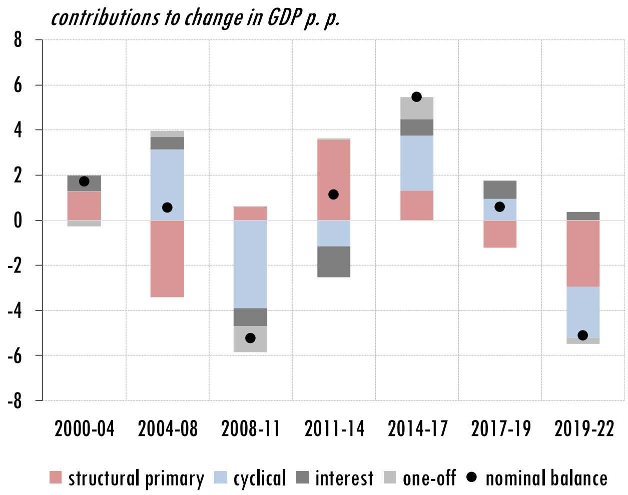
Without taking into account the effect of COVID-19 measures, the general government sector deficit is expected to further worsen next year and will remain considerably larger in 2022 compared to this year in spite of a slight improvement. For methodology reasons, the given assessment is somewhat more focused on state budget projections than on general government sector projections. In the Budget Proposals, the main part of the expected effects of COVID-19 measures is included in the reserves item, which does not exist for the general government sector under the ESA methodology. The Ministry of Finance estimates the impact of individual measures which are yet to be statutorily defined for 2021 and 2022, and categorises it according to individual items of revenue and expenditure of the general government sector. This inevitably diminishes the transparency of projections, in particular because the Fiscal Council is convinced that, in unusual circumstances, special attention should be devoted to fiscal trends without considering the impact of COVID-19 measures.

Figure 1: Balance and primary balance



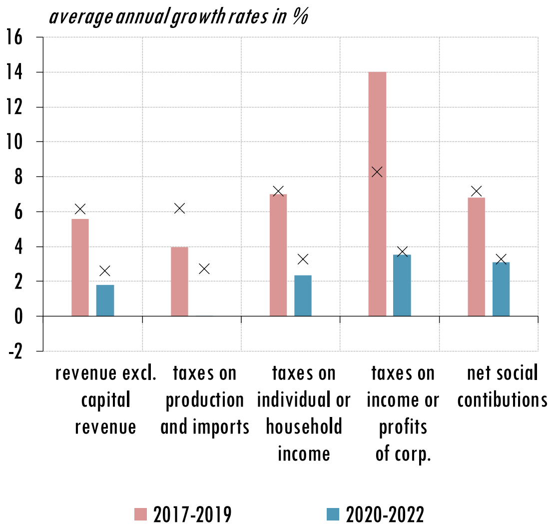
Source: SORS, MoF, FC calcualtions.

Figure 2: Change in general government nominal balance



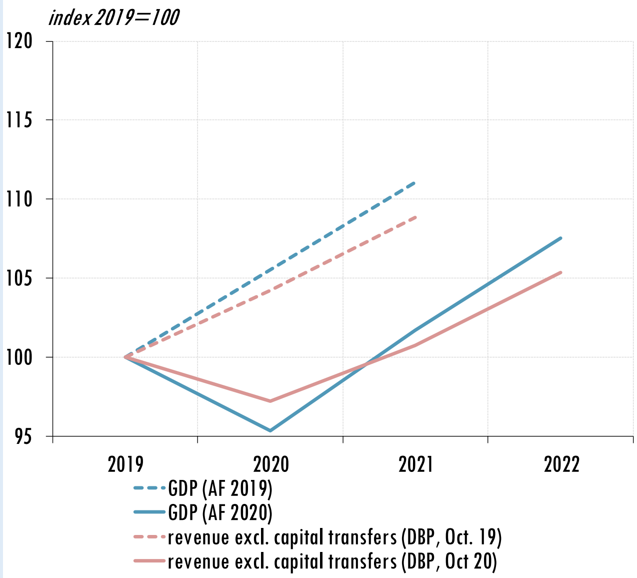
Source: SORS, MoF, FC calculations.

Figure 3: Revenue types and their bases



Note: Crosses denote average annual growth rates of macroeconomic bases.
Sources: SORS, MoF, IMAD, FC calculations.

Figure 4: Nominal GDP and revenue excluding capital transfers



Source: SORS, MoF, IMAD, FC calculations.

According to the available projections excluding the direct effect of COVID-19 measures, the general government balance will show a deficit of −2.7%, which is expected to double to −5.8% next year. In spite of an expected slight improvement in 2022, the deficit will still be substantial (−4.6% of GDP). In the entire 2020–2022 period, a cumulative worsening of the balance will mainly be contributed to by a deterioration in primary structural balance, which will primarily be the result of the envisaged extensive expansionary policy in 2021. At the same time, another important contribution will be the cyclical deterioration of economic conditions (see Figure 2).

After this year's modest fall, the general government sector revenue is expected to recover completely in the next two years without taking into account the impact of COVID-19 measures. With a renewed growth of most taxes (with the exception of taxes on income or profits of corporations) and social contributions, the revenue is expected to grow (2.8%) next year. Significantly higher capital transfers will also make an important contribution to the renewed growth. The growth of total revenue is projected to strengthen in 2022, which will primarily be the result of higher revenue from current taxes on income and wealth and from social contributions. We estimate that revenue projections excluding the impact of COVID-19 measures are approximately consistent with the forecasts of macroeconomic bases from IMAD's autumn forecast.

Without taking into account the impact of COVID-19 measures, the balance in 2021 will be worsened by substantially higher general government sector expenditure, which is forecasted to rise by around a tenth. The expenditure growth is expected to be nearly twice as high as in the 2018–2020 period and will largely be the result of the expected increase in investment expenditure by more than 40%. Expenditure on subsidies, capital transfers, other current transfers and compensation of employees is projected to be much higher than this year, while the growth of social benefits is expected to stay at the same level as this year. The growth of intermediate consumption expenditure is expected to slow down. Such expenditure projections imply a pronounced expansionary fiscal policy, whose basic guidelines are appropriate given the macroeconomic conditions, but is nevertheless

Table: Projections of main aggregates of the general government (excluding direct effects of COVID-19 measures)

EUR million, except where otherwise noted	outcome SORS	DBP 2021			change			change in %			contribution in p.p.		
	2019	2020	2021	2022	2020	2021	2022	2020	2021	2022	2020	2021	2022
General government revenue	**21,226**	**20,997**	**21,582**	**22,508**	**-229**	**585**	**926**	**-1.1**	**2.8**	**4.3**	**-1.1**	**2.8**	**4.3**
Total taxes	10,452	9,956	10,101	10,634	-495	145	533	-4.7	1.5	5.3	-2.3	0.7	2.5
Taxes on production and imports	6,622	6,135	6,352	6,547	-487	217	195	-7.4	3.5	3.1	-2.3	1.0	0.9
Current taxes on income, wealth, etc.	3,812	3,807	3,734	4,072	-5	-72	338	-0.1	-1.9	9.0	0.0	-0.3	1.6
Social contributions	7,723	7,955	8,137	8,467	232	182	330	3.0	2.3	4.1	1.1	0.9	1.5
Property income	410	320	324	352	-90	5	28	-22.0	1.4	8.6	-0.4	0.0	0.1
Capital transfers	356	403	634	574	47	232	-61	13.2	57.6	-9.6	0.2	1.1	-0.3
Other	2,304	403	634	574	-1,901	232	-61	-82.5	57.6	-9.6	-9.0	1.1	-0.3
General government expenditure	**20,977**	**22,215**	**24,421**	**24,904**	**1,238**	**2,206**	**483**	**5.9**	**9.9**	**2.0**	**5.9**	**9.9**	**2.0**
Compensation of employees	5,474	5,709	6,166	6,342	235	456	176	4.3	8.0	2.9	1.1	2.1	0.7
Intermediate consumption	2,956	3,134	3,195	3,378	178	61	183	6.0	1.9	5.7	0.8	0.3	0.7
Social transfers	8,423	8,936	9,448	9,699	513	512	251	6.1	5.7	2.7	2.4	2.3	1.0
Interest	825	787	779	701	-38	-8	-77	-4.7	-1.0	-9.9	-0.2	0.0	-0.3
Subsidies	347	349	487	461	2	137	-25	0.7	39.4	-5.2	0.0	0.6	-0.1
Gross fixed capital formation	1,836	2,146	3,047	3,002	310	901	-45	16.9	42.0	-1.5	1.5	4.1	-0.2
Other	1,116	1,153	1,300	1,320	37	147	20	3.4	12.7	1.5	0.2	0.7	0.1
Balance	**249**	**-1,218**	**-2,839**	**-2,395**	**-1,467**	**-1,621**	**443**						
Balance (% of GDP)	**0.5**	**-2.7**	**-5.8**	**-4.6**									

Sources: SORS, MoF, FC calculations.

exposed to significant risks, while its structure is partly inadequate. The realisation of the projected increase in investment expenditure means that the investments will attain the highest level to date, which is why, considering past experience, the Fiscal Council voices doubts over the feasibility and efficiency of such an extensive one-off increase. In addition, the expected expenditure increase excluding the expenditure on investment and interest rates (6.8%) exceeds the estimates of long-term growth potential and, at least in certain segments, it is not adequately based on currently applicable legislation or measures. This primarily applies to the projected 8% growth in expenditure on compensation of employees. The total expenditure growth without considering the impact of COVID-19 measures is expected to slow down to 2.0% in 2022 and is predicted to be mainly contributed to by higher expenditure on compensation of employees and intermediate consumption.

Box 2.2: Review of measures to limit the effects of the COVID-19 epidemic on fiscal aggregates

According to the Ministry of Finance, by the end of September, COVID-19 measures represented EUR 1.59 billion in state budget expenditure, taking into account the implemented and already recorded measures. The largest part of COVID-19 expenditure is allocated for subsidies (EUR 864 million). Social insurance contributions for employees who worked during the epidemic constitute about a half of this sum, while the payments for temporary lay-off allowance and the payments of social contributions for these employees constitute the other half. Around EUR 400 million was allocated for other current transfers, of which the largest part was allocated for the allowances for workers in healthcare, education and social care (EUR 165 million). The compensation for the loss of income of healthcare service providers at the time of the epidemic, protective equipment expenditure and solidarity bonus for pensioners also represents an important part of current transfers. A total of EUR 284 million was allocated for transfers to individuals and households, of which the largest part was allotted for the payments of basic income for the self-employed and other eligible groups and for the payments of tourist vouchers. Given the projections from the revised budget for 2020, about EUR 1 billion are still available for the implementation of COVID-19 measures in the last three months of this year. Considering previous realisations and the assessments of the financial effects of measures which remain in force until the end of the year, we assess that the actual realisation will be lower than projected in the revised budget.

