Speech by the President of the Fiscal Council at the presentation of the assessment of the draft budget of the Republic of Slovenia for 2024 in the National Assembly (21 October 2022)

As a representative of an institution that monitors the transparency of public finances and draws attention to the risks to their medium-term sustainability, I must, as I have on several occasions in the past, point out the inadequacy of the way in which budget documents are addressed, irrespective of any rules of procedure. After discussing the 2022 revised budget a few weeks ago, we discussed the framework for the 2022–2024 budgets in the previous item; we are currently discussing the 2024 budget, and the 2023 debate is still to come. This approach does not allow for a comprehensive and timely debate on public finances. I will therefore take a more comprehensive view of the fiscal outlook for the period 2022–2024.

The budget documents are being prepared in an uncertain situation which justifies the extension of the exceptional circumstances into 2023. This is also the position of the European Commission, which has issued three recommendations to the Member States on how to prepare their budgets. First, the uncertain situation requires flexibility to take effective and targeted measures to mitigate the consequences of the energy crisis. Second, it is essential that investments are efficient, in particular those enabling a green transition and being financed to the greatest possible extent with European funds. Third, growth in current spending should lag behind the estimate of long-term growth in economic potential. This would prevent fiscal policy from creating additional inflationary pressures and risks to medium-term sustainability. We agree with all the recommendations, which are similar to the opinion of the European Fiscal Board, and have prepared our assessment of the proposed budgetary documents in this light.

<u>Flexibility</u> is ensured by a substantial budget reserve of €2.5 billion in 2023 and €1.8 billion in 2024. As much as €1.2 billion of the reserve in 2023 is earmarked for inflation mitigation measures, which have not yet been determined. The reserve is substantial, given that the total impact of all the measures so far on the state budget has amounted to EUR 650 million. Also because it is unlikely that inflation mitigation measures will be needed only this winter, these funds need to be handled in a particularly rational way. Inflation mitigation measures must be effective and must not permanently worsen public finances. It is essential that they are temporary and, as far as possible, targeted at helping the most vulnerable groups of the population and the most exposed sectors of the economy. Contrary to the Government's findings, we consider that some of the measures are not properly targeted. In introducing them, consideration should be given to the incentives to rationalise the consumption of energy products as well as burden-sharing of the energy shock, which is unlikely to be temporary, between the State and the private sector. The Fiscal Council has asked the Ministry of Finance for clarification on the intended use of funds on reserve. We have received assurances that the funds in the sub-accounts of the COVID and inflation reserve items cannot be used for other purposes than those intended, in line with the draft Implementation of Budget Act. However, there is still some doubt as to the intended use of these funds. Last week, the Government adopted the draft Act on Healthcare Emergency Measures to Contain the Spread of the COVID-19 and Mitigate its Consequences in the Health Sector. It suggests that the practice of addressing systemic problems through emergency legislation to address an emergency is continuing as in fact, one-third of the main solutions cited by the Government within this act do not relate to COVID-19. On the basis of this act and past practice in the period of exceptional circumstances since 2020, there are no guarantees that the pattern of action that characterised the period of the epidemic will not remain the same in the

adoption of emergency legislation in the area of inflation. The Fiscal Council therefore calls for a high level of transparency in the identification of financial implications and actions in this area.

Investment is again planned at record levels, although the outturn over at least the past three years has confirmed our assessment that plans exceed the