REPUBLIC OF SLOVENIA
FISCAL COUNCIL

Assessment of compliance of the general government budgets with the fiscal rules in 2021

June 2022

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SUMMARY

Last year, fiscal trends were again seriously affected by the epidemic. The scope of measures taken to mitigate its impact was again substantial, however, the general government deficit decreased, mainly due to a marked rebound in economic activity and the resulting cyclically driven high revenue growth. Nevertheless, fiscal policy was pro-cyclically expansionary according to the latest available assessments of the cyclical position of the economy, which are in the current situation more uncertain than usual. The procyclicality was partly due to an increased investment activity and partly to a rise in public spending not related to the epidemic. While the growth in investment activity was as expected lower than budgeted, its increase was financed equally by European and domestic funds. The remaining part of public expenditures, which, in addition to investment, excludes interest expenditure and one-off expenditure, together with expenditure on COVID measures, increased last year by the most since 2008 and significantly exceeded estimates of potential economic growth. Despite the deficit reduction, a significant part of the unexpectedly high revenue growth thus also translated into higher current spending, which was in many respects of a structural or permanent character. Furthermore, a number of new discretionary measures were adopted at the end of last year, further constraining manoeuvring room for future fiscal policy.

Economic activity picked up significantly last year after a contraction in 2020, surpassing the pre-crisis level and growing at the highest rates in the EU. The high growth was mainly driven by the adaptation of business entities and households to the epidemic situation. The economic recovery also benefited from government measures, both directly through the strengthening of investment activity and indirectly through measures that contributed to an increase in disposable income and thus to private consumption growth. Economic growth exceeded all the available forecasts owing to, primarily, favourable trends at the end of the year when, contrary to assumptions and despite the worsening of the epidemiological situation, restrictive measures were milder than in the preceding outbreaks.

The general government deficit decreased to -5.2% of GDP last year and, while excluding the impact of expenditure on COVID measures, it amounted to -0.7% of GDP. The decrease was mainly due to strong revenue growth, notably from tax and social contributions, combined with growth in domestic consumption and improvements in the labour market. On the other hand, non-epidemic expenditure growth picked up further last year. This was only partly related to higher government investment activity, and partly stemmed from a strong pick-up in growth of other public spending. The deterioration of the public finance balance during the epidemic was among the largest in the EU Member States, both overall and when the impact of expenditure on COVID measures is excluded.

Last year, general government gross debt decreased to 74.4% of GDP, thus exceeding the pre-crisis level by around 10 pps of GDP. The decline in the share was largely driven by economic growth, which more than offset the further deterioration in the primary balance. Last year, borrowing continued in a favourable financial market environment, mainly as a result of the ECB's accommodative policy. The central bank's share of government debt securities owners further increased to almost 40% last year due to the government bond-buying programme introduced in the epidemic.

The epidemic also led to the application of exceptional circumstances last year in accordance with the legislation. This means that, in particular, due to the growing uncertainty in the calculation of key input variables, the Fiscal Council's ex-ante and ex-post quantitative assessments of compliance with the fiscal rules are only indicative and, similar to the European Commission, place more emphasis on qualitative assessments. Despite the application of exceptional circumstances, the Fiscal Council must determine, based on national legislation, whether the actual volume of general government expenditures was in line with the last applicable maximum set by the amendment of the Framework under Article 13 of the Fiscal Rule Act. The threshold of the Framework for the maximum permitted level of general government expenditures was increased three times between November 2020 and September 2021, i.e. by EUR 900 million. The level of expenditure outturn was lower than the last maximum defined by the ordinance, but the ex-post assessment based on the latest known estimates of the output gap shows that the realisation was slightly higher than the current estimates of the maximum permitted level of expenditure.

Legislative basis

Pursuant to point 4 of paragraph two and point 3 of paragraph three of Article 7 of the Fiscal Rule Act (the FRA), the Fiscal Council is required to produce an assessment of compliance of the general government budgets with the fiscal rules by 30 June of the current year for the previous year. On 31 March 2022, the Statistical Office of the Republic of Slovenia published the data on the *Main Aggregates of the General Government 2018–2021*[1] according to the ESA methodology. The Fiscal Council also obtained data from the consolidated public finance balance sheet and the four budgets from the Ministry of Finance compiled under the cash flow methodology.[2]

At the Government's request, the Fiscal Council on 16 October 2020 assessed that, according to the information available at the time, the two criteria under Article 12 of the Fiscal Rule Act had been met, thus again permitting the application of exceptional circumstances and subsequently a temporary deviation from the medium-term balance in 2021.[3] The extent of permitted deviations from the medium-term balance under Article 13 of the Fiscal Rule Act is defined by the National Assembly by adopting an amended framework proposed by the Government. The National Assembly adopted three amended Frameworks that refer to 2021,[4] i.e. in November 2020,[5] April 2021[6] and September 2021.[7] An amended framework referred to in Article 13 of the Fiscal Rule Act is assessed by the Fiscal Council pursuant to point 8 of paragraph two and point 5 of paragraph three of Article 7 of the Fiscal Rule Act.

Although the legislation does not explicitly prescribe the method for making an ex-post assessment of the implemented budgets' compliance with the fiscal rules during the period of exceptional circumstances, the expenditures of the general government must comply with the adopted frameworks for drawing up budgets in connection with Articles 6 and 13 of the Fiscal Rule Act. In the assessment, the Fiscal Council examines, in particular, whether the realised part of expenditures linked to the cyclical position of the economy, excluding expenditures in direct relation to the mitigation of the consequences of the epidemic, complies with the most recently adopted framework and the ex-post assessment of the maximum permitted level of expenditures of the general government sector. The maximum permitted level is calculated according to the formula in Article 3 of the Fiscal Rule Act, in which expenditures in direct relation to the mitigation of the consequences of the epidemic are considered one-off expenditures. Due to increasing uncertainty about the calculation of input parameters, the Fiscal Council only makes an indicative quantitative assessment for the period of exceptional circumstances. This applies also to assessments based on Article 15 of the Fiscal Rule Act, according to which the Fiscal Council assesses compliance with the rules pursuant to the Stability and Growth Pact (SGP).

[1] Statistical Office of the Republic of Slovenia (2022).

[2] Available at: https://www.gov.si/en/topics/fiscal-policy/.

[3] Fiscal Council (2020b).

[4] The first framework to include 2021 was adopted in April 2019 (Official Gazette of the Republic of Slovenia (Uradni list RS), 2019).

[5] Official Gazette of the Republic of Slovenia (Uradni list RS) (2020).

[6] Official Gazette of the Republic of Slovenia (Uradni list RS) (2021a).

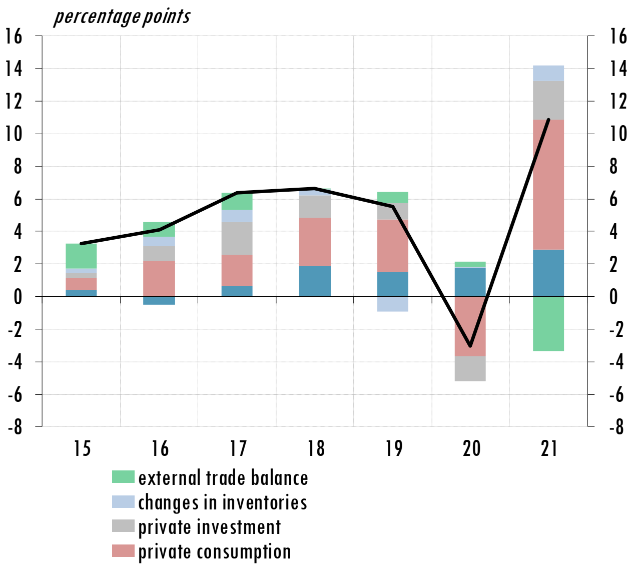
[7] Official Gazette of the Republic of Slovenia (Uradni list RS) (2021b).

1. Macroeconomic and fiscal trends in 2021

1.1 The macroeconomic situation and assessment of the cyclical position of the economy

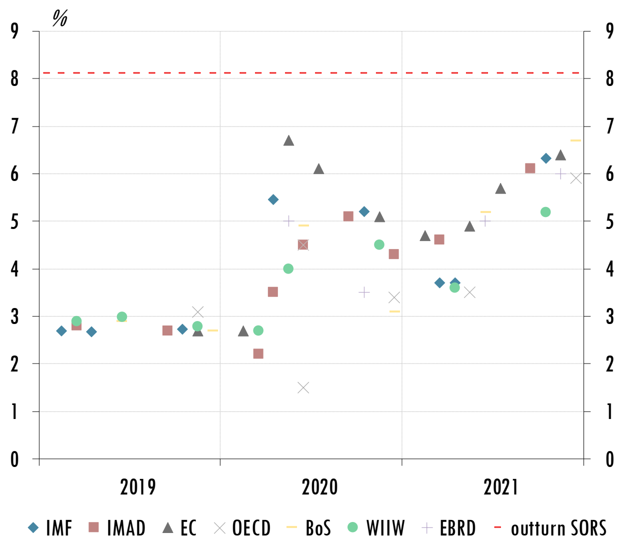
The strong economic rebound in 2021, which exceeded forecasts, was primarily the result of increased private consumption. In 2021, GDP grew by 8.1% in real terms and by 10.9% in nominal terms. Economic growth exceeded forecasts owing primarily to favourable trends at the end of the year when, contrary to assumptions and despite a deteriorating epidemiological situation, restrictive measures were milder than in the previous outbreaks. After the quarterly level of GDP from the last quarter of 2019 was exceeded in mid-2021, the annual average level of GDP also exceeded the level from 2019 (by 3.6%). Economic activity exceeding the pre-crisis level and economic growth were last year among the highest in the EU and also above the EU-27 average.[8] High growth last year was mainly the result of the further adaptation of economic entities and households to the epidemic, which in the deteriorating epidemiological situation enabled the uninterrupted functioning of many activities that were most severely affected by the outbreak in 2020. The economic recovery also benefited from government measures, i.e. both directly through the strengthening of investment activity and indirectly through measures that contributed to an increase in disposable income, and thus to private consumption growth. Following a sharp decline in 2020, last year saw the biggest increase ever in private consumption, making the largest contribution to GDP growth. The increase in investment activity was mainly the result of higher investments in equipment and machinery, while construction stagnated. Despite many difficulties along supply chains, recovering foreign demand led to a relatively strong rebound of foreign trade last year, but its contribution to economic growth was nevertheless negative as imports recovered faster than exports following the significant recovery of domestic consumption. The current account surplus decreased markedly last year as a result of deteriorating terms of trade in addition to the dominant quantitative impact. Rapid economic recovery alongside an increase in energy prices significantly accelerated inflation, which was on average last year the highest in the last decade.