After adopting the revised state budget, the Government also adopted Anti-Corona Package No. 5 (ACP5)[1], whose financial effects remain quite uncertain due to the nature of the planned measures. A large part of measures with a substantial fiscal effect expected is related to the

Table 1: Overview of outcome and projections of state budget expenditure for COVID-19 in 2020

in EUR millions	Outcome I-IX 2020	Revised state budget 2020
Subsidies	**864**	**935**
-Payment of social contributions PDIIS Art. 33 ZIUZEOP	435	
-Payments for temporarily laid-off	280	
-Payment of social contributions PDIIS Art. 28 ZIUZEOP	80	
-Payment of social contributions HIIS Art. 28 ZIUZEOP	44	
-Shorter work-time scheme		69
-Other	25	
Current domestic transfers	**401**	**472**
-Bonus Art. 71 ZIUZEOP	165	
-Compensation of health-care providers - Art. 76 ZIUOOPE	91	
-Management of the epidemic MEDT	70	127
-Solidarity bonus for pensioneers	67	
-Other	8	
Transfers to individuals and households	**284**	**309**
-Basic income Art. 36. ZIUZEOP	83	
-Tourism vouchers	98	116
-Solidarity bonuses and increased bonus for large families	28	
-Compensation of loss of income in educational instiutions	24	
-Other	51	
Wages and scoial security contributions - Art. 71 ZIUZEOP	**33**	**34**
Reserves		**781**
Other	**6**	**49**
Total	**1,588**	**2,580**

Source: MoF.

purchases of protective equipment and medical equipment, to extensions of bonuses for public sector employees and to improving access to health services. Furthermore, basic income for the self-employed will be paid out again and their social insurance contributions will also be financed for the last three months of 2020. In the documents submitted to the Fiscal Council, the Government estimates that the joint effect of these measures will be about EUR 800 million in the current and the following year. The Fiscal Council finds this amount relatively high given the actual realisation of previous measures.

Taking into account the submitted budget documents, the fiscal effects of COVID-19 measures will continue in the next two years, but they will be considerably lower than this year. To limit the effects of the COVID-19 epidemic, approximately EUR 800 million is earmarked in the Budget Proposals expenditure for 2021, of which EUR 500 million is categorised under the reserves item, which is understandable given the high uncertainty. The largest part of the remaining amount represents EU funds for investment spending from the REACT-EU initiative and funds for protective equipment. The explanation of the general part of the revised budget for 2022 specifies that no funds are planned to be allocated for COVID-19 measures in 2022, while these funds are projected to amount to about EUR 200 million according to the documents submitted to the Fiscal Council. At this point, we would like to highlight the differences between the state budget projections and general government sector projections relating to the COVID-19 measures, which are partly a result of methodological variations[2] and partly a result of inconsistency in the projections.

Table 2: Effect of COVID-19 on public finances

EUR million		2020	2021	2022
State budget (cash flow methodology)	expenditure	2,580	774	213
General government (ESA methodology)	revenue	-305	77	49
	expenditure	2,432	456	25

Source: MoF, FC calculations.

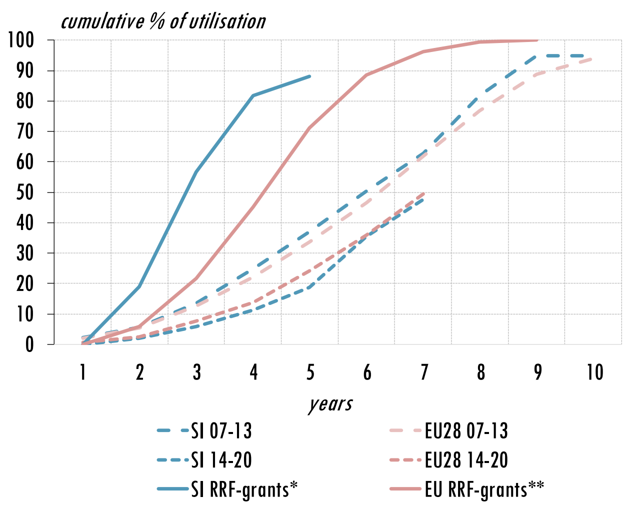
[1] Act Determining Temporary Measures to Mitigate and Remedy the Consequences of COVID-19 (ZZUOOP).
Available at: https://www.dz-rs.si/wps/portal/Home/deloDZ/zakonodaja/izbranZakonAkt?uid=A1770287C5D720DBC12585F40025AFDF&db=pre_zak&mandat=VIII. Only in Slovene.
[2] These differences are also subject to the exchange of instructions between the Eurostat and the producers of statistics. See: https://ec.europa.eu/eurostat/data/metadata/covid-19-support-for-statisticians, or instructions related specifically to measures: https://ec.europa.eu/eurostat/documents/10186/10693286/GFS_draft_note.pdf

Box 2.3: Available EU funds

In the next nine years, EUR 13.3 billion of EU funds are at Slovenia's disposal, of which EUR 2.1 billion are available as grants from the Next Generation EU recovery instrument.[1] In the coming years, funding is available from the existing Multiannual Financial Framework for 2014–2020, the new Multiannual Financial Framework for 2021–2027, the Next Generation EU recovery instrument agreed in July and from the already approved loans from the Instrument for temporary Support to mitigate Unemployment Risks in an Emergency (SURE,[2] see Table). Only the last two instruments are new in terms of limiting the consequences of the epidemic. The Recovery and Resilience Facility (RRF), which is expected to be used particularly for investments, forms the bulk of the Next Generation EU funds. Most funds will be available in the form of loans (EUR 3.6 billion), while EUR 1.6 billion will be available as grants. The remaining instruments within Next Generation EU are REACT-EU funds, which, in order to be exhausted as fast as possible, will be incorporated in the existing multiannual financial framework, Just Transition Fund aimed at regions which are highly dependent on non-renewable energy sources, and in rural development funds.

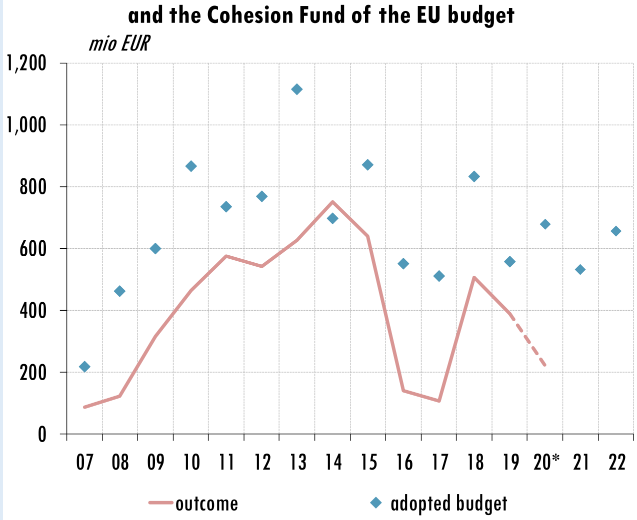
The RRF funds are expected to be drawn much faster than the funds from the usual multiannual financial framework, although Member States, including Slovenia, have issues relating to the slow drawing up of these funds. The RRF funds will be allocated based on national plans, which will be subject to the EC's approval. Although the draft plan was drawn up by the Slovenian government in October according to publicly available information, it was not publicly accessible at the time of the drafting of the assessment. The RRF funding is aimed at achieving the EU's medium-term strategic objectives and is expected to be spent in accordance with the annual recommendations of the EC to individual Member States within the European Semester, i.e. CSR. The implementation of the CSR in the EU as a whole is fairly incomplete, because only about a third of recommendations have been implemented, while the trend is gradually decreasing downward since their introduction in 2013.[3] This year, Slovenia received three recommendations,[4] which relate primarily to its adequate response to the epidemic and, as such, they probably will not hinder the absorption of funds. Considerable difficulties may arise due to the projected fast spending of these funds, which is expected to substantially exceed the pace of absorption of funds from the past multiannual financial frameworks (see Figure 1). Considering the Development Programmes Plan, the Slovenian plans seem even more ambitious compared to the EU as a whole, with more than a half of funding projected to be spent by 2022, which is nearly three times more than the projections for the entire EU. At this point, the question of the rational use of funds arises, which was highlighted by the European Court of Auditors in its report on the funds absorbed from the multiannual financial frameworks. The Court found that EU

Figure 1: Actual and planned dynamics of EU funds utilisation



Note: 2007-13 CF, ERDF, ESF, 2014-20 sredstva CF, ERDF. First year of RRF funds utilisation is 2020.
**NRP projections. **Bruegel projections.*
Source: EC, Bruegel, MoF, FC calculations.

Figure 2: Funds received from the Structural Funds and the Cohesion Fund of the EU budget



** actual outcome in the first 8 months, **data from the adopted budgets (not including changed and revised budgets), except 2022: Proposed budget.*
Source: MoF, FC calculations.

funds were mostly spent in compliance with rules, yet without full consideration of achieving proper results in the use of funds.[5] Doubts also arise in relation to potentially contradicting objectives of the RRF funds.[6] The mechanism is designed as a tool of the counter-cyclical policy and a tool for achieving EU's medium-term strategic objectives at the same time. The first objective requires prompt action, while the second one demands comprehensively devised measures.

Effective and fast absorption of available EU funds will pose a significant challenge, because cohesion funds in Slovenia were insufficiently planned in the past, while their absorption was slow and fragmented. The planning of EU funds in the budget documents is one of the main sources of deviations of the projected expenditure from the realised expenditure.[7] The average actual realisation of the projected cohesion funds from state budgets was less than 60% in the 2007–2019 period. Only about half of the confirmed cohesion policy operations from the 2014–2020 multiannual financial framework were disbursed by 30 June 2020 or only about 40% of all funds available.[8] Thus, the absorption of funds from the last financial framework was even slower than

Table: Overview of available EU funds (in EUR milliion)

Next Generation EU Fund (NextGenEU)	**5,691**
-Recovery and Resilience Fund (RRF) - grants	1,589
-Recovery and Resilience Fund (RRF) - loans	3,593
-React EU - grants	312
-Just Transition Fund - grants	129
-Rural development -grants	68
The European instrument for temporary Support to mitigate Unemployment Risks in an Emergency (SURE) -	**1,100**
Multiannual Financial Framework 2021-2027	**4,622**
-cohesion funds	2,974
-of which European Regional Development Fund (ERDF)	1,365
-of which European Social Fund (ESF)	645
-of which Cohesion Fund (CF)	834
-of which Connecting Europe Facility (CEF)	130
-natural resources and the environment	1,648
Multiannual Financial Framework 2014-2020*	**1,856**
-cohesion funds	1,856
-of which European Regional Development Fund (ERDF)	963
-of which European Social Fund (ESF)	367
-of which Cohesion Fund (CF)	526
-of which Youth Employment Initiative (YEI)	1
Total	**13,269**
-of which loans	**4,693**

*Source: EC, SVRK. Note: *still available cohesion funds as of June 30, 2020.*

1 The Fiscal Council drafted the assessment on available EU funds based on the information made publicly available by the EC and the Slovenian government. In accordance with paragraph seven of Article 10 of the FRA, which stipulates that all institutional units of the general government sector must submit to the Fiscal Council all information, data and analysis at their disposal and which are required for the execution of tasks of the Fiscal Council, on 24 September 2020 the Fiscal Council requested the SVRK to provide precise assessments, however, no answer was received.

