Speech by the President of the Fiscal Council on amendments to the state budget for 2022 at the National Assembly of the Republic of Slovenia (13 November 2021)

Ladies and Gentlemen,

In September, the Fiscal Council assessed that the conditions for the existence of exceptional circumstances would continue to be met in 2022 – especially due to the uncertainty surrounding the further course of the epidemic. Since exceptional circumstances have been invoked in March 2020, the Fiscal Council's analyses distinguish between total general government expenditure and expenditure without taking into account the direct effect of COVID-19 measures. Let me reiterate that the existence of exceptional circumstances only allows for flexibility in the conduct of the fiscal policy in order to directly address the challenges brought by the epidemic. At the same time, exceptional circumstances must not be used for the adoption of measures that reflect the final stage of the political cycle.

This Committee has already approved the amendments to the framework, which modifies the expenditure ceilings and target balances for 2021. This modification is very important for the assessment of future plans. Even taking into account the usual seasonal component as highlighted by the Ministry of Finance, we expect that, based on the data already available for the first ten months, the actual state budget expenditure for the whole of 2021 will be lower than anticipated in the amended framework. This could also result in a lower deficit. The situation was exactly the same last year when the 2020 revised budget was being drafted. Given that the projection for 2021 and 2022 was also made on this basis, this high level of expenditure is mapped from the preceding year onto the following years. In the Fiscal Council's view, this approach to planning increases the risks of a structural deterioration of public finance. These risks are reflected, among others, in certain legislative proposals currently under consideration in the National Assembly. The implementation of the current proposals could worsen the public finance position by around EUR 500 million in 2022. This, however, does not yet include the otherwise systemically regulated and most likely actually necessary increase in health and social care salaries that were agreed on this week. This will be disclosed in the general government accounts, but is unlikely to be included in the proposed budget documents. The Health Insurance Institute of Slovenia, which is expected to fund most of the increase (EUR 100 million out of EUR 120 million, according to available sources), is actually the only one of the public finance funds for which no changes in expenditure are envisaged in the proposed budget documents. The surplus of budget revenue over expenditure in October only occured to the fact that it does not include the COVID-19 expenditure which has not yet been disbursed and for which claims could have been submitted by 13 September 2021.

The general government deficit, excluding expenditure on COVID-19 measures, is expected to increase significantly also in 2022 as a result of expenditure growth. Despite increased revenue, the deficit excluding COVID-19 measures is projected to rise to 5% of GDP.

The projected high growth in total expenditure is significantly driven by the increase in current expenditure, that is expenditure excluding COVID-19 measures and investment, which should be limited in the face of a sharp increase in public debt. Such are also the warnings of the European Commission. What stands out is the fact that the state budget current expenditure in 2020 and 2021 was or is expected to be around EUR 200 million lower than in previous budget plans, while the plans for 2022 anticipate an increase of around EUR 700 million relative to previous budget plans.

As a result, growth in current government expenditure is projected at 5.6% in 2022, which is significantly higher than the currently estimated economic potential growth. This is the growth in current expenditure excluding COVID-19 and investment. This will increase indebtedness by more than is justified by cyclical conditions and by more than is warranted to save health and lives. In fact, nominal general government debt is projected to increase by almost EUR 2 billion in 2022, and all COVID-19 measures combined are projected to cost around EUR 640 million (of which around one third is for the direct control of the epidemic) according to the state budget projections, and around EUR 240 million according to the general government balance projections. The aforementioned expected lower outturn this year will result in current expenditure growth even higher than currently projected and justified by the existing legislation.

Public investment is anticipated to be an additional driver of higher government spending in 2022. It is expected to reach almost 7% of GDP, up by almost 2 percentage points relative to the highest shares recorded in 2009 and 2014. I reiterate that the Fiscal Council shares the opinion that public investment can make an important contribution to kick-starting the economy in the short term and to building resilience and increasing economic potential in the long term, but only if it is well targeted and implemented efficiently. The decrease in the investment outturn estimate for this year compared to the current budget confirms our previous assessment that the plans in this area exceed the absorption capacity of the economy and administration. The labour shortages already mentioned today could be exacerbated by such an expansionary policy, which could increase the potential for macroeconomic imbalances.

I would like to emphasise again that the basic orientation of the fiscal policy for 2022 – which is stimulative – is generally appropriate, but the plans are accompanied by significant risks that, if materialised, may have serious consequences for the sustainability of public finance. As can be seen from the draft budgetary plans submitted by the member states to the European Commission, Slovenia's deficit in 2022 – in a relatively favourable economic situation – is expected to be among the highest in the euro area. We assess that the stimulus is excessively based on current expenditure growth. A deficit is not necessarily bad if additional borrowing is used efficiently, but an important aspect to consider here is whether a deficit of 5% of GDP is created when GDP is falling or when it is growing at 5% as projected. Moreover, the static surplus in 2022, excluding investment and COVID-19 measures, is planned at about half of what it was in the three years before the crisis, and also below the average of the last twenty years.

The fiscal policy will need to start consolidating public finance when the period of exceptional circumstances ends, although it is currently unclear under what fiscal rules this will take place. Nevertheless, it will matter at which level this consolidation will start. It is therefore important that the fiscal policy remains responsible and efficient while providing stimulus to the economy. We believe that the realisation of the favourable macroeconomic outlook and the high liquidity of the state budget would allow for a faster reduction of debt without jeopardising the economic recovery, even with more moderate public expenditure growth than currently projected. This will become particularly important when room for manoeuvre is no longer exogenously created as a result of a stimulative monetary policy, which for the time being still provides financing at favourable conditions to all (including Greece). In addition to a possible tightening of the monetary policy, it should be kept in mind that the consequences of an ageing population and the green transition will begin to have an even greater effect on public finance in the future.