Figure 1.1: Contributions to nominal GDP growth



Source: SORS, FC calculations.

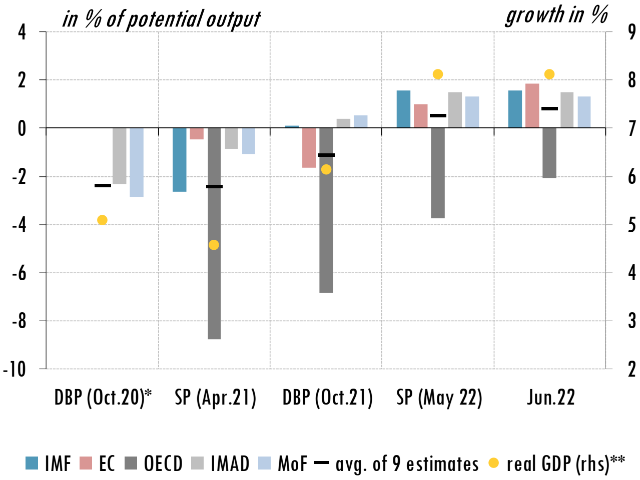
Figure 1.2: Forecasts of real GDP growth for 2021



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

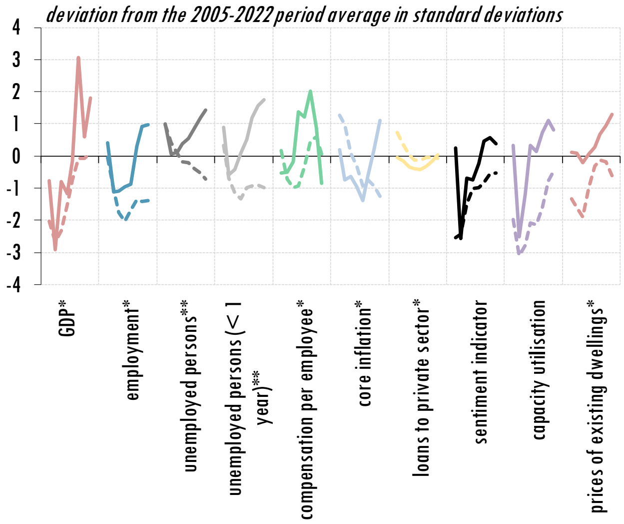
[8] On the EU-27 average, real GDP grew by 5.3% last year, while on average the level of economic activity lagged the pre-crisis level of 2019 by 0.9%.

Figure 1.3: Output gap estimates for 2021 by documents



Source: SORS, EC, IMF, MoF, OECD, IMAD, FC calcualtions, see note under Table 2.2.
** During the preparation of the assessment up-to-date estimates by IMF, EC and OECD were not available .*
*** Forecast IMAD/outturn SORS.*

Figure 1.4: Indicators of economic cycle dynamics 2009-2010 and 2020-2021



*Notes: * y-o-y growth rates , ** inverted values. Data for 2009-2010 are shown as dashed line, data for 2020-2021 are shown as solid line.*
Sources: SORS, ECB, Eurostat, Employment Service of Slovenia, FC calculations.

Based on various currently available output gap estimates and an overview of a broader set of indicators that determine the state of the economic cycle, the Fiscal Council estimates that the level of GDP in 2021 was above the level of potential product. Output gap estimates differ due to different methodologies and differences in input data; furthermore, they can significantly change over time or especially in the event of a major shock, as they are sensitive to major changes in economic forecasts (see Figure 1.3). Due to the extent of the current crisis, its heterogeneous impact on economic activity and, in particular, its potential long-term consequences, the assessments of the cyclical position of the economy are even more uncertain.[9] This is illustrated by the extremely wide range of different output gap assessments for 2021, which are, according to the latest available estimates, in the range of -2.1% to 3.0%.[10] Other indicators monitored by the Fiscal Council to determine the cyclical position of the economy show that in 2020 the negative deviation from the long-term average for the vast majority of indicators was similar to that of the financial crisis a decade ago, but at the same time their recovery from the initial shock was much faster in 2021.

1.2 Fiscal trends – the general government sector (ESA)

Last year's general government deficit primarily resulted from the epidemic, and its decrease compared to the previous year from economic recovery. The deficit was EUR -2,705 million or -5.2% of GDP, which was around EUR 1 billion less than projected in the 2022 Draft Budgetary Plan.[11] According to the ESA methodology,[12] expenditures to limit the consequences of the epidemic based on the data of the Statistical Office of the Republic of Slovenia amounted to EUR 2,349 million or 4.5% of GDP, which was approximately EUR 280 million more than envisaged by the 2022 Draft

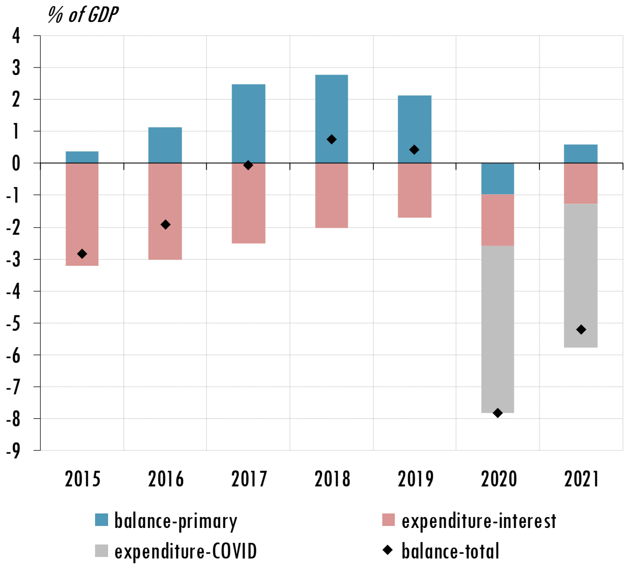
[9] For an analysis of the uncertainty of output gap estimates in the context of the current crisis in Slovenia, see Box 1.1 in the Fiscal Council (2020b).

[10] It should also be noted that the OECD output gap assessment for a long time has deviated significantly from all other estimates used by the Fiscal Council.

[11] It was drafted in October 2021 (Government of the Republic of Slovenia, 2021).

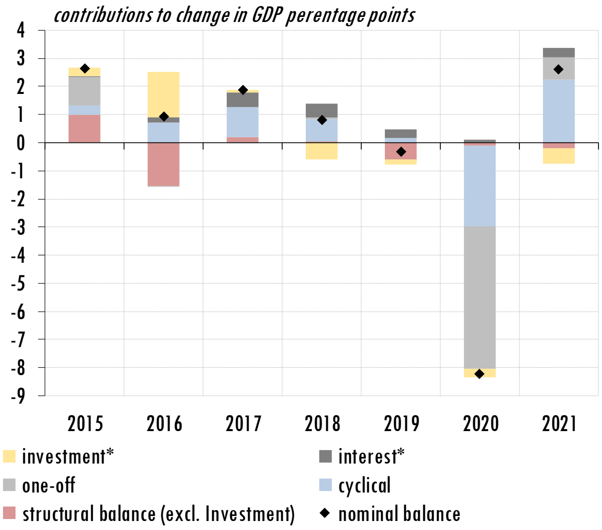
[12] This is an internationally comparable methodology that, in accordance with the Fiscal Rule Act, is also used to produce assessments of compliance with fiscal rules and is based on an accrual approach. This means that the transaction is recorded when the liability or claim occurs. The assessment of the direct impact differs from the assessment of the Fiscal Council in its Monthly Information (see https://www.fs-rs.si/publications/monthly-information/), which is based on the balance of the state budget and the cash flow methodology. This means that the transaction is recorded when it is executed .

Figure 1.5: General government budget balance



Source: SORS, FC calculations.

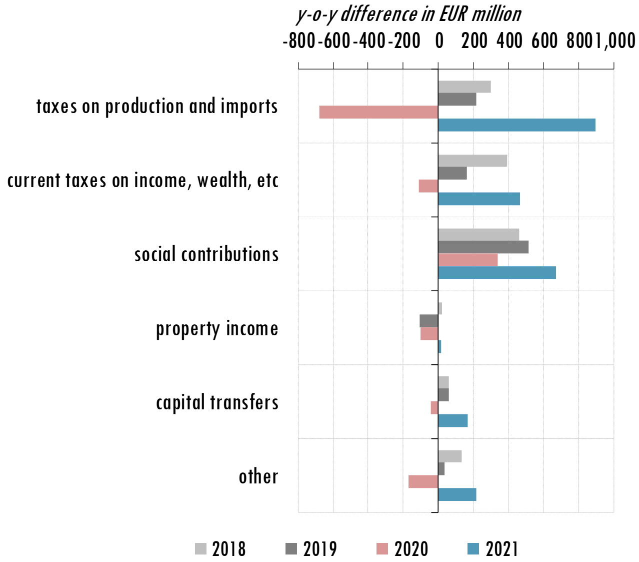
Figure 1.6: Factors of change to nominal general government balance



*Source: SORS, FC calculations. *Positive sign denotes a decrease, negative sign denotes an increase.*

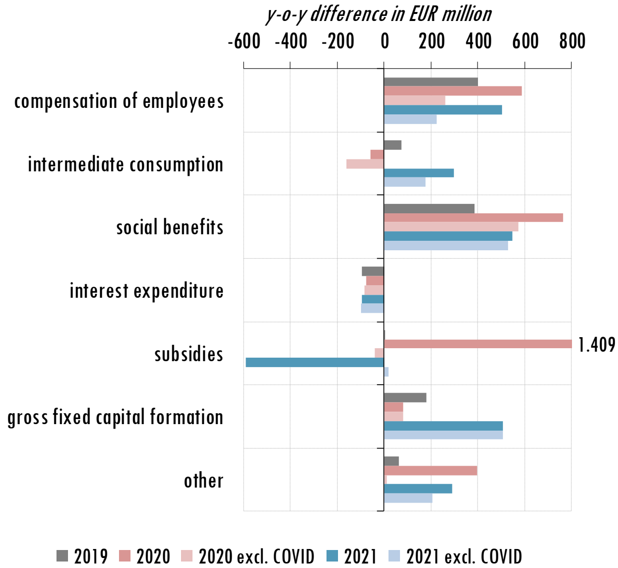
Budgetary Plan. Since the onset of the epidemic, the Fiscal Council has been warning, in accordance with the legislation,[13] that fiscal trends not directly related to measures to mitigate the consequences of the epidemic must not endanger the medium-term fiscal balance and its sustainability. In line with this orientation, in assessing the budget documents during a period of exceptional circumstances, emphasis is placed on developments excluding the direct impact of epidemic-related measures. Without the effect of expenditure on COVID measures, last year's deficit amounted to EUR -356 million or -0.7% of GDP. This is significantly less than the year before (EUR -1,212 million) and the 2022 Draft Budgetary Plan projections (EUR -1,684 million). Last year's balance improvement, which does not take into account the direct effect of expenditure on COVID measures, was largely a result of the recovery in economic activity and the subsequent high increase in revenues.