2 By the end of September, the EC approved EUR 87.4 billion in loans from the SURE instrument to 16 Member States. Available at: https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/financial-assistance-eu/funding-mechanisms-and-facilities/sure_en.

3 Bruegel (2019). What drives national implementation of EU policy recommendations?

4 European Commission (2020). EC Council Recommendation on the 2020 National Reform Programme of Slovenia and delivering a Council opinion on the 2020 Stability Programme of Slovenia.

5 European Court of Auditors (2018). Special report: Commission's and Member States' actions in the last years of the 2007—2013 programmes tackled low absorption but had insufficient focus on results. September 2018.

6 Wolff, G. B. (2020). Without good governance, the EU borrowing mechanism to boost the recovery could fail. Bruegel. Available at: https://www.bruegel.org/2020/09/without-good-governance-the-eu-borrowing-mechanism-to-boost-the-recovery-could-fail/.

7 For more information, see Fiscal Council (2020). Analysis of the forecast deviations of macroeconomic and fiscal aggregates in the 2016—2019 period.

8 SVRK (2020). Report on the Implementation of the European Cohesion Policy 2014—2020 for the period from January 2014 to June 2020.

the absorption from the 2007–2013 financial framework (see Figure 1), which is typical of the entire EU. Considerable fragmentation of funds is also typical for the absorption of cohesion funds in addition to slow absorption. In the current financial framework, more than 5,600 different projects are being implemented, of which only a third is related to investments. The fragmentation of projects may also have a substantial impact on the efficiency of investments (see Box 2.4).

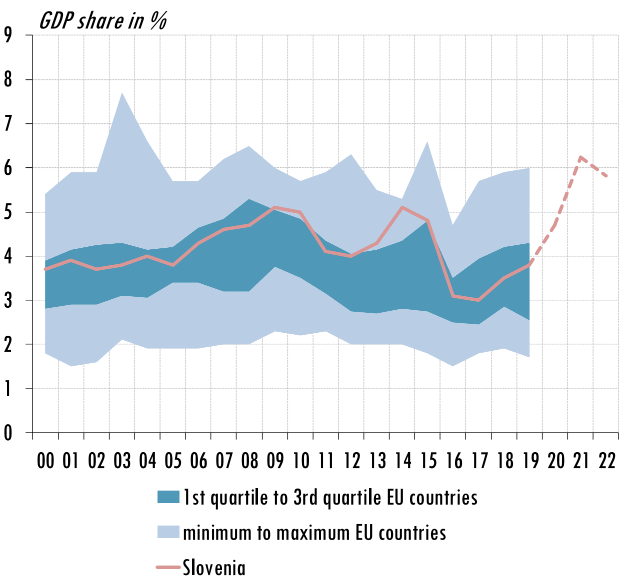
Box 2.4: Management and efficiency of government investments

Government investments are an important budget component and its macroeconomic role is multifaceted. They can represent an effective counter-cyclical tool of the fiscal policy, because they can substitute the private sector demand, especially when it comes to a standstill, for example, due to increased economic uncertainty. The multiplier effect of investment depends on a large number of factors, particularly on the macroeconomic conditions (multiplier effects are assumed to be larger in crisis situations and in a low interest rate environment)[1] and on the structure and quality of the investments. At the same time, by strengthening the economy's supply side through improved infrastructure or investment in research and development, government investments may also affect productivity and thereby develop long-term economic potential or a greater resilience of public finances in future crises.

Considering the Budget Proposals, the general government sector investments are expected to increase significantly in the coming years in the context of stimulating demand after the crisis triggered by COVID-19 is over. The share of government investments in GDP in Slovenia is comparable to the share of EU Member States, on average being among higher in the 2000–2019 period. The highest share of investments in the past 20 years coincided with a stimulative fiscal policy right before and during the global financial and economic crisis, while also coinciding with an accelerated absorption of funds at the end of the EU's previous financial perspective in 2014 and 2015. Investments, particularly those aimed at strengthening medium- and long-term economic potential, are projected to be financed primarily from the new EU instruments (see Box 2.3).[2] Given the considerable volume of investments whose share in GDP is expected to significantly exceed the long-term average and attain the highest levels in the EU to date, it will be crucial to ensure their efficiency. This will be particularly important in the context of enabling the implementation of the fiscal policy also in a situation when its room for manoeuvre narrows, with public debt being considerably higher than before the crisis.

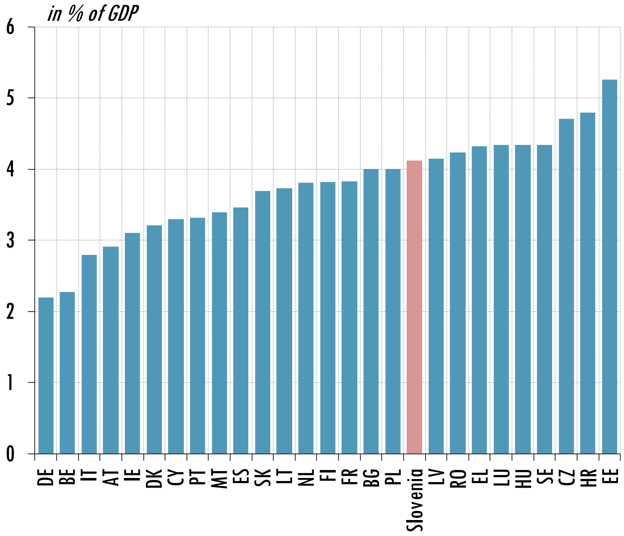
The effectiveness of investments depends largely on their governance. Experience shows that the management of government investments is inadequate in many cases – not limited only to less developed countries – and reduces their effectiveness. International comparisons[3] reveal that government investments in transport infrastructure are between one fifth and one half more expensive than originally planned, while investments in energy infrastructure are on average by two thirds more expensive than originally planned. Delays in the completion of such projects also correspond to these proportions.[4] The implementation of investments is often not justified, for example, due to demand for

Figure 1: General government investment



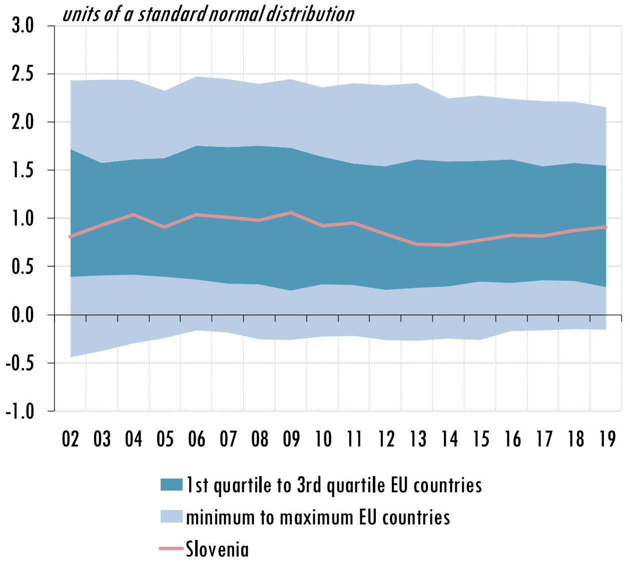
Sources: Eurostat, MoF, SORS, IMAD, FC calculations.

Figure 2: Average general government investment 2000-2019



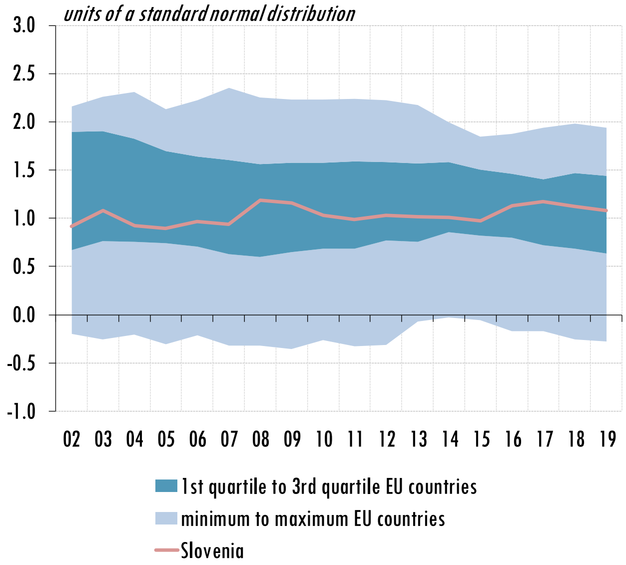
Source: Eurostat, FC calculations.

Figure 3: Governance indicators - control of corruption



Source: WB, FC calculations.

