Speech of the President of the Fiscal Council on the presentation of the assessment of compliance of the Draft Revised Budget of the Republic of Slovenia 2022 and the proposed Ordinance amending the Ordinance on the framework for the preparation of the general government budget for the 2022–2024 period with the fiscal rules in the National Assembly of the Republic of Slovenia (24 September 2022)

The Fiscal Council received all data and documents necessary for the evaluation of the budget documents within the deadlines set in the Memorandum of Understanding concluded with the Ministry of Finance. Various departments of the Ministry were available for additional clarifications on questions and dilemmas that arose during the assessment. The Fiscal Council counts on constructive cooperation in accordance with the Memorandum also in the future.

At first glance, fiscal trends show an improvement on last year's unfavourable situation. The Draft Revised Budget foresees a reduction in the overall government budget deficit from EUR 3.1 billion in 2021 to EUR 2.0 billion in 2022. The decrease compared to last year is due to high nominal GDP growth and consequently higher revenues, particularly tax revenues, and a much less negative impact of one-off factors on the balance than last year, despite the adoption of inflation-mitigation measures. Last year, state budget expenditures for COVID measures totalled EUR 2.8 billion, while this year their financial impact, together with the measures adopted so far to mitigate the effects of the inflation, is expected to be EUR 1.5 billion, i.e. about half as much. On the other hand, state budget expenditure excluding one-off factors is expected to increase significantly this year, by as much as EUR 1.9 billion or 16.2%. Only about one-third of this increase is expected to result from the projected high investment activity. Spending, which excludes the impact of investment as well as one-off factors, is expected to increase by EUR 1.2 billion or 11.4% this year, which would be a record high. Such growth would be well above the medium-term sustainable growth path as defined by the currently estimated long-term potential output growth of around 4.5%.

The Draft Revised Budget and the realisation of the state budget for the first eight months of the year implicitly show that a deficit of EUR 1.7 billion would be realised in the last four months alone, only partly as a result of measures to mitigate the effects of the epidemic and inflation, the financial effect of both in the last four months of this year is expected to reach EUR 660 million. In addition to the stabilisation of cyclical income growth, which otherwise makes sense from the perspective of expectations of a slowdown in economic activity towards the end of the year, it implicitly foresees a considerable increase in consumption in the last four months. This should be partly due to the expected nearly four times higher investment activity than in the first eight months of the year, which is deemed to be unrealistic as well as inefficient given the high input costs. The year-round projection of investment is less realistic than that foreseen by the current budget, and the reduction in investment plans is almost entirely due to the expected lower planned volume of investments financed by EU funds. However, according to the Government, the need to use up the remaining cohesion funds from the previous financial perspective is one of the main reasons for the proposed increase in the expenditure ceiling. The bulk of the year-end projected deficit should otherwise be the result of other, i.e. current, spending, which, in our opinion, is not based on the measures currently valid and therefore points to unrealistic planning of a part of the expenses that are unrelated to the epidemic, inflation or investments. The most prominent component of a rise in current spending are the costs of labour, which, in addition to the costs of public administration, include transfers to public institutions for this purpose. In the first eight months of this year, they increased by 3.3% while they are planned to increase by as much as 26.4% in the last four months.

We therefore consider the Draft Revised Budget to be unrealistic, as the deficit is likely to be smaller than projected, but this will set the basis for the autumn budget documents for 2023 and 2024 too high. This is exactly the same conclusion as that made in the autumn of the previous two years, when the revised state budget for 2020 was adopted and when the 2021 out-turn, which served as the basis for the 2022 Budget Amendments, was estimated. In both cases, the actual out-turn confirmed the Fiscal Council's assessments, as in the end the deficit was actually much smaller than expected. This opened the way for expenditure increases in the context of favourable economic trends, which were largely of a permanent nature and therefore structurally weakened the position of public finances. The Draft Revised Budget again increases the risks of overspending, this time at a time when financing conditions on international financial markets are also tightening.

However, if the Draft Revised Budget is implemented, this would imply a highly expansionary fiscal policy, which we consider inappropriate given the current macroeconomic situation, which, according to the currently available data, remains favourable despite the uncertainties. The latter are characterised, in particular, by supply-side constraints and high inflation, while the implementation of the fiscal policy outlined in the Draft Revised Budget, which would stimulate demand in the short term through investment and high wage growth, could further increase macroeconomic imbalances. It would also increase the risks of a prolonged persistence of high inflation, which would be counterproductive in the face of efforts to mitigate price increases, and a move away from the medium-term sustainability of public finances.

A comparison of the Draft Revised Budget and the valid budget for this year, adopted last October, shows that the EUR 640 million increase in spending in the Draft Revised Budget is mainly due to more expenditure on COVID measures (EUR 447 million) and expenditure to mitigate the effects of the price increases (EUR 169 million). At the same time, mainly due to a less unrealistic estimate of revenue from EU funds, the projection of investment spending is reduced by EUR 368 million. Thus it can be concluded that, in the Draft Revised Budget, the appropriations to ensure the financing of the new facts have only been increased. Other commitments, on the other hand, have not been adjusted to the actual out-turn in the first eight months of the year, which clearly shows that the expenditure in the currently valid budget was set too high when the budget was adopted last year. The Fiscal Council pointed this out clearly last October.

Preparing the revised budget separately from the revision of the budget documents for the coming two years also represents another departure from medium-term budgetary planning, which is the basis for the preparation of a comprehensive and coherent fiscal policy. The Fiscal Council acknowledges that the current situation is characterised by considerable uncertainty, but its view is that this should not be an excuse for incomplete fiscal planning. On the contrary, producing credible medium-term projections could contribute to reducing the uncertainty faced by households and businesses, although the fiscal plans would be adjusted over time to reflect the actual situation. Unrealistic and incomplete planning also opens the way for irrational spending and increases risks to medium-term sustainability and is a continuation of the practice of the last two years, when, according to the Fiscal Council's assessment, the flexibility that was allowed by the application of exceptional circumstances clause has been used up to a certain extent. At the same time, the revised budget also does not fully take into account the updated macroeconomic forecasts, which, in a highly uncertain environment, further contributes to the unreliability of the presented fiscal plans.