Figure 1.7: General government revenue



Source: SORS, MoF, FC calculations.

Figure 1.8: General government expenditure



Source: SORS, MoF, FC calculations.

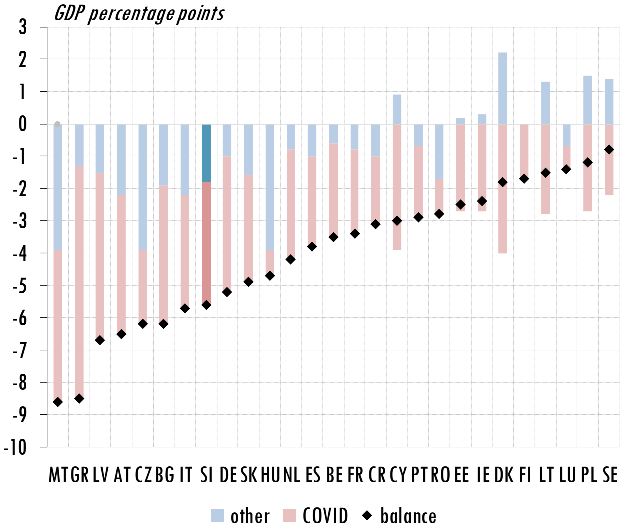
[13] Under paragraph one of Article 12 of the Fiscal Rule Act, a deviation from the medium-term balance is only permitted provided that it does not endanger fiscal sustainability in the medium term.

Revenues increased last year (by 11.9%) slightly more than nominal GDP, significantly surpassing the pre-crisis level. The increase in revenues was primarily the result of higher revenues from taxes and social contributions that exceeded the pre-crisis level of 2019 by 8.7%. The high growth was linked to a strong rebound of domestic consumption and rapid improvements in the labour market, and, in relation to revenues from personal and household income taxes, to a large extent also due to the payment of allowances to public sector employees within the framework of measures to mitigate the consequences of the epidemic.[14] Following a decline in 2020, other fiscal revenues also recovered last year, but they contributed to total growth considerably less than the abovementioned categories. While general government revenue from EU funds at the end of the previous financial perspective did increase by more than 50% on the previous year, it contributed only 0.8 pps to the total growth in revenue.

Expenditures increased by 6.1% last year; growth excluding the effect of expenditure on COVID measures reached 7.3%. According to the ESA methodology, general government expenditure on COVID measures amounted to EUR 2,349 million or 4.5% of GDP[15] and was according to the Statistical Office of the Republic of Slovenia only slightly lower than in 2020. Expenditure growth, excluding expenditure on COVID measures, did not result solely from enhanced investment activities but also from other increased spending, in particular on social benefits. Growth in "core" expenditures, which in addition to COVID measures exclude expenditure on interest, investments, capital transfers and one-off expenditure, was thus the highest since 2008.

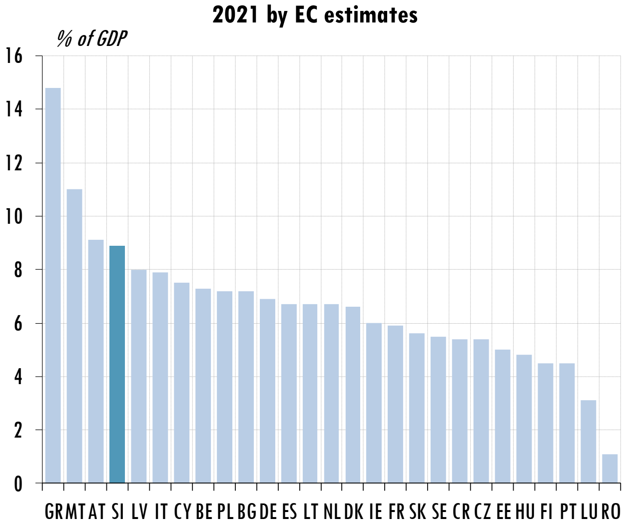
On average in the EU last year, both the deficit and the deterioration of the balance compared to the pre-crisis year 2019 were lower than in Slovenia. The deficit at the level of the EU-27 average decreased from -6.8% of GDP to -4.7% of GDP last year, while its deterioration compared to 2019 amounted to -4.1 pps of GDP. Slovenia's general government balance deteriorated by 5.6% of GDP over the past two years, which is the eighth largest deterioration among Member States. Both in

Figure 1.9: Change in general government balance 2021/2019



Source: Eurostat, EC, FC calculations.

Figure 1.10: Volume of temporary measures to mitigate the effects of the epidemic in 2020 and 2021 by EC estimates



Source: EC.

[14] See Box 2.3 of the Fiscal Council (2021d) for more on the issue of public sector allowances during the epidemic.

[15] Due to methodological differences, this estimate differs from the level of expenditure of the State budget for COVID measures, which, according to the Ministry of Finance amounted to EUR 2,788 million last year. It also differs from the estimate of the Ministry of Finance for the general government sector in the 2022 Stability Programme (4.6% of GDP) and the EC (3.8% of GDP). Differences in estimates according to the ESA methodology are likely to persist for some time, given the large number of measures and their different treatment.

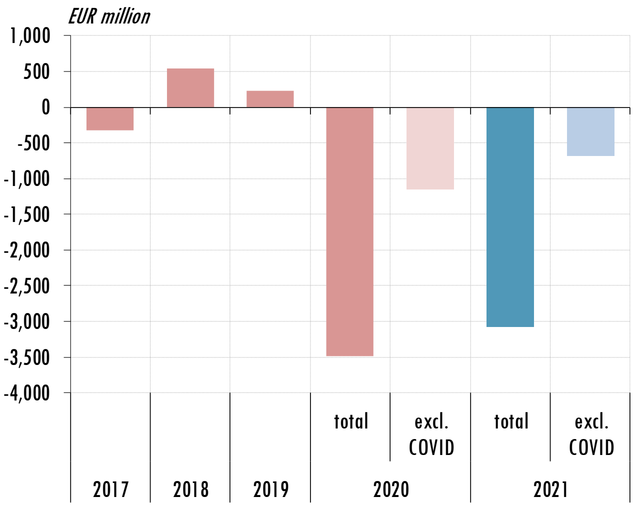
Slovenia and at the level of the EU average, the deterioration was largely due to measures to mitigate the consequences of the epidemic. These accounted for 8.9% of GDP in Slovenia over the last two years, which is the fourth largest volume of measures among Member States.[16] The deterioration of public finances in 2021 compared to the pre-crisis level was also among the largest in the EU (seventh largest) when excluding the impact of temporary measures to mitigate the effects of the epidemic in Slovenia.

1.3 Fiscal trends – public finance budgets (the GFS cash-flow methodology)

According to the final data, the government budget deficit amounted to EUR -3,080 million in 2021 and EUR -689 million, excluding the direct impact of COVID measures. The deficit in both comparisons was smaller than in 2020, which was mainly the result of the revenue growth as economic activity recovered. In line with the Fiscal Council's expectations, it was smaller (by EUR 878 million) than the estimated 2021 outturn from September, which served as a basis for the preparation of 2022 and 2023[17] budget documents.

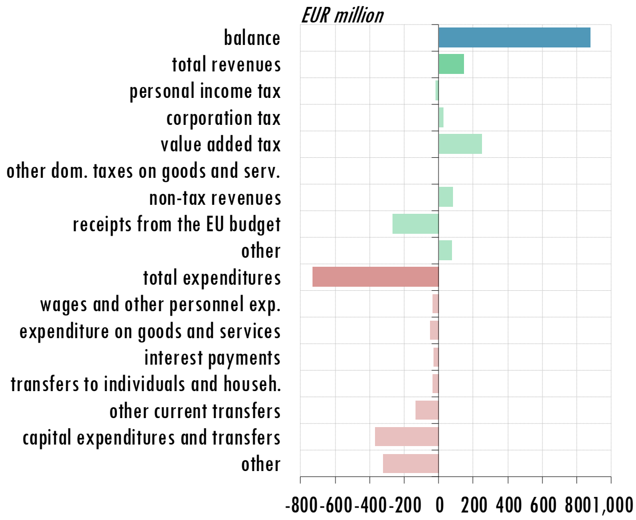
Revenue last year increased by 23.1% compared to 2020 and was EUR 146 million higher than the Ministry of Finance's estimate of outturn in September last year. This growth was driven by the effect of a low base, as revenue fell sharply at the start of the epidemic in 2020, a relatively rapid recovery in economic activity in 2021 and certain one-off factors. The increase was largely due to higher tax revenue, which was 6.5% higher than just before the crisis in 2019. Non-tax revenue was around a fifth higher than the year before, mostly as the result of the awarded mobile network concession and borrowing-related extraordinary revenue. Revenue from EU funds increased by approximately 30%, namely due to increased cohesion funding at the end of the multiannual framework and prepayments under the Recovery and Resilience Facility. Despite an increase in EU

Figure 1.11: State budget balance



Source: MoF, FC calculations.

Figure 1.12: Difference between state budget outturn and outturn estimate for 2021



Source: MoF, state budget outturn and outturn estimate for 2021 (Sep. 21).

[16] The European Commission's assessment of the size of the impact of COVID is also slightly different from that of SORS and the Ministry of Finance due to the different treatment of individual measures. Given that the European Commission has evaluated measures in all Member States according to the same criteria, the Fiscal Council uses its assessment in this comparison.

[17] Fiscal Council (2021d).