Figure 4: Governance indicators - government effectivness



Source: WB, FC calculations.

services being weaker than assumed at the time of planning.[5] Simulations from Schwartz et al. (2020) also show that inappropriately managed public investment may even exhibit a negative multiplier effect, increase general government debt and crowd-out private sector investments. This applies to developed and, to an even larger degree, to less developed countries. The poor management of investments was also estimated to be one of the major reasons for a significant decline in GDP at the outbreak of the COVID-19 epidemic in some EU Member States.[6] Therefore, a major part of RRF funds is to be implemented to improve the quality of governance in these countries.[7]

The quality of government investment governance is crucially related to the institutional framework as well as to the planning, fragmentation and supervision of investment projects. The importance of quality investment management is reflected in many initiatives led by international networks and institutions for the establishment of rules and best practices in this area. For example, these include G20 (i.e. Quality Infrastructure Investments – QII), OECD (Getting Infrastructure Right principles) or IMF (Public Investment Management Assessment). Participation in the aforementioned initiatives may contribute to the recognition of deficiencies in investment management and may thus encourage improvements in this area.[8]

The choice of investment projects must therefore be economically justified, based on clear criteria, independent of political factors and compliant with actual needs and funds absorption capacities. The effectiveness of investment projects is also largely related to the capacity of coordinated operation of bodies making decisions concerning the adequacy of investments in terms of spatial planning or environmental legislation. In the case of a swift and comprehensive increase in investment, limitations on the supply side, e.g. on the labour market, should be taken into account. The planning of investment expenditure in budget documents is usually too optimistic, which is also typical of Slovenia and which was often significantly related to deviations from the expected inflows from EU funds (see Box 2.3). The lack of supervision over the implementation of investment projects is often reflected in an increased risk of corruption, the probability of which is particularly increased when the number and the volume of investment projects surge. In addition, the expenses of projects financed by grants are usually higher than the expenses of projects financed by loans. Transparency at all stages of the project, including an effective public procurement system, on-going audit oversight of projects by independent professional bodies, and strict enforcement of criminal sanctions, can greatly contribute to the prevention of such cases.[9] Data from the World Bank (e.g. Worldwide Governance Indicators or Doing Business Survey) show that, despite the trend of improvement in some areas, Slovenia still has a lot of room to reduce the backlog and to start employing best practices for addressing the factors inhibiting investment effectiveness.

[1] For example, see Auerbach, A.J and Y. Gorodnichenko (2011). Fiscal multipliers in recession and expansion. NBER Working Paper 17447 in Buffie E. et al. (2012). Public Investment, Growth and Debt Sustainability: Putting the Pieces Together. IMF Working Paper 12/144.

[2] Large-scale investments to overcome the crisis and to restore and increase the long-term economic potential are also supported by the IMF (see: IMF (2020). Fiscal Monitor: Policies for the Recovery), which at the same time calls attention to many pitfalls of rapid increase in investment, also with regard to the various phases of the crisis or the way to overcome it.

[3] Schwartz et al. (Ed.) (2020). Well Spent: How Strong Infrastructure Governance Can End Waste in Public Investment.

[4] A survey in the IMF analysis indicates that delays and higher costs are the main risk factors for infrastructure investment in Central and Eastern European countries. See Ari et al. (2020). Infrastructure in Central, Eastern and Southeastern Europe: Benchmarking, Macroeconomic Impact and Policy Issues.

[5] For example, the analysis of the eligibility of transport infrastructure investments prepared by the Spanish Fiscal Council AIRef (2020). Spending Review 2019/2020 – Transport infrastructures. Available at: https://www.airef.es/en/spending-review-study-2-transport-infrastructure/).

[6] For example, Sapir, A. (2020). Why has Covid-19 hit different European Union economies so differently? Policy Contribution. Issue No. 18. Bruegel.

[7] For example, Wolff, G. B. (2020). Without good governance, the EU borrowing mechanism to boost the recovery could fail. Bruegel. Available at: https://www.bruegel.org/2020/09/without-good-governance-the-eu-borrowing-mechanism-to-boost-the-recovery-could-fail/

[8] According to the IMF, it is supposed to prepare an assessment of the quality of public investment management in Slovenia. Available at: https://www.imf.org/external/np/fad/publicinvestment/#1.

[9] IMF (2019). Fiscal Monitor, Chapter 2: Curbing Corruption.

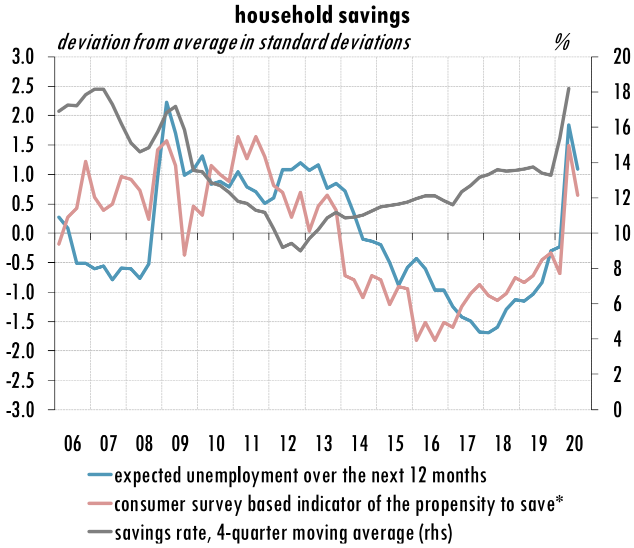
3. Risks to the macroeconomic and fiscal scenarios

Key findings

- Projections of macroeconomic and fiscal developments are exposed to risks mainly due to uncertainty regarding the epidemiological situation and the related economic policy measures.
- The Fiscal Council assesses that in the case of macroeconomic projections, negative risks prevail, while in the case of fiscal projections, the risks are somewhat more balanced.
- The negative risks of fiscal projections related to macroeconomic risks and possible further measures to limit the effects of the epidemic are largely balanced by the assumption of a large-scale and rapid increase in investment expenditure in particular, but also in other categories of general government expenditure.
- In the context of uncertainty regarding the epidemiological situation, the expenditure, which are planned in the Budget Proposals mainly in the reserve item, are justified, but special attention should be paid to eligibility in the actual use of these funds.
- The review of risks also shows that, in the current situation, economic policy should avoid structural measures that would worsen the position of public finances in the medium term.
- Risks are illustrated by scenarios which, even in the case of only a short-term deviation from the assumptions of the baseline scenario, imply a wide range of possible developments in the dynamics of macroeconomic and fiscal aggregates.

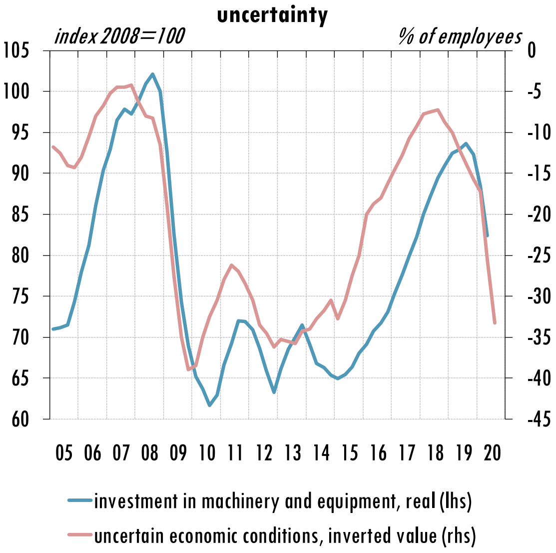
According to the Fiscal Council, the macroeconomic scenario on which the projections of the Budget Proposals are based is dominated by negative risks. The direct risks associated with the COVID-19 epidemic are related to the consequences of measures to contain the epidemic. Based on the experience from the first wave of the crisis, a potential further escalation of these measures would limit economic activity especially in the service sector. The indirect risks associated with the epidemic

Figure 3.1: Indicators of expected unemployment and household savings



*the difference between survey indicator of savings in the next 12 months and the indicator of financial situation of households in the next 12 months.
Source: SORS, FC calculations.

Figure 3.2: Investment in machinery and equipment and uncertainty

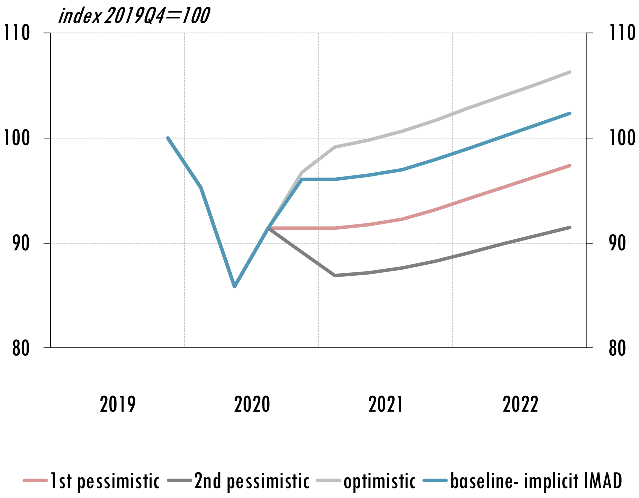


Note: Seasonally adjusted data, 4-quarter moving average.
Source: SORS, FC calculations.

relate to uncertainties that change the behaviour of economic agents and are estimated to have the greatest impact on private sector investments.[17] Increased uncertainty could also be reflected, *inter alia*, in the continued high level of private sector savings, which is also driven by demand constraints in the household sector that affect some important segments of their consumption (e.g. travel). In addition to the risks related to the epidemic, the international environment is dominated by risks that existed before the outbreak, but have further deepened in the last year. These include, in particular, uncertainties related to Brexit and tensions in international trade, especially those related to a possible further strain in US-China trade relations. Economic growth forecasts in the most important trading partners have improved as restrictive measures have been eased, but the improvement in the situation and expectations in early autumn is losing momentum as the epidemiological situation deteriorates. This could also affect the slower recovery of demand from Slovenian trading partners.

Based on identified high risks a decision was made to develop additional macroeconomic scenarios. The scenarios we have prepared differ mainly in the assumption on the dynamics of economic trends at the transition from 2020 to 2021,[18] while the quarterly dynamics are adjusted accordingly to the assumptions from the baseline scenario in the subsequent periods. With regard to the baseline macroeconomic scenario presented by IMAD's autumn forecast, we developed one optimistic and two pessimistic scenarios. In light of current epidemiological trends, we paid special attention to economic developments at the end of 2020 and the beginning of 2021 and we therefore converted IMAD's autumn forecast for 2020–2022 into implicit quarterly GDP growth rates observing the outturn in the first half of 2020.[19] In all scenarios, we assumed high quarterly growth in the third quarter of 2020, which compensates for about a third of the decline in activity in the first two quarters and affects the carry-over of growth dynamics to 2021. In the less pessimistic scenario, we assumed that quarterly GDP would not change in the last quarter of 2020 and in the first quarter of 2021, in contrast to the high implicitly assumed growth in both of those quarters in the baseline scenario. In a

Figure 3.3: GDP scenarios



Source: SORS, FC calculations.

[17] See ECB Economic Bulletin (2020). The impact of the recent spike in uncertainty on economic activity in the euro area. Issue 6/2020.

[18] Among other things, we want to indicate the fact that even short-term economic forecasts are very difficult, mainly due to unpredictable epidemiological trends and the related uncertainties in the operation of economic agents. Furthermore, the scenarios are merely a technical and greatly simplified presentation of the response of a limited set of macroeconomic and fiscal aggregates and should not be taken as a forecast or the most probable development of events.

[19] GPD in fixed prices was used in all simulations presented.

Table 3.1: GDP annual growth scenarios

	2019	2020	2021	2022
baseline - IMAD forecast	2.8	-6.7	5.1	3.7
1st pessimistic	2.8	-7.9	1.3	3.2
2nd pessimistic	2.8	-8.4	-3.2	3.0
optimistic	2.8	-6.5	8.7	4.0

Source: SORS, IMAD, FC calculations.

more pessimistic scenario, we used an additional assumption that activity in these two quarters decreases by half of the fall in GDP in the first quarter of 2020.[20] The optimistic scenario is based on the assumption that the epidemiological situation would be rapidly brought under control, the restrictions would be lifted and, consequently, consumer and economic confidence would increase as early as at the transition from 2020 to 2021.

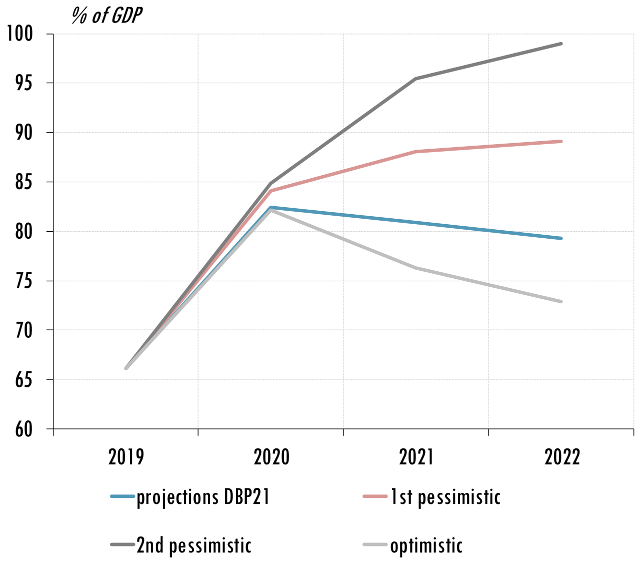
Scenarios indicate the prevailing possibility of slower GDP growth, especially in 2021. Due to the focus on short-term developments at the end of 2020 and the beginning of 2021, the differences between individual scenarios are largest for 2021, in which the range of GDP growth deviation between the optimistic and more pessimistic scenarios is around 12 pps. According to IMAD's baseline scenario, GDP expressed in fixed prices would reach pre-crisis levels (last quarter of 2019) in mid-2022. Meanwhile, the pre-crisis level of GDP in 2022 would not be reached in either of the two pessimistic scenarios, while this level would be reached by mid-2021 in the optimistic scenario. At the same time, we can conclude that GDP in fixed prices in all these scenarios in 2022 would lag behind the level it would have reached this year with the growth projected for the 2020–2022 period before the crisis (IMAD's 2019 autumn forecast): in the baseline scenario by about 6%, in the optimistic scenario by more than 2%, and in the pessimistic scenarios by as much as 10% or 15%. These figures represent the estimated GDP loss for the given period.

The risks to the materialisation of the fiscal scenario are multifaceted and somewhat more balanced than the risks associated with the macroeconomic scenario. As with macroeconomic risks, they are mainly related to possible additional measures to mitigate the consequences of the epidemic and, at the same time, they depend on macroeconomic conditions. The already adopted discretionary economic policy measures and potential additional measures of this type, which are neither directly nor indirectly related to the epidemic, should also be observed. Simulations based on various macroeconomic scenarios indicate a wide range of possible values of fiscal aggregates at the end of the period observed. However, there are also positive risks to the realisation of the baseline fiscal scenario. These are related to more favourable macroeconomic developments and higher general government revenue based on higher macroeconomic bases resulting from the revision of national accounts data (see Box 1.1) and to more favourable outturn than projected due to the amendment of the September 2020 budgetary framework when adopting the revised state budget for 2020 (see Chapter 2.1). The positive risks to the projected balance in the baseline fiscal scenario also relate to the projected large-scale investments of the general government sector, where doubts on the actual absorption of EU funds and the projected rapid implementation of projects arise based on previous experience with budget planning, the absorption capacity of the administration and the limitations on supply side (see Boxes 2.3 and 2.4).[21]

[20] Analyses show that one day of GDP loss during the period of restrictive measures in the first wave of the epidemic is estimated at around EUR 60 million (analysis performed by the Bank of Slovenia staff, available at https://www.bsi.si/en/media/1478/slovensko-gospodarstvo-bo-v-boju-s-koronavirusom-placalo-visoko-ceno).

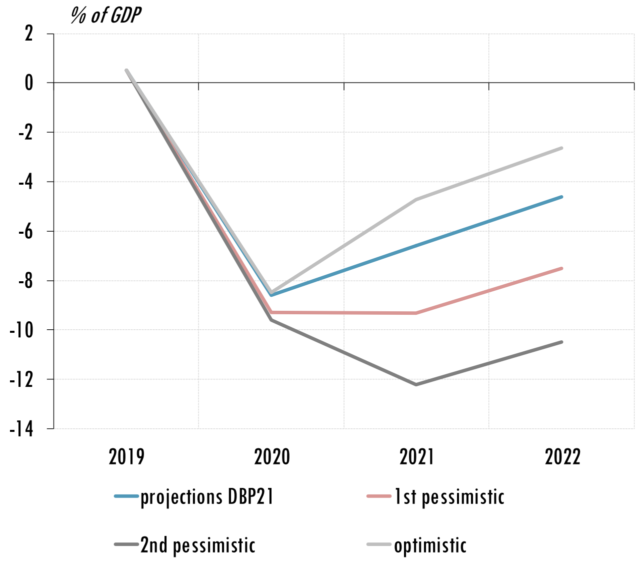
[21] Nevertheless, it should also be borne in mind that, according to the Framework Proposal, the planned spending of European cohesion policy funds for the 2014–2020 programming period should take into account at least 20% higher spending rights than existing ones, which may indicate a partial overestimation of investments in the budget documents.

Figure 3.4: General government debt scenarios



Source: SORS, MoF, IMAD, FC calculations.

Slika 3.5: General government balance scenarios



Source: SORS, MoF, IMAD, FC calculations.

The envisaged volume of measures to mitigate the consequences of the epidemic in the budget documents is subject to high uncertainty. This is reflected in the Budget Proposals in the relatively high reserve item, in spite of the fact that a large part of funds earmarked for further measures to mitigate or limit the consequences of the epidemic are, to a certain extent, already included in other budget items. We estimate that the risks for the fiscal position associated with the earmarked amount of reserves are high due to uncertainty regarding the future course of the epidemic. If the epidemiological situation should improve, the state budget reserves would not be used, which means that the expected state budget expenditure in this category would not be realised. In contrast, the funds earmarked under reserve and other budget items could be sufficient to cover any additional epidemic-related expenses. An exception would arise if the epidemic situation escalated again and thus restrictive measures were tightened, which would lead to a decrease in the economic cycle-related revenue.

Should the risks concerning economic growth at the transition from 2020 to 2021 materialise, this could have a significant impact on the fiscal results in the coming years. We simulated the trends of public finance aggregates based on the macroeconomic scenarios described above. We highlight that simulations do not include a probable discretionary response of the fiscal policy that would follow the assumed economic shocks. If the pessimistic macroeconomic scenarios should materialise, this could also have a negative impact on the public finance results,[22] as the general government debt could reach the level of 100% of GDP in 2022 considering the more pessimistic scenario. While the general government debt would also increase in the less pessimistic scenario, in the optimistic scenario with a faster economic growth the debt could decline faster than projected in the baseline scenario, amounting to just over 70% of GDP in 2022.

[22] Simulations do not include a probable discretionary response of the fiscal policy that would follow such economic shocks. Simulations were carried out using a simple model, which enables a simulation of the effects of various economic growth assumptions on public finance and of fiscal policy effects on economic growth. In this model, economic activity affects public finance through automatic stabilisers, while the fiscal policy affects economic activity reversely through multipliers. The Fiscal Council regularly implements this model to present the risks of changed macroeconomic circumstances. For a more detailed explanation of the model, see: http://www.fiscalcouncil.ie/wp-content/uploads/2012/09/FAR_Sept2012.pdf (Annex B).

Considering the listed risks, which are directly or indirectly associated with the COVID-19 epidemic, we also call attention to the fiscal risks arising from other discretionary decisions taken by economic policymakers. Such decisions, which could impact public finance results, could include the recent decision to liberalise fuel prices or the decision to ban the operation of shops on Sundays. Both decisions could reduce tax revenue, at least in the short term. The realisation of proposed tax reforms to introduce lower taxes, higher tax reliefs and limit the payment of taxes could pose an additional short-term risk on the revenue side. The risk on the expenditure side of budgets is mainly represented by initiatives to change the single salary system or to exclude certain occupational groups from this system, which could put pressure on higher general government expenditure. Given such and similar requests in relation to the growth of social transfers and given that the political cycle is currently already in a mature phase, solutions should be sought that will solve problems not only in the short term, but also systemically, and that will be fiscally sustainable in the long run.

4. Assessment of compliance with fiscal rules

Key findings

- In March 2020, the Fiscal Council assessed that the declaration of an epidemic fulfilled the condition set by the FRA for the enforcement of exceptional circumstances that allow for a temporary deviation from fiscal rules, which at the same time must not endanger the medium-term fiscal balance.
- Following the Government's request, the Fiscal Council notes that the conditions set out in the Fiscal Rule Act enable the exceptional circumstances to be enforced, given the available data at the time of drafting this assessment, this year and next, while for 2022 this cannot be unequivocally confirmed.
- According to currently known data, fiscal policy is expected to become countercyclically expansionary in 2021, which is appropriate in the given situation, and to be relatively neutral in 2022.
- This is also indicated by the assessment of the adequacy of the maximum permitted level of general government expenditure, which depends on the cyclical position and which does not include one-off epidemic-related expenditure. Considering the domestic fiscal rule, general government expenditure is expected to be too high in 2022, mainly due to the high level in 2021.

4.1 Fulfilment of conditions for the enforcement of exceptional circumstances

The Fiscal Council notes that, given the available data and forecasts at the time of drafting this assessment, both conditions are met that, pursuant to Article 12 of the Fiscal Rule Act (hereinafter: FRA), enable exceptional circumstances to be enforced and thus permit a temporary deviation from achieving medium-term fiscal sustainability. In 2021, at least one of both legally stipulated conditions is expected to be met, while for 2022 this cannot be unequivocally confirmed. These findings are not static, but depend on the given circumstances and available forecasts, which is why they are subject to uncertainties and may change in the future.