Table 1.1: Impact of COVID measures on state budget outturn

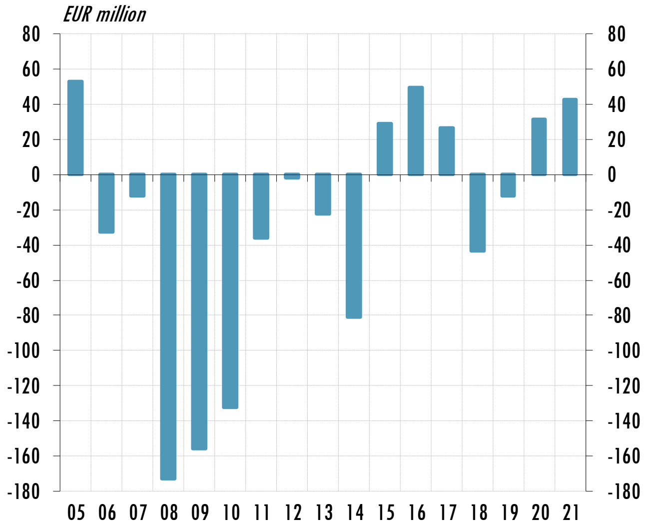
	2020 EUR million		2021 EUR million		excl. COVID 2021/2020	
	COVID	excl. COVID	COVID	excl. COVID	EUR million	%
Revenue	**-324**	**9,402**	**397**	**10,776**	**1,375**	**14.6**
VAT	-118	3,646	21	4,209	563	15.4
Excise duties	-56	1,370	48	1,422	52	3.8
Personal income tax	-27	1,191	70	1,444	253	21.2
Corporate income tax	-173	946	154	961	15	1.6
EU funds[1]	74	651	121	826	176	27.0
Non-tax	0	672	0	817	145	21.5
Other revenue	-24	925	-17	1,097	172	18.6
Expenditure	**2,005**	**10,559**	**2,788**	**11,466**	**906**	**8.6**
Total labour costs	196	3,252	777	3,432	180	5.5
Transfers to individuals and households	384	1,582	1,007	1,525	-57	-3.6
Expenditure on goods and services	166	1,143	266	1,258	114	10.0
Investment	22	889	59	1,179	290	32.6
Current transfers to social security funds	135	1,268	1	1,349	81	6.4
Subsidies	965	433	414	401	-32	-7.3
Interest	0	772	0	727	-45	-5.8
Payments to the EU budget	0	526	0	629	103	19.5
Other expenditure	136	694	265	966	272	39.2
Balance	**-2,329**	**-1,158**	**-2,391**	**-689**	**468**	

Sources: MoF, FURS, FC estimates and calculations. Note: [1] The effect on balance of revenue from EU funds used for financing of COVID measures is neutralized, so that they are interpreted as higher total revenue from EU funds.

funding spending, the outturn was lower than projected in September 2021 (by EUR 270 million) and even more so than budget projections from October 2020 (by EUR 684 million).

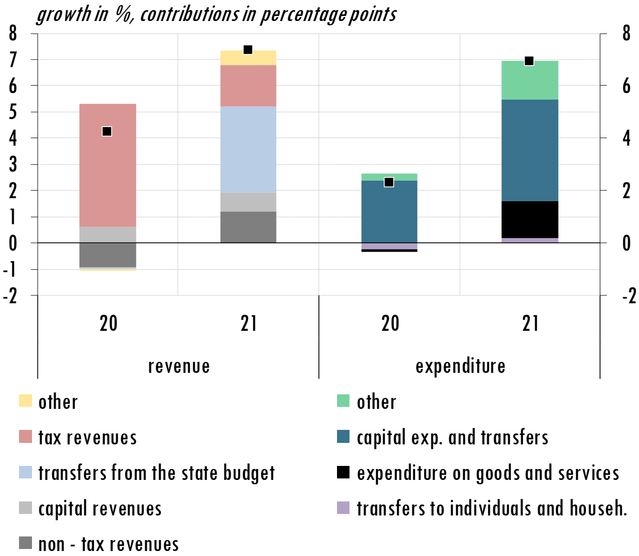
Last year, expenditure was 13.4% higher than in 2020 or, excluding the impact of COVID measures, it increased by 8.6%, which was significantly more than the long-term average growth. Growth in expenditure was higher only in 2008 (during the boom) and in 2009 (in light of anti-crisis measures). Despite the high growth, expenditure was lower than estimated in the September outturn projection (by EUR 732 million). Almost half of total expenditure growth was due to higher labour costs, which also include transfers to public institutions for this purpose. Labour costs increased by 22.0% on a year-on-year basis, mainly due to the payment of allowances, even though the growth in total labour costs was a relatively high 5.5% even without counting COVID allowances. The higher volume of transfers to individuals and households also contributed approximately one third of total expenditure growth, mainly as a result of the large extent of COVID measures under this heading. Following the 2020 stagnation, investment expenditure increased by 35.9% last year but still fell far short of projections despite a relatively high outturn. The actual outturn was in fact EUR 736 million lower than the projections in the 2021 budget adopted in October 2020, and around EUR 320 million lower than the outturn estimate for 2021 prepared by the Ministry of Finance last September. Growth in expenditure for goods and services and contributions to the EU budget was relatively high, while

Figure 1.13: Budget balance of local government



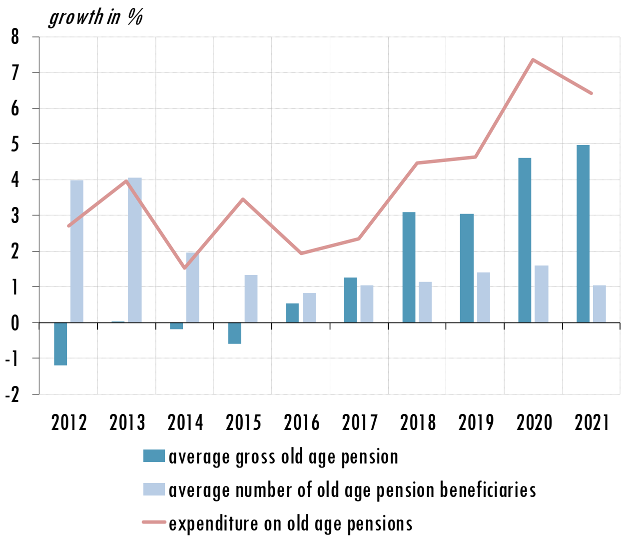
Source: MoF.

Figure 1.14: Revenue and expenditure of local government



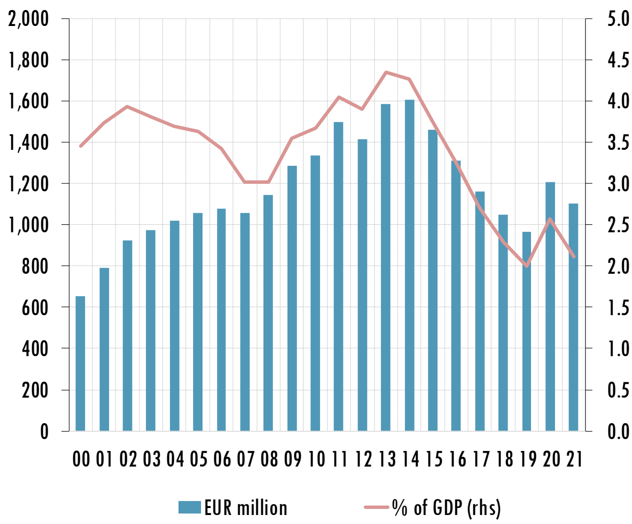
Source: MoF, FC calculations.

Figure 1.15: Pensions



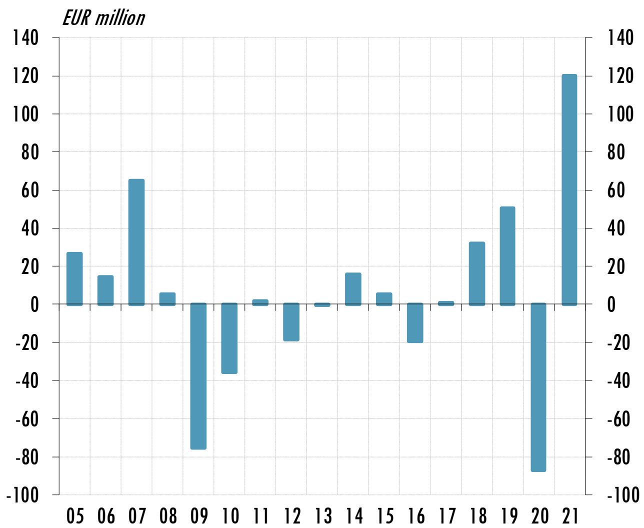
Sources: Pension and Disability Insurance Fund of Slovenia (ZPIZ), MoF, FC calculations.

Figure 1.16: Pension and Disability Insurance Fund - transfers from the state budget



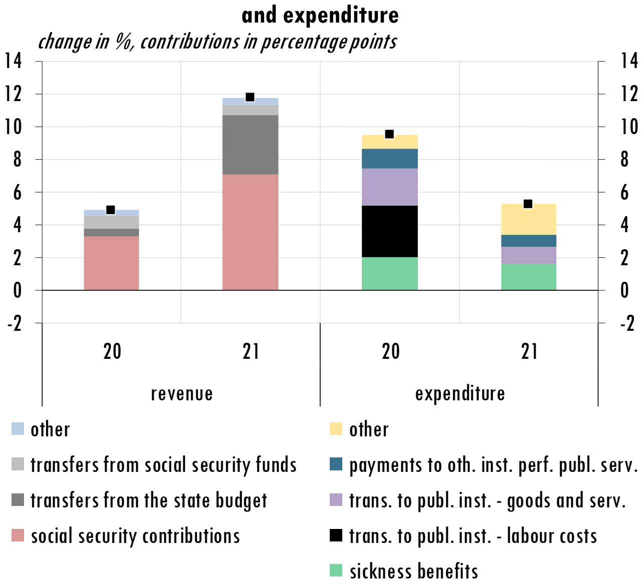
Sources: MoF, SORS, FC calculations.

Figure 1.17: The Health Insurance Institute budget balance



Source: MoF.

Figure 1.18: The Health Insurance Institute revenue and expenditure



Source: MoF, FC calculations.

expenditure for interest, subsidies and transfers to social security funds was lower than in the previous year.

Last year, the state budget expenditure on COVID measures amounted to EUR 2,788 million, which was about EUR 800 million more than in the previous year. The largest part of the expenditure was employee allowances amounting to around EUR 820 million, which was four times more than in the previous year. Around EUR 630 million was paid for job preservation measures, which was almost half the amount paid in 2020. This was partly due to a shorter period of activity restrictions and partly due to the relatively rapid economic recovery. Expenditure on measures to contain the epidemic (vaccination, testing, protective equipment, etc.) was also higher than in 2020, as was expenditure for tourism vouchers with the introduction of new vouchers and the extension of the 2020 vouchers.

The surplus of municipal budgets (EUR 45.4 million) increased further last year. Both revenue growth (from 4.2% in 2020 to 7.3% in 2021) and expenditure growth (from 2.3% to 6.9%) increased. On the revenue side, growth in personal income tax slowed down after a sharp rise as a result of higher lump-sum payments in 2020 (from 10.2% to 0.6%). However, revenue from the state budget increased by more than half, namely due to the Municipal Costs Relief Act adopted in December 2020. This provides additional resources for rebalancing the development of municipalities in the amount of 6% of the total appropriate spending of municipalities, which amounted to EUR 77 million last year. Higher growth in total revenue than the year before was also due to developments in the property market. Following a decrease in 2020, revenue from real property transaction tax, real estate transfer tax and public utilities charges increased by more than a tenth last year, contributing to around a quarter of total revenue growth. The increased growth in expenditure was mainly due to stronger investment activity, which increased by more than a tenth. Total labour costs were also higher than the year before (8.5%); in addition to municipal administration employees, these costs also include public institutions established by municipalities. Following a decrease in 2020, transfers to individuals and households increased slightly last year, mainly the payments of the difference between the kindergarten programme prices and the parents' payments.