On 17 March 2020, the Fiscal Council assessed[23] the announcement of the epidemic as an unusual event, which, under Article 12 of the FRA, makes it possible to invoke exceptional circumstances for measures aimed at mitigating the consequences of such an event, and thus to temporarily deviate from the medium-term fiscal balanced position.[24] Considering the epidemiological situation, the Fiscal Council assesses that the conditions for the enforcement of exceptional circumstances still exist at the time of drafting this assessment. At the same time, the Fiscal Council notes that the Government, bound by paragraph two of Article 12 of the FRA to determine the

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

[24] On 23 March 2020, the EU Council, on the proposal of the EC, adopted a decision permitting "the possibility of a general deviation" (a general escape clause) from fiscal compliance during the pandemic. The latest available data gathered by the network of EU independent fiscal institutions, including the Fiscal Council as a network member, indicate that the exceptional circumstances that existed until the end of May 2020 and which permit deviations from national fiscal rules have been established by 19 out of 25 network members. See https://www.euifis.eu/download/european_fiscal_monitor_special_updatevol2_01.pdf (p. 1).

existence of exceptional circumstances on the basis of the Fiscal Council's assessment, has already used its assessment from March in Government's documents, while it has not yet formally established the occurrence of exceptional circumstances on the basis of the Fiscal Council's assessment.[25]

The Government's request to establish the occurrence of exceptional circumstances submitted at the end of September 2020 fails to follow the timeline for the preparation of the budget assessment that is to be drawn up by the Fiscal Council. Nevertheless, the law does not specify the time frame for the preparation of an exceptional circumstances assessment within the timeline of the budget drafting procedure. The Fiscal Council notes that, although their compliance with fiscal rules is to be determined by the Fiscal Council, the Government requested the assessment simultaneously with, i.e. upon the submission of budget documents for 2021 and 2022. In this regard, policies in budget documents should have depended on the assessment of the potential occurrence or existence of exceptional circumstances in the period that these documents refer to.

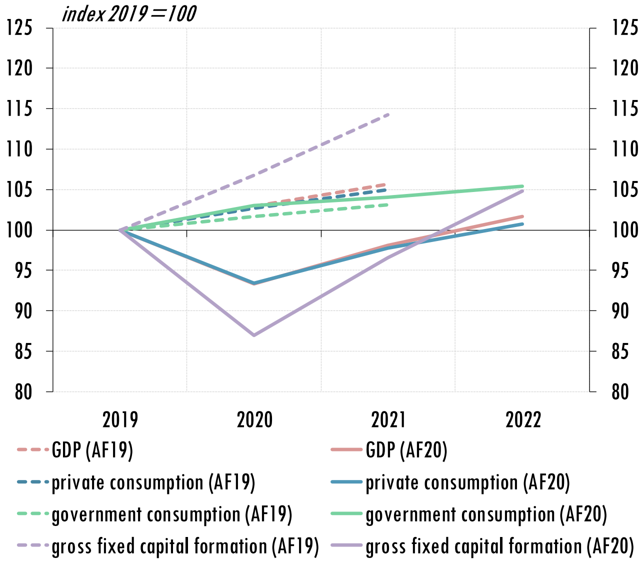
Although not in detail, the FRA lays down two conditions for the existence of exceptional circumstances that permit temporary deviations from the medium-term fiscal balanced position, provided that this does not endanger fiscal sustainability. In accordance with paragraph one of Article 12 of the FRA, such deviation is only permitted in (i) periods of severe economic downturn or (ii) in the case of an unusual event outside the control of the party concerned which has a major impact on the financial situation of the general government sector, as defined by the Stability and Growth Pact. The FRA does not set out the criteria for determining the severity of an economic downturn or the magnitude of the unusual event which has a major impact on the financial situation of the general government sector.[26] Therefore, the Fiscal Council applies in its assessment the criteria for defining the adequacy of conditions which, according to the Fiscal Council, correspond best to the requirements referred to in the FRA.

The currently available data and forecasts show that the conditions enabling exceptional circumstances to be enforced could be met for this year and next, while for 2022 this cannot be unequivocally confirmed at the time. Given the (a) severe economic downturn in the first half of 2020, which according to the available data stood at 8% year-on-year, while a quarterly decline of GDP in the second quarter of 2020 amounted to almost 10%, and (b) the fact that the level of GDP in constant prices before the crisis (from the fourth quarter of 2019) will be reached in mid-2022 according to the Fiscal Council's calculations based on the autumn's forecast by the Institute of Macroeconomic Analysis and Development (hereinafter: IMAD), the Fiscal Council expects that (i) the condition referred to in the preceding paragraph will be met in 2021, while for 2022 this cannot be unequivocally confirmed. IMAD's forecasts also suggest that, with the exception of government spending, no component of domestic consumption in constant prices will reach the 2019 level in 2021. Similarly, the 2019 employment level is only expected to be reached in 2022, while the number of unemployed people in 2022 will be more than 10% higher than in the year before the crisis. The comparison of the level from the most recent IMAD's forecast with the projected level based on IMAD's autumn 2019 forecast (the last forecast before the crisis) reveals that, in 2022, household consumption will supposedly decrease by 6% and gross fixed capital formation by about 15%, while government spending will remain virtually unchanged. Based on such comparison, the GDP would be lower by 6%. Although the Fiscal Council's assessment submitted in March 2020 determined the fulfilment of

[25] https://www.gov.si/assets/ministrstva/MF/ekonomska-in-fiskalna-poltika/evropski-semester/Stability-Programme-2020.pdf.

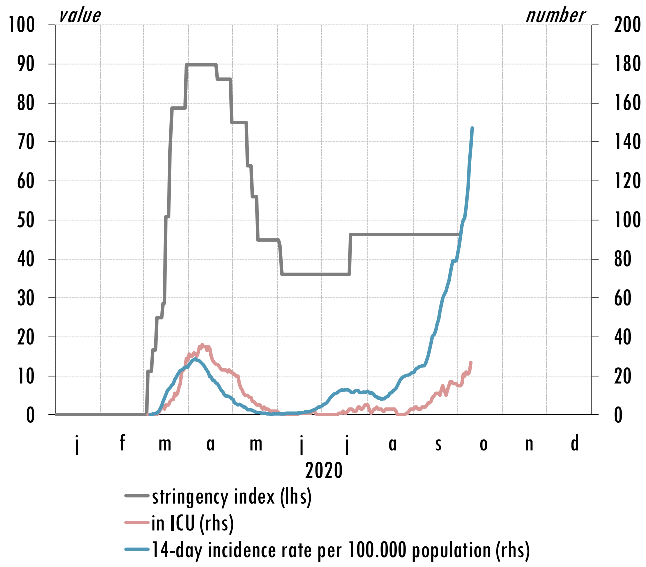
[26] For example, Article 2(2) of Council Regulation (EC) No 1467/97 defines a severe economic downturn as a negative GDP growth rate in fixed prices or an accumulated loss of output during a protracted period of very low annual GDP volume growth relative to its potential. According to the Fiscal Council, such definition may apply to the standard conditions of a business cycle, but not in the case when the annual GDP of an individual country and nearly all EU countries shrinks by almost 10%.

Figure 4.1: Real GDP and domestic consumption components during the crisis



Source: SORS, IMAD, FC calculations.

Figure 4.2: Stringency, ICU patients and 14-day incidence rate per 100.000 population



Source: OxCGRT, ECDC, covid-19.sledilnik.org, FC calculations.

condition (ii) based on the declaration of the epidemic, the Fiscal Council estimates that, in spite of the absence of an epidemic being declared at this point, the condition (ii) remains fulfilled in light of the current epidemic situation and the tightening of restrictive measures. The fulfilment of condition (ii) for the entire 2021–2022 period that the draft budget refers to cannot be assessed by the Fiscal Council due to considerable uncertainty as to the future course of the epidemic.

Upon establishing the occurrence of the aforementioned conditions, the Fiscal Council has called for caution in the enforcement of measures during the period of exceptional circumstances. It noted that, in accordance with applicable European fiscal rules,[27] the measures adopted to tackle exceptional circumstances should be temporary and should directly address the exceptional circumstances. Just as in March 2020, the Fiscal Council reiterates its expectations that the Government will precisely define and quantify the measures adopted to mitigate the consequences of the epidemic. Upon establishing the occurrence of conditions that enable the enforcement of exceptional circumstances, the Fiscal Council also warned that, after the period of exceptional circumstances has ended, the medium-term fiscal balanced position of the general government should be re-established as stipulated by Slovenian and European law.

The fulfilment of the aforementioned conditions permitting the enforcement of exceptional circumstances will be regularly examined by the Fiscal Council in its future assessments of budget documents. The assessment regarding the fulfilment of conditions for the enforcement of exceptional circumstances is not static, but may change depending on the given circumstances and projections. Thus, additional uncertainty is introduced into budget planning that requires additional caution and reflection on how to frame fiscal policy to eliminate any future need for implementing measures that could substantially change the course of the adopted policy.

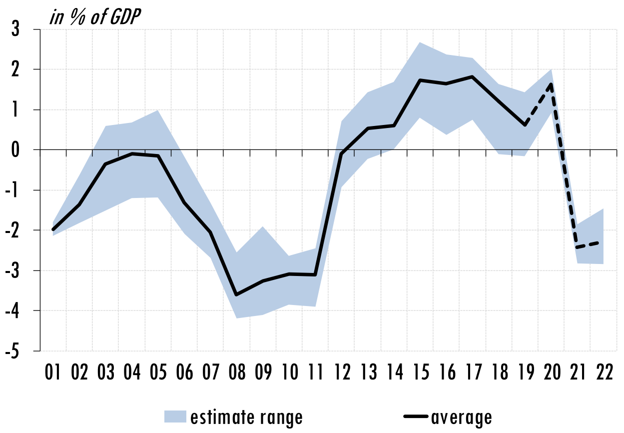
[27] EC (2019). Vade Mecum on the Stability and Growth Pact 2019 Edition, p. 26 Available at: https://ec.europa.eu/info/publications/vade-mecum-stability-and-growth-pact-2019-edition_en.

4.2 Assessment of compliance with fiscal rules in the budget documents

Despite the possibility of a temporary deviation from the medium-term balance and the enforcement of the general escape clause, the Fiscal Council is indicatively reviewing the compliance of the submitted budget documents with the domestic fiscal rule. In spite of the permitted temporary deviation from the medium-term balance, the FRA requires the Fiscal Council to prepare an assessment of the compliance of fiscal developments presented in the Framework Proposal and in the Budget Proposals with fiscal rules. Despite the forecasts in the Stability Programme from April 2020, according to which the projected balance of the general government sector will exceed 3% of GDP this year, the EC has not initiated an Excessive Deficit Procedure for Slovenia, which indicates the enforcement of the General Escape Clause under the Stability and Growth Pact.[28] Estimates of the structural position i.e. the orientation of public finances are associated with a high degree of uncertainty due to the risks related to the levels of input variables (see Box 4.1). Such assessments can therefore only be indicative; however, they still give a sense of the fiscal policy's course and can serve as a warning to economic policymakers in decisions that determine the structure of changes in the policy orientation and which may thus affect the structural position of public finances after the crisis is over.

According to current estimates, the fiscal policy is expected to be expansionary in 2021 and relatively neutral in 2022. The primary structural balance is projected to shift from a relatively high surplus maintained over the last eight years, including 2020, to a significant deficit in 2021. The easing of the fiscal policy in 2021 is estimated at around 4 pps. of GDP. Given the current fiscal rules, such a structural deterioration indicates the need for a fairly large-scale consolidation of public finances in the post-crisis period. According to current estimates of the cyclical situation, the easing of the fiscal policy is being delayed, since the output gap was most negative in 2020, while in 2021 it is

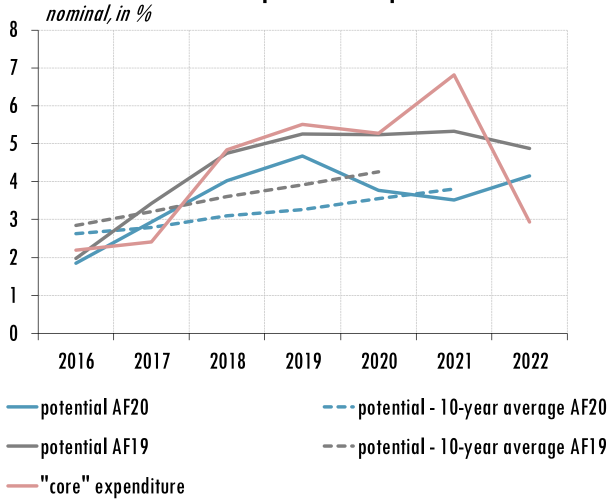
Figure 4.3: Estimates of primary structural balance



Note: Cyclical component is removed from the calculation of structural balance based on output gap estimate used by the Fiscal Council. Current calculation does not include certain institutions, which produce estimates for Slovenia (EC, IMF, OECD), because their estimates have not yet been revised. Border values are determined based on minimum and maximum values of currently available output gap estimates. Estimates of one-off effects are taken from Table 4.2.

Source: MoF, IMAD, FC calculations.

Figure 4.4: Growth of "core" general government expenditure and the potential output



Note: "Core" expenditure is general government expenditure excluding COVID-19 related expenditure, investment and interest expenditure.
Sources: SORS, MoF, IMAD, FC calculations.

[28] Apart from the implementation of the General Escape Clause and the recommendations for an expansionary fiscal policy in 2021 (https://ec.europa.eu/info/sites/info/files/economy-finance/si.pdf), European institutions have so far not provided clear guidelines for conducting the fiscal policy in the post-crisis period. This topic will first be put on the agenda of the Eurogroup meeting in March 2021.
(https://www.consilium.europa.eu//media/45983/work-programme-for-publishing.pdf?utm_source=dsms-auto&utm_medium=email&utm_campaign=Eurogroup+Work+programme+until+June+2021)

Table 4.1: Frameworks for the preparation budgets

	General Govt.		State budget		Local governments		Pension fund		Health fund	
	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
Framework, Apr. 2019 (OG 26/2019)										
2021	1.1	22,160	1.2	10,455	0.1	2,360	0.0	6,180	0.0	3,525
2022	1.2	23,000	1.0	10,705	0.1	2,430	0.0	6,530	0.0	3,725
Proposed Framework, Oct. 2020										
2021	-6.6	24,900	-5.7	13,520	0.1	2,440	0.0	6,180	0.0	3,525
2022	-4.6	24,950	-3.2	12,650	0.1	2,430	0.0	6,530	0.0	3,725
Difference										
2021	-7.7	2,740	-6.9	3,065	0.0	80	0.0	0	0.0	0
2022	-5.8	1,950	-4.2	1,945	0.0	0	0.0	0	0.0	0

Source: OG (Official Gazette of the Republic of Slovenia), MoF, FC calculations. Note: max E : maximum permitted level of expenditure.

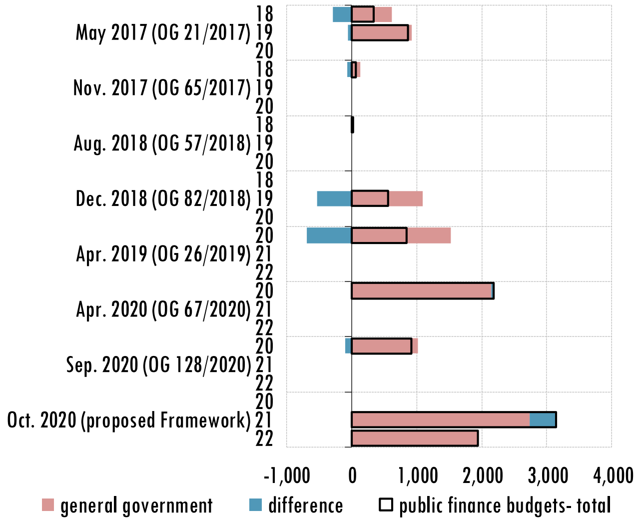
expected to gradually narrow, also due to the countercyclical expansionary fiscal policy. The assumed high general government investments play a pivotal role in this regard, wherefore their effectiveness will be essential for the sustainable recovery of the economy and the ability to repay the increased general government debt incurred during the crisis in the long run (see Box 2.4). It should also be noted that the growth of expenditure excluding the impact of COVID-19 measures, investment and interest expenditure in 2021 is expected to strongly exceed the growth of the long-term economic potential, both estimated currently and estimated in the pre-crisis period (see Figure 4.4). In 2022, the growth of such defined expenditure is expected to fall below the currently estimated growth of economic potential, which indicates a shift to a pro-cyclical restrictive policy or, according to current estimates of the economy's cyclical position, a departure from a fiscal policy which would be stability-oriented.

Despite the possibility of a temporary deviation from the medium-term fiscal balance due to exceptional circumstances, the Government must determine the maximum allowed level of expenditure. In accordance with Article 13 of the FRA, it can do this by revising the framework for the preparation of general government budgeting, which the government submitted to the Fiscal Council for assessment together with the Budget Proposals. The Framework Proposal contains revised estimates of general government sector expenditure for 2021 and 2022. Considering the currently applicable Framework for the preparation of the 2020–2022 budgets, the revisions made to the Framework Proposal relate primarily to the state budget and, to a lesser extent, to the ZZZS (see Table 4.1). In the given situation, the Fiscal Council can only estimate what the threshold value of general government expenditure in 2021 and 2022 would be if fiscal rules applied. In this context, it examines in particular whether the part of expenditure determined in the Framework Proposal is adequate in relation to the position of economic cycle, which illustrates the structural orientation of the fiscal policy. In accordance with its competences, the Fiscal Council does not assess the eligibility of expenditure related to the remedy of the effects of the epidemic.

The Framework Proposal is in line with the Budget Proposals for state budget expenditure, however, the difference between the change in expenditure of public finance accounts and the change in expenditure of general government is not explained. The average expenditure in the Budget Proposals for the 2021–2022 period is almost 0.5% lower than the maximum permitted state budget expenditure in the Framework Proposal. Divergent trends of state budget expenditure, which are the most important component of general government expenditure, and of total general government expenditure are evident from the Framework Proposal. While the Framework Proposal

Figure 4.5: Changes to budgetary frameworks and the difference between change in sum of public finance budgets expenditure and general government expenditure

EUR million



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

projects a reduction in state budget expenditure in 2022 compared to 2021, general government expenditure is expected to increase in 2022. In addition, the total change in public finance accounts expenditure (only the state budget and municipal budget expenditures change in the current Framework Proposal) exceeds the change in general government expenditure in the Framework Proposal by about EUR 400 million in 2021, while it lags the change in general government expenditure for 2022 by EUR 5 million. The difference between the two changes is usual 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, improved transparency regarding this difference is required, especially for 2021. This year, the difference between the change in general government expenditure and the change in the sum of expenditure of public finance accounts is among the largest considering the amendments to the frameworks for the preparation of the general government budgets from previous years, especially in the perceived direction. This may also imply issues with methodological solutions for the representation of items related to COVID-19 measures, or issues in budgetary planning with the inclusion of institutional units not included in general government accounts.

According to the baseline calculation of the Fiscal Council, the general government expenditure in 2021 and 2022 from the Framework Proposal would not be in line with the maximum permitted expenditure ceiling set by the FRA with the same conclusion applying to all other scenarios used. In the calculations of the baseline scenario, in addition to the assumed level of general government revenue implicitly derived from the Framework Proposal, we took into account the estimate of the one-off and temporary measures contained in the Budget Proposals (see Table 4.2). We also considered

Table 4.2: Assumptions regarding one-off effects

EUR million	2020	2021	2022
Revenue	305	-77	-49
Expenditure	2,580	774	213
Total	**2,885**	**697**	**164**

Source: MoF, FC calculations.