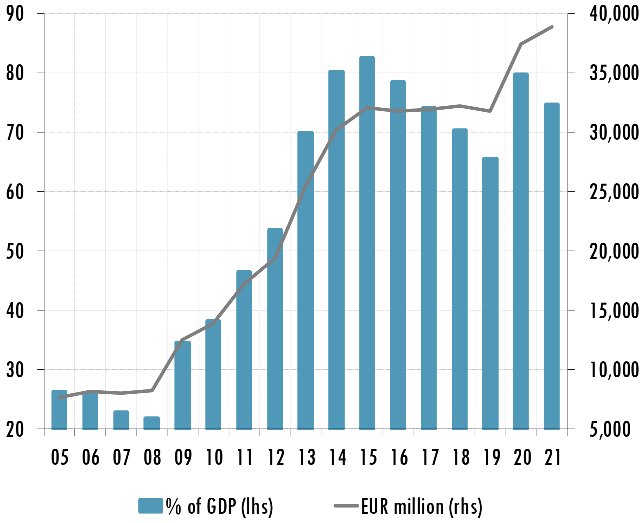
Growth in Pension and Disability Insurance Institute of Slovenia (ZPIZ) expenditure slowed to 5.2% (2020: 7.1%) last year, mostly due to the unchanged number of beneficiaries, while the average pension growth was higher than the year before. The average pension increased due to the exceptional adjustment at the end of 2020 (2.0%) and the regular adjustment in January last year (2.5%). Total pension expenditure increased by nearly EUR 900 million or 20% in the last four years and constituted 10.0% of GDP last year. Most of the increase was due to the rise in the average old-age pension, which increased by 16.6%, while consumer prices in this period increased by 4.7%. Given the high salary growth and labour market recovery, growth in revenue from social contributions (8.6%) increased last year, thus the total transfer from the state budget to the Pension and Disability Insurance Institute of Slovenia (ZPIZ) decreased by around EUR 100 million to EUR 1.1 billion.

The Health Insurance Institute of Slovenia (ZZZS) ended 2021 with the highest surplus ever (EUR 120 million). This was due to the strengthening of revenue growth (from 4.9% in 2020 to 11.8% in 2021), while expenditure growth slowed (from 9.5% to 5.3%). Higher revenue was largely due to higher payments of social contributions as a result of the labour market recovery and high growth in salaries. Another factor that contributed significantly to growth were the 90% higher level of transfers from the state budget, particularly due to the received EUR 179 million for current expenditure in the light of increased costs of controlling the epidemic. The decline in expenditure growth was largely due to almost unchanged transfers to public institutions, which increased significantly the previous year. Expenditure for sickness benefits and payments to providers that are not budget users also increased by less than a year before.

1.4 General government debt

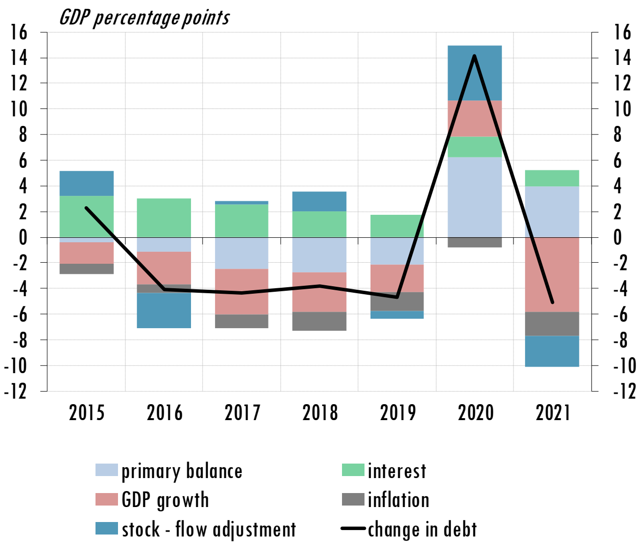
General government gross debt declined to 74.4% of GDP last year (EUR 38.9 billion), but still exceeded the pre-crisis level by around 10 pps of GDP. Despite a decline in the debt ratio by 5.1 pps of GDP, the debt increased in nominal terms by EUR 1.4 billion. The decline in the ratio was largely driven by economic growth, which more than offset a further deterioration in the primary balance. Last year's decline was among the largest among EU Member States, while the increase from

Figure 1.19: General government debt



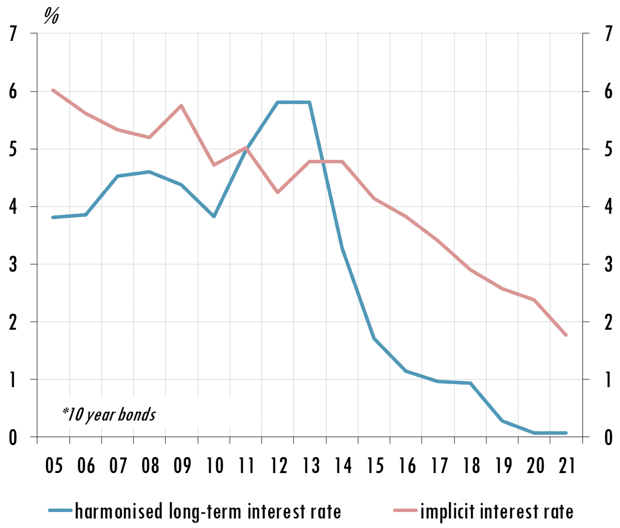
Source: SORS.

Figure 1.20: Change in general government debt



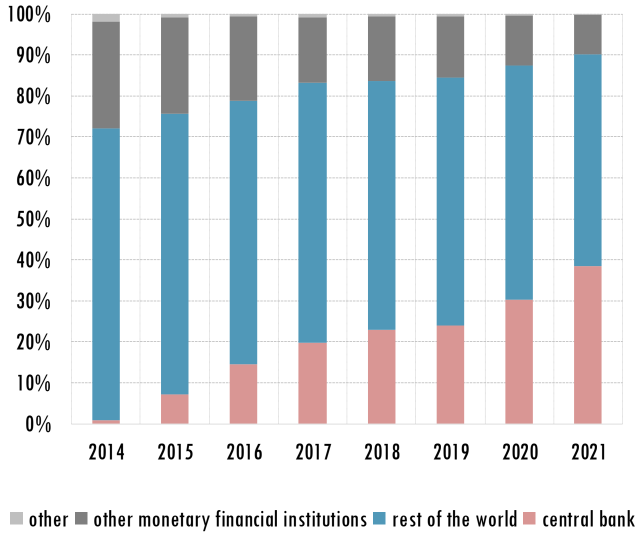
Source: SORS, FC calculations.

Figure 1.21: Harmonised long-term interest rate* and implicit public debt interest rate



Source: ECB, SORS, FC calculations.

Figure 1.22: Structure of government debt securities holders



Source: BoS, FC calculations.

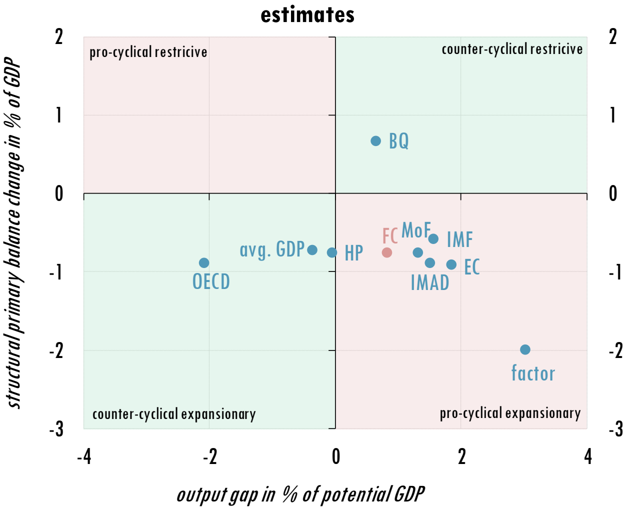
pre-crisis level in 2019 was slightly below the EU-27 average. Borrowing continued last year under favourable financial market conditions, mainly reflecting the accommodative ECB policy. At the beginning of the epidemic, it launched a new programme for the purchase of government bonds (Pandemic Emergency Purchasing Programme – PEPP), under which it purchased EUR 6,499 billion in Slovenian public debt on the secondary market by the end of March, representing almost the total nominal debt increase since the end of 2019. The central bank's share of government debt securities increased further to almost 40% last year. On average last year, the required yield on the Slovenian 10-year bond remained at a similar low level as the previous year (0.07%), while the implicit interest rate of total debt decreased further by 0.6 percentage points to 1.8%. The maturity distribution of liabilities remains favourable. The weighted average time to maturity of the debt (10 years) increased by one year last year. After a significant increase in 2020, the amount of the general government's funds in the single treasury account decreased by EUR 406 billion and totalled EUR 5.8 billion or 11.1% of the GDP at the end of December last year.

2. Compliance with the fiscal rules in 2021

In a period of exceptional circumstances due to increased uncertainty in the calculation of key input variables, the Fiscal Council provides quantitative assessments of compliance with fiscal rules only indicatively and puts greater emphasis on qualitative assessment.[18] Since the entry into force of the exceptional circumstances in March 2020, the Fiscal Council provides quantitative assessments of compliance with fiscal rules only indicatively, both in the case of ex-ante and ex-post assessments of budgetary documents.[19] The key issue is the uncertainty in the assessment of the cyclical position of the economy, which is determined based on an estimate of the output gap. At a time of heightened uncertainty, the variability of output gap estimates is even greater than usual.[20] Since its inception, the Fiscal Council has sought to reduce this uncertainty by using a set of nine output gap estimates.[21] In exceptional circumstances, not only assessing the cyclical position of the economy but also taking into account the fiscal implications of measures to limit the effects of the epidemic as one-off effects plays an important role in the conclusions on compliance with fiscal rules. Such an orientation provides for a clearer estimate of fiscal policy orientation, which is also consistent with the position of the European Commission.[22] Although the current context places greater emphasis on qualitative estimate, it is, to some extent, inevitably based on quantitative indicators. Among these, it is based on domestic law to determine whether the actual level of general government expenditure corresponded to the last applicable ceiling set by the amendment to the framework under Article 13 of the Fiscal Rule Act, even at the time of enforcement of exceptional circumstances.

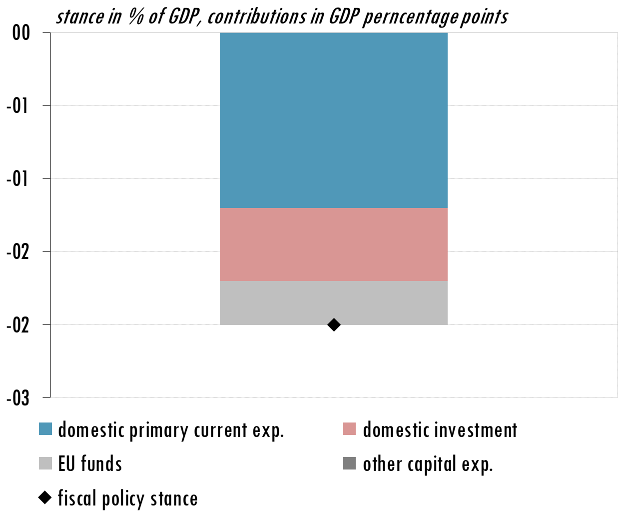
According to most indicators, fiscal policy was pro-cyclically expansionary in 2021, which was only to a certain extent due to the strengthening of investment activity, as other spending not related to the epidemic also increased. Fiscal conditions continued to be particularly precarious last

Figure 2.1: Fiscal policy stance according to various output gap estimates



Source: SORS, MoF, FC estimates. Note: Estimates of fiscal policy stance based on various estimates of output gap used by the Fiscal Council are presented. See footnote 21 and compare to Table 2.2.

Figure 2.2: Fiscal policy stance indicator according to EC calculations*



*Source: European Commission. Note: *Negative sign denotes expansionary fiscal policy.*

[18] At the time of the activated general escape clause, the EC approach is similar, while, in the meantime, it started to use additional and new quantitative indicators to assess the fiscal policy stance. See European Commission (2021).

[19] Assessments of compliance with fiscal rules are available at: /https://www.fs-rs.si/publications/assessments-of-compliance-with-fiscal-rules/.

[20] See Box 1.1 in Fiscal Council (2020b) for an analysis of the uncertainty of estimates of the output gap during the current crisis in Slovenia.

[21] For more details on the output gap calculations used by the Fiscal Council, see Fiscal Council (2018, pp. 23–26).

[22] European Commission (2020). While the European Commission does not consider the measures taken to mitigate the effects of the epidemic as one-off factors in the calculation of the structural position at the time of the epidemic, it does take the view that the fiscal policy orientation is more appropriately assessed if these measures are considered as one-off factors.

year and were once again marked by an epidemic. Fiscal developments were mainly influenced by direct fiscal policy measures and responses to the epidemic in the form of heterogeneously restrictive measures on the one hand and the flexibility of economic agents and consumers on the other hand. Despite the decrease compared to the previous year, the deficit was relatively high for the second consecutive year, mainly due to further large-scale measures to mitigate the effects of the epidemic. In addition, fiscal policy was also characterised by a strengthening of investment activity in connection with the completion of the previous European financial perspective. The share of government investment in GDP increased by 0.6 percentage points last year, with EU and domestic funding each contributing half of the growth. A sharp and rapid increase in investment could only lead to a strengthening of the long-term economic potential if investments are efficient.[23] Growth in other government spending also increased last year, especially in social transfers, also in connection with some discretionary structural measures unrelated to the epidemic. Despite the otherwise narrowing of the deficit, an important part of the unexpectedly strong revenue growth, which was the result of a marked rebound in economic activity, spilled into higher current spending. Also in the context of high government demand, some signs of constraints on the supply potential side were already seen towards the end of the year, both in the labour market, in the context of a rapid decline in unemployment to historically low levels and in the construction sector, which, in addition to the prevailing external factors, have also led to an increase in inflationary pressures.

Last year, the government expenditure outturn was below the level set by the threshold of the framework, which was last amended in September last year. The Framework Ordinance covering 2021 was first adopted in April 2019 and subsequently amended three times. The maximum level of general government expenditure was increased by a total of EUR 900 million between November 2020 and September last year. The actual expenditure was around EUR 250 million lower than the last applicable framework. The deficit was also lower than expected at the time of the changes to the framework, mainly as a result of higher revenue levels. The same is true of the state budget, which saw a EUR 736 million decrease in expenditure. In autumn last year, when assessing the revision of the framework, the Fiscal Council pointed out that the state budget's expenditure targets were too high.[24] The lower than the last change in the framework was also the expenditure of the Pension and Disability Insurance Institute of Slovenia (ZPIZ) and the Health Insurance Institute of Slovenia (ZZZS), while the expenditure of the municipalities' budgets was EUR 15 million higher than the last revision of the framework.

Table 2.1: Frameworks for drawing up budgets for 2021 and outturn

	general government		state budget		local gov.	pension fund	health fund
	expenditure	balance (GDP %)	expenditure	balance (GDP %)	expenditure	expenditure	expenditure
Apr.19	22,160	1.1	10,455	1.2	2,360	6,180	3,525
Nov.20	24,900	-6.6	13,520	-5.7	2,440		
Apr.21	25,300	-8.6	14,320	-8.6		6,250	
Sep.21	25,800	-7.5	14,990	-7.9			
actual	**25,548**	**-5.2**	**14,254**	**-5.9**	**2,455**	**6,206**	**3,518**
actual-valid framework (Sep. 21)	*-252*	*2.3*	*-736*	*2.0*	*15*	*-44*	*-7*

Source: MoF, Official Gazette of the Republic of Slovenia (Uradni list RS), SORS, FC calculations.

[23] See Box 2.4 in Fiscal Council (2020d) and Fiscal Council (2021b) for more information on the effectiveness of public investments.

[24] Fiscal Council (2021c).

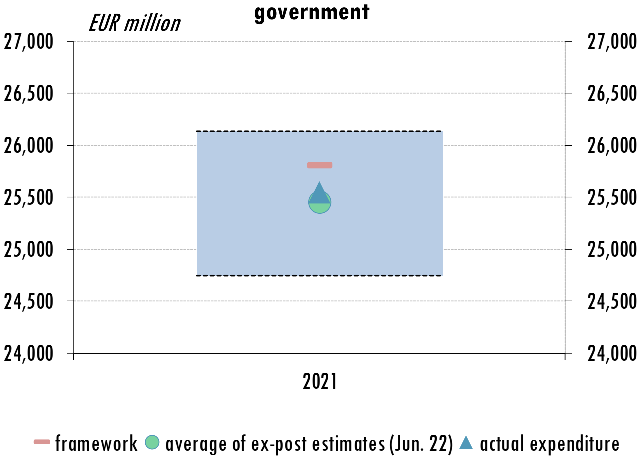
Table 2.2: Deviation of expenditure outturn from maximum expenditure based of various output gap estimates

outturn	FC (average of all)	MoF	IMAD	EC	IMF	OECD	HP	avg. GDP	factor	BQ
25,548	**25,452**	25,393	25,323	25,315	25,482	25,850	25,394	25,431	24,748	26,135
difference	***95***	*155*	*224*	*233*	*66*	*-303*	*154*	*117*	*800*	*-588*
output gap		*1.3*	*1.5*	*1.9*	*1.6*	*-2.1*	*-0.1*	*-0.4*	*3.0*	*0.6*

Sources: EC, IMF, MoF, OECD, SORS, IMAD, FC estimates and calculations. Note: For more details on calculation of output gap estimates used by the Fiscal Council, see Fiscal Council (2018, pp. 23–26).

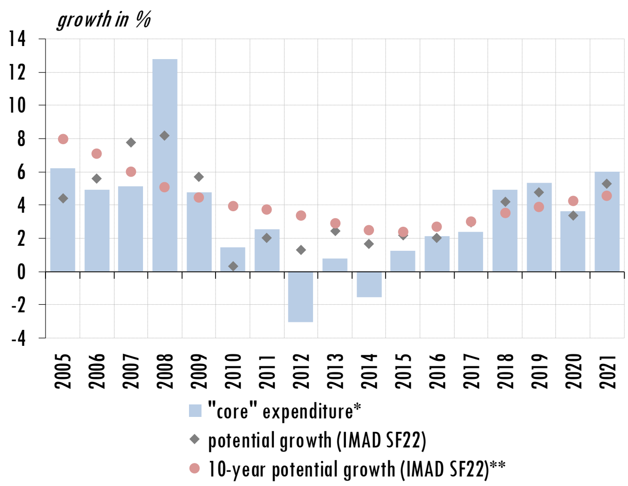
The ex-post estimate shows that the realised general government expenditure last year was slightly higher than the current estimates of the maximum allowable level of expenditure. In the ex-post evaluation of the maximum allowable expenditure, we took into account the currently available data of the variables entering the calculation, in particular the assessment of the output gap and one-off effects. Since, in most of the currently available estimates, the level of GDP in 2021 was above the level of potential output, the Fiscal Council used the formula under the paragraph four of Article 3 of the Fiscal Rule Act. The economic growth in 2021 and thus the general government revenue were higher, the output gap estimate was positive rather than negative, and the volume of one-off expenditure, including expenditure on epidemic control, was significantly higher than that which formed the basis for setting the maximum allowable level of expenditure in September last year. Thus, the significant deviations in outturn from the expectations of the autumn of last year confirm the assessment that the current situation is very uncertain and that, in such a situation, only an indicative estimate of quantitative indicators of compliance with fiscal rules makes sense. Based on currently available output gap estimates, it appears that last year the realised general government expenditure was higher than allowed according to seven out of nine[25] different output gap estimates used by the Fiscal Council, while according to two of the nine different output gap estimates it was significantly lower. On average, it was EUR 95 million higher than that allowed.

Figure 2.3: Maximum level of expenditures of the general government



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

Figure 2.4: "Core" expenditure and the potential output



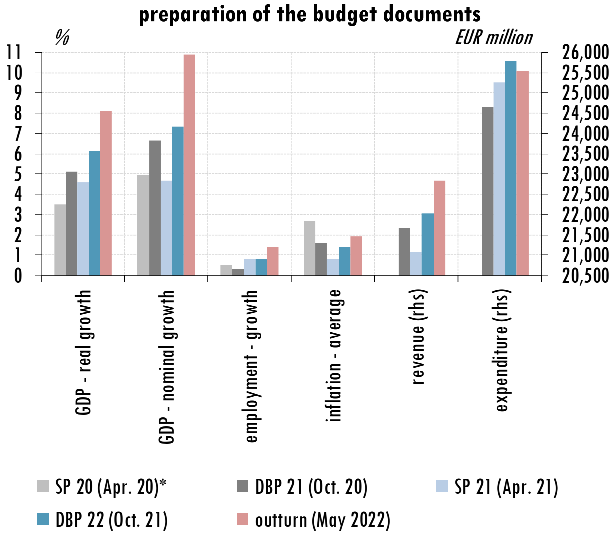
Source: SORS, IMAD, FC calculations. Notes:"Core" expenditure is general government expenditure excluding investment and interest expenditure as well as one-off expenditure including COVID related expenditure. **10-year growth is calculated as an average of data for previous five years, current year and next four years.*

[25] Including estimates of all institutions using the production function method, which is a commonly agreed methodology at EU level, when calculating the output gap.

Indicative quantitative estimates show that practically no rule under European legislation was respected in 2021, with alternative indicators also suggesting inadequate fiscal policy given the cyclical position of the economy. The headline deficit and debt ratios also exceeded the Maastricht criteria last year, despite the decline. The structural position, according to all available current estimates of the output gap, was worse than the medium-term fiscal objective under EU rules (MTO). The reduction in the structural deficit was also less than required if the general escape clause had not been in place. The debt ratio decreased in line with annual dynamics, which corresponds to a 1/20 deviation of the debt level from the level of 60% of GDP in the base year on average for three years. However, its reduction was lower than required under the other three rules concerning debt. In particular, expenditure growth stood out over the past year. This is shown both by the calculation of net expenditure growth under the EU rule and by some other ancillary indicators. Expenditure growth, which, in addition to one-off factors, together measures to mitigate the effects of the epidemic, does not include investment and interest expenditure, clearly exceeded the estimated long-term growth in economic potential last year.

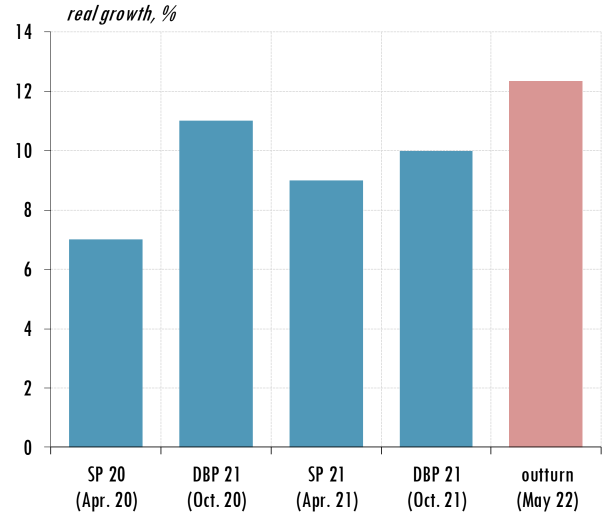
Annex 3.1 Changes in the macroeconomic and fiscal projections for 2021

Figure 3.1: Forecasts for 2021 available at the time of preparation of the budget documents



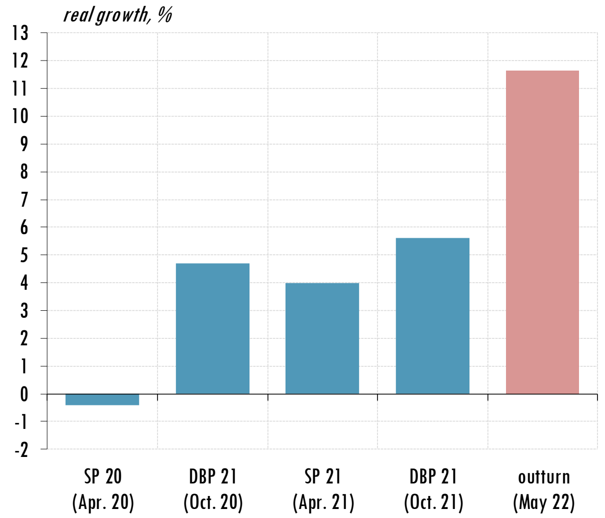
*Source: forecasts: IMAD, MoF; outturn: SORS. * SP 20 did not contain fiscal forecasts for 2021.*

Figure 3.2: Changes in the 2021 forecast – gross fixed capital formation



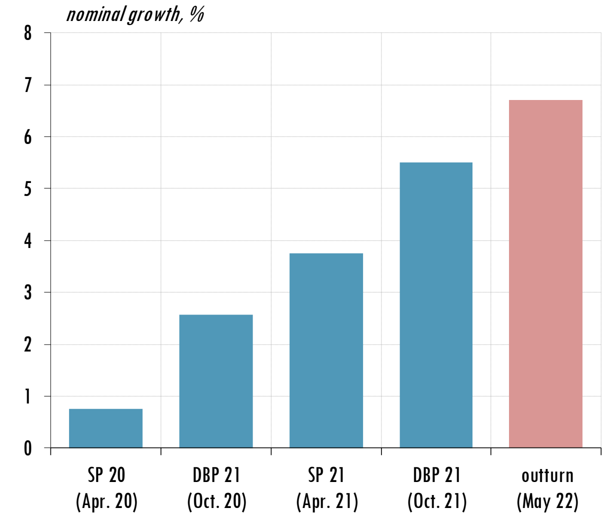
Source: SORS, forecasts IMAD.

Figure 3.3: Changes in the 2021 forecast – private consumption



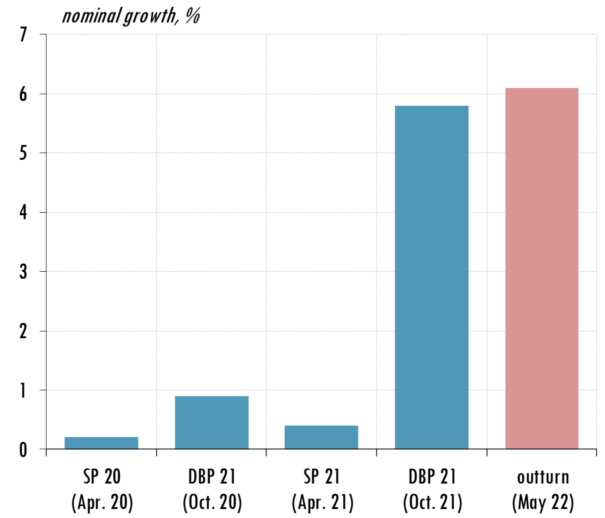
Source: SORS, forecasts IMAD.

Figure 3.4: Changes in the 2021 forecast – compensation of employees



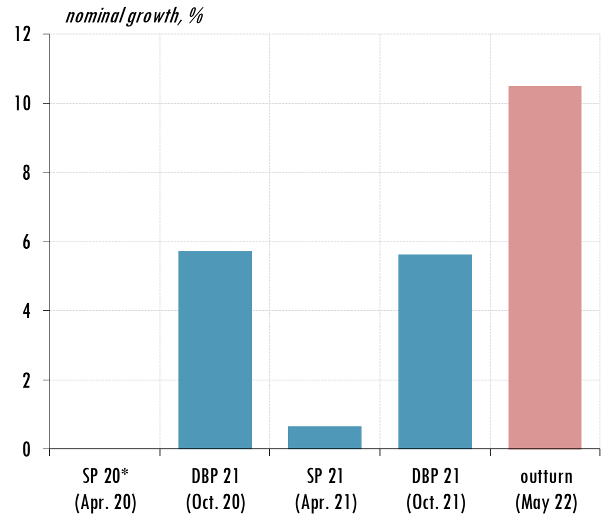
Source: SORS, forecasts IMAD.

Figure 3.5: Changes in the 2021 forecast – gross wages per employee



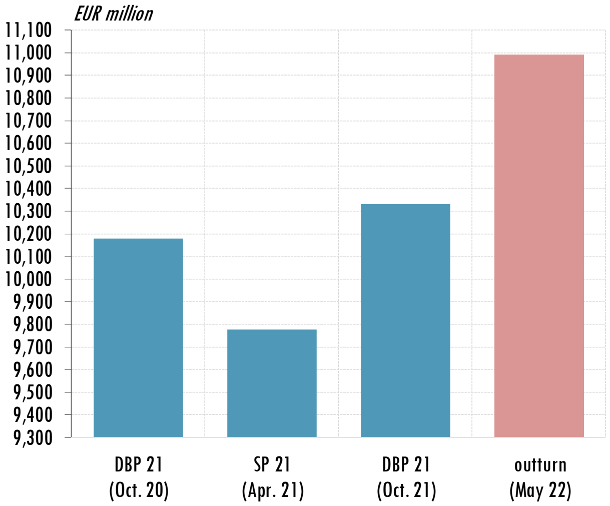
Source: SORS, forecasts IMAD.

Figure 3.6: Changes in the 2021 forecast – gross operating surplus/mixed income



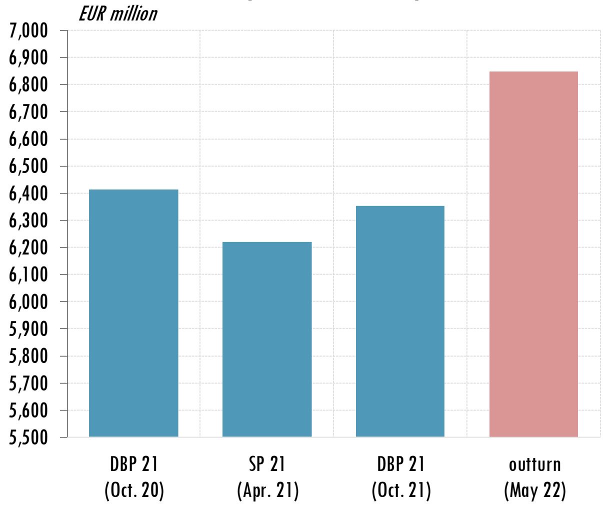
*Source: SORS, forecasts IMAD. *A forecast of this aggregate was not published.*

Figure 3.7: Changes in the 2021 forecast – total taxes



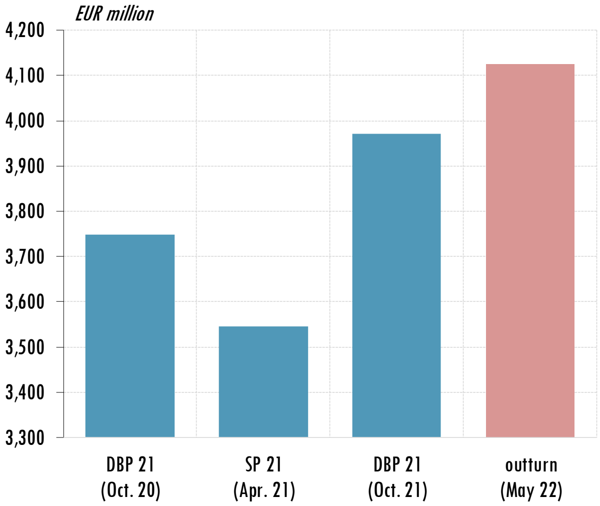
Source: SORS, forecasts MoF.

Figure 3.8: Changes in the 2021 forecast – taxes on production and imports



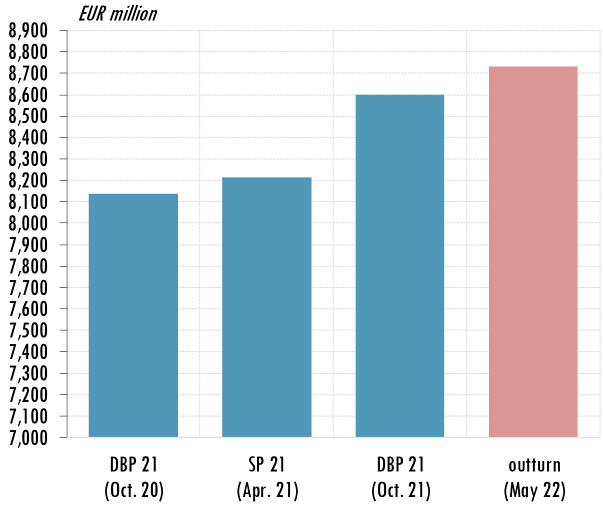
Source: SORS, forecasts MoF.

Figure 3.9: Changes in the 2021 forecast – current taxes on income and wealth



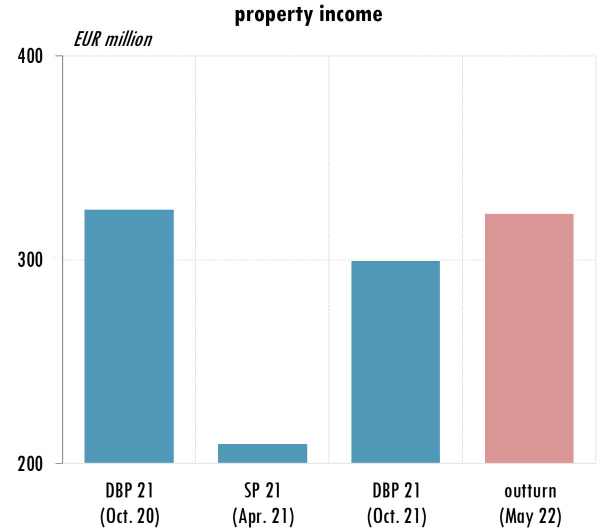
Source: SORS, forecasts MoF.

Figure 3.10: Changes in the 2021 forecast – social security contributions



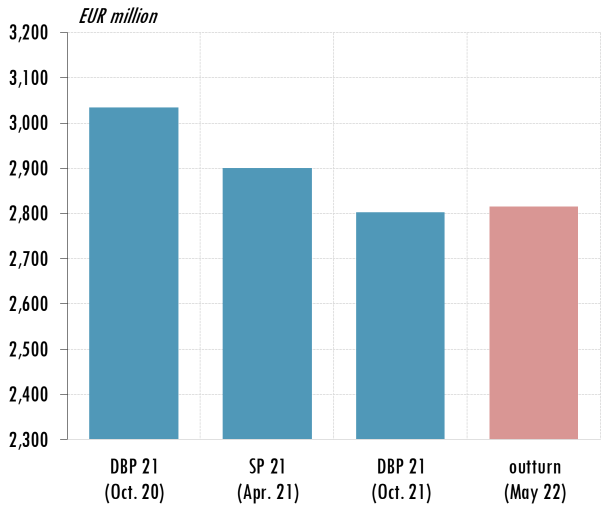
Source: SORS, forecasts MoF.

Figure 3.11: Changes in the 2021 forecast – property income



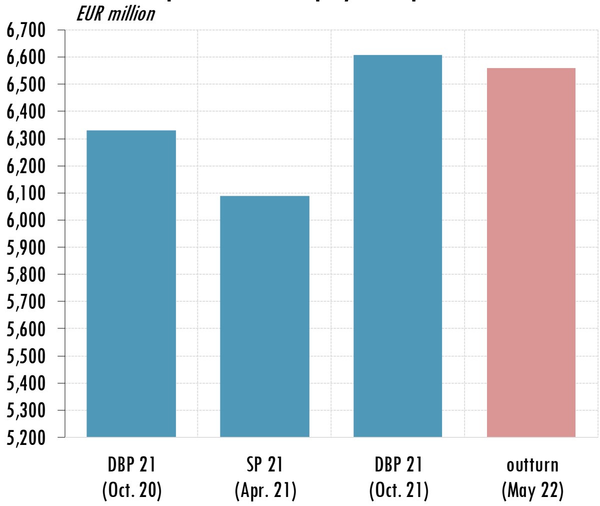
Source: SORS, forecasts MoF.

Figure 3.12: Changes in the 2021 forecast – other revenue



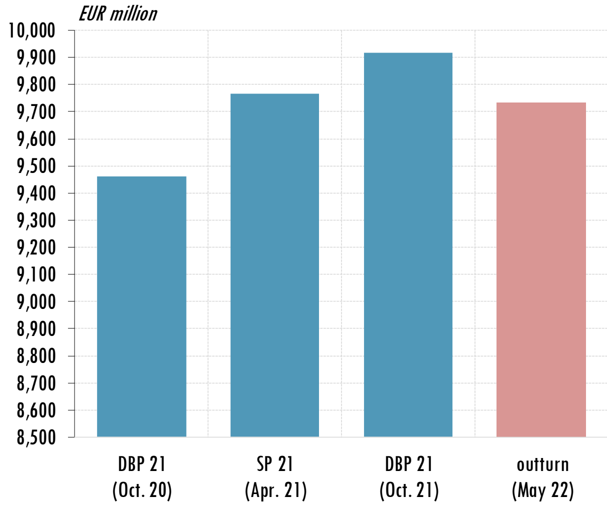
Source: SORS, forecasts MoF.

Figure 3.13: Changes in the 2021 forecast – compensation of employees expenditure



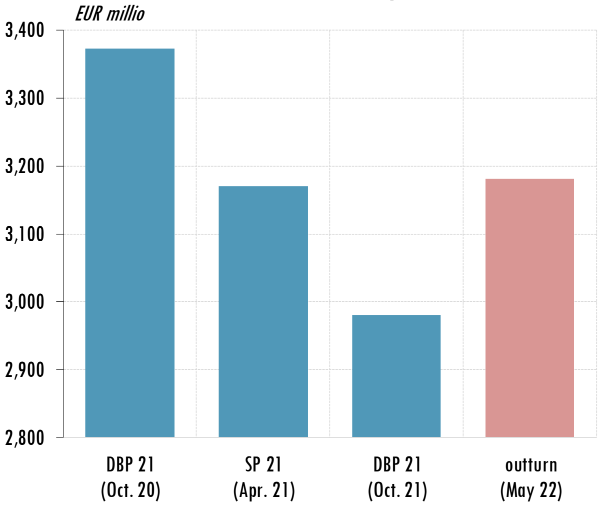
Source: SORS, forecasts MoF.

Figure 3.14: Changes in the 2021 forecast – social benefits



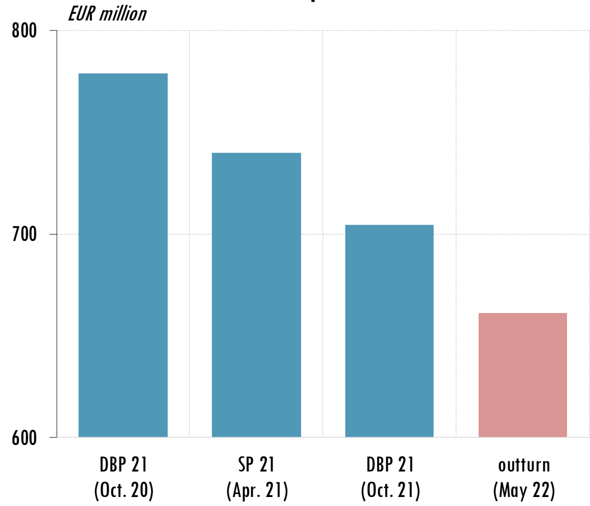
Source: SORS, forecasts MoF.

Figure 3.15: Changes in the 2021 forecast – intermediate consumption



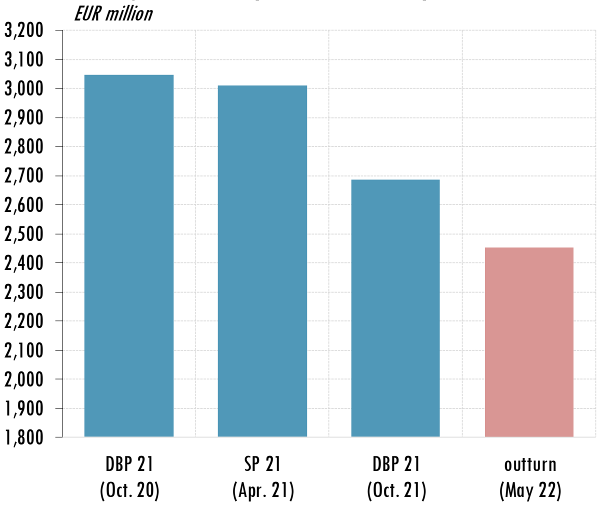
Source: SORS, forecasts MoF.

Figure 3.16: Changes in the 2021 forecast – interest expenditure



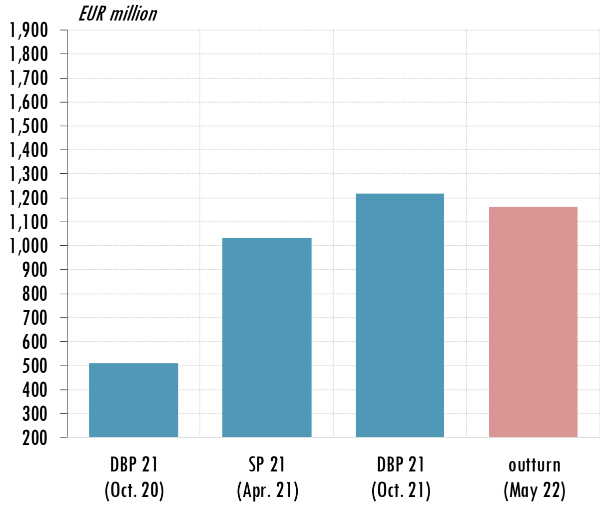
Source: SORS, forecasts MoF.

Figure 3.17: Changes in the 2021 forecast – gross fixed capital formation expenditure



Source: SORS, forecasts MoF.

Figure 3.18: Changes in the 2021 forecast – subsidies



Source: SORS, forecasts MoF.

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