Table 4.3: Indicative calculation regarding the maximum expenditure rule

			2021 baseline scenario	2022 baseline scenario	2021 baseline scenario (revision)	2022 baseline scenario (revision)
Revenue (DBP21)	*% of GDP*		44.4	43.7	44.4	43.7
Revenue (FC calculation)	*EUR million*	R	21,661	22,557	21,835	22,738
Expenditure (proposed Framework)	***EUR million***	**E**	**24,900**	**24,950**	**24,900**	**24,950**
Gross domestic product	*EUR million*	Y	48,818	51,630	49,211	52,045
Output gap (FC estimate)	*% of pot. output*	OG	-2.4	-1.3	-2.4	-1.3
Potential output (FC estimate)	*EUR million*	YP	50,001	52,305	50,403	52,725
Elasticity of budget to the output gap		á	0.468	0.468	0.468	0.468
Lowest allowed structural balance	*% of pot. output*	mSS	-1.1	-1.1	-1.1	-1.1
One-offs (FC)	*% of GDP*	o	1.4	0.3	1.4	0.3
Maximum expenditure (FC estimate)	***EUR million***	**E_max=R-(mSS+á*OG/100)*YP-o*Y/100**	**23,456**	**23,611**	**23,644**	**23,801**
Difference	*EUR million*	E-E_max	1,444	1,339	1,256	1,149

Note: In the baseline scenarios, the GDP available at the time of preparing the budget documents (IMAD, AF20) and the GDP recalculated on the basis of the published revision to national accounts data were used (see Box 1.1). 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 output gap were taken as used by the Fiscal Council. For one-off effects, see Table 4.2.
Source: DBP21 (Oct. 20), Framework Proposal (Oct. 20), SORS, FC calculations.

the range of production gap estimates taken into account by the Fiscal Council. Considering the range of output gap estimates, based on current information, and various GDP levels (see Boxes 1.1 and 4.1) to determine the limits of expenditure, the proposed maximum allowed level of the general government expenditure in 2021 and 2022 could fall outside such limits. The projected expenditure of the general government sector in the Framework Proposal is higher than all presented calculations of the maximum allowable expenditure under the FRA. This also applies to all calculations based on the different scenarios of the dynamics of economic activity presented in Chapter 3, assuming the target share of general government revenue in GDP as implicitly derived from the Framework Proposal. At the same time, the national fiscal rule nevertheless allows for an increase in the maximum permissible expenditure. In the baseline scenario for 2021, the aforementioned expenditure (as determined by the formula referred to in Article 3 of the FRA) exceeds the actual 2019 expenditure of the general government sector by around EUR 2.7 billion, while this expenditure in 2022 exceeds the 2019 expenditure of the general government sector by around EUR 2.8 billion.[29]

The estimated deviations are relatively high and with the given uncertainties, they indicate the probability that the actual expenditure could be higher than permitted by the FRA. Keeping in mind the minimum and maximum estimates of the output gaps, the deviations amount to between EUR 900 million and EUR 1.600 million in 2021, and between EUR 700 million and EUR 1.600 million in 2022, which represents about 1.5–3.0% of GDP in both years. The range of deviations based on calculations using different scenarios of economic activity and the adjusted estimates of the production gap are even larger, which applies both in absolute and relative terms. It should be noted that such large deviations, even observing all the uncertainties related to such estimates (see Box 4.1), suggest a high

[29] Such an increase is similar to the rise in expenditure for 2020 in the previous revision of the Framework in September 2020 compared to April 2019 (EUR 3.2 billion), which was primarily due to additional commitments related to the COVID-19 epidemic.

probability that the actual expenditure would be too high in relation to the given or projected cyclical situation of the economy. According to current estimates, this is hold more for 2021 than for 2022.[30] This is probably also due to the high base in 2020, in which actual expenditure could also be lower than projected (see Chapter 2.1).

[30] A simulation with the same input data as observed in the calculation of the maximum permissible expenditure of the general government sector for 2021 based on the baseline scenario (Table 4.3) shows that the output gap should be more markedly negative this year (by about 5 pps.); this would correspond to the estimate of the output gap for 2020 (the cyclical situation should therefore be much worse) in order for the projected expenditure in the Framework Proposal to correspond to the maximum allowable expenditure set under the FRA. From the point of view of historical revisions of estimates of the output gap, these would be similar to the estimates in the periods of significant shocks of economic activity, which however lasted longer than anticipated this time. The institutions which have produced the longest and most consistent set of output gap estimates (MF and EC) have changed the output gap estimates for 2008 and 2013 in the last available assessments compared to the real-time estimates in both years by 3–7 pps.

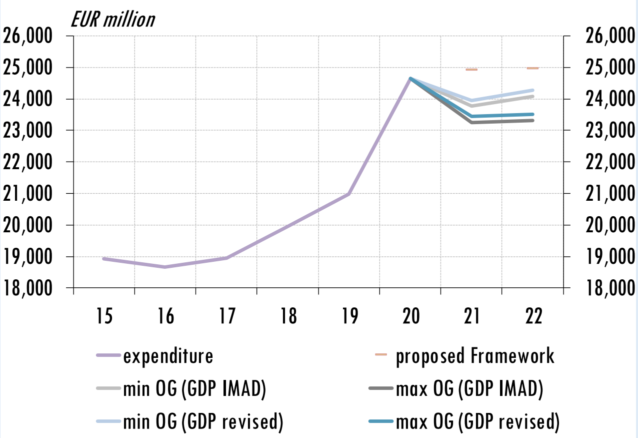
Box 4.1: Uncertainties in estimating the maximum permissible level of expenditure

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 revenue 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, depending on the cyclical position at the time of drafting the assessment. The planned level of expenditure does not include temporary or one-off expenditure.

In setting the maximum possible expenditure ceiling, numerous ambiguities arise due to the current situation, thus the following factors were observed in the calculation:

- The forecasts of fiscal aggregates in the Budget Proposals and in the Framework Proposal are prepared on the basis of IMAD's autumn forecast from the end of September. The revision to national accounts data from the end of September (see Box 1.1) is not taken into account in the Budget Proposals due to inconsistencies in the timeline for the preparation of the budget

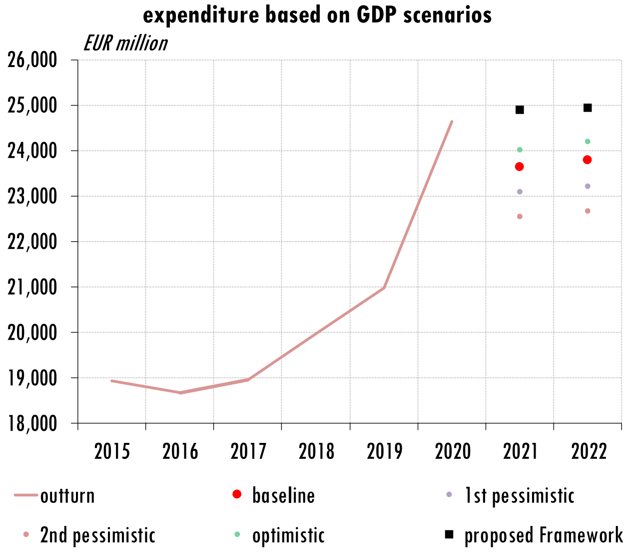
Figure 1: Maximum allowed general government expenditure based on different base GDP values



Note: The border values are set according to minimum and maximum output gap esitmate used by the Fiscal Council as well as to different GDP levels (see Box 1.1).

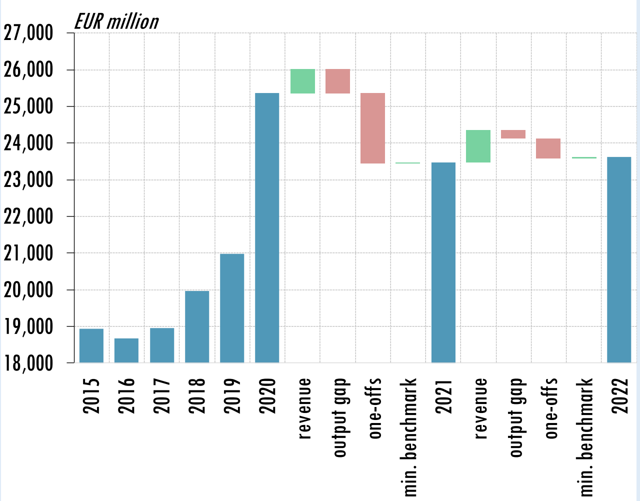
Source: SORS, MoF, UL RS, FC calculations.

Figure 2: Simulation of maximum allowed general government expenditure based on GDP scenarios



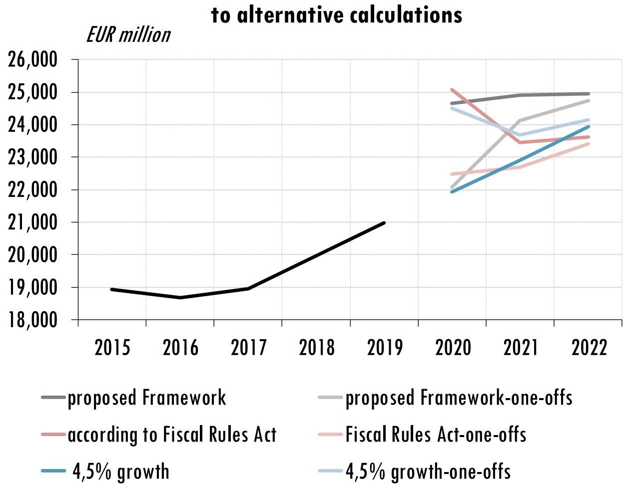
Note: GDP levels are based on the scenarios from Chapter 3.
Source: SORS, MoF, OG RS, FC calculations.

Figure 3: Contributions to a change in maximum allowed general government expenditure in the baseline scenario



Note: Green bars denote positive, while red bars denote negative contribution to a change in maximum allowed expenditure.
Source: SORS, MoF, FC calculation.

Figure 4: General government expenditure according to the proposed Framework and according to alternative calculations



Note: Expenditure levels as set based on the Fiscal Rule Act and excluding one-off effects as well as considering assumed long-term potential growth with added one-off effects.
Sources: SORS, MoF, FC calculations

documents. In our assessment, we included both nominal GDP levels derived from IMAD's autumn forecast and the GDP levels based on the revision to national accounts data, observing the projected growth rates from IMAD's autumn forecast.

- The uncertainty about assessing the output gap is particularly high in the context of stronger fluctuations in economic activity.[1] The Fiscal Council prepares its own output gap estimate on the basis of the average estimates of other institutions and statistical methods. This time, the uncertainties related to the point estimate of the output gap, in addition to the usual range of the minimum and maximum estimates of the output gap,[2] were presented and included in the calculations based also on simulations of economic activity (see Chapter 3). The base level of the estimated output gap was adjusted for assumed shocks in GDP simulations considering the long-term average of correlation between the changes in GDP growth and the changes in output gap estimates.
- The assessment of the Fiscal Council regarding the value of one-off or temporary measures is determined on the basis of data on budget components which are related to the COVID-19 measures and which were included in the preparation of the Budget Proposals and of DBP21. The assessment also considers the effects of the measures implemented by September 2020 and the assessment of the measures under ACP5 (see Table 4.2). The value of temporary and one-off measures is one of the main variables that influence the determination of the maximum allowed level of expenditure not depending on the cyclical factors.

[1] For example, see Box 1.1 in Fiscal Council (2020). Assessment of compliance of the general government budgets with the fiscal rules in 2019. Available at: http://www.fs-rs.si/ocena-fiskalnega-sveta-skladnost-izvrsenih-proracunov-sektorja-drzava-s-fiskalnimi-pravili-v-letu-2019/

[2] The range of the maximum and minimum estimates of the output gap is relatively small this time, being about one third less than the long-term average. Some of the updated estimates were not available, thus the EC, IMF and OECD estimates were not included in the calculation of the output gap used by the Fiscal Council, which further increases uncertainty regarding the amount of maximum allowed expenditure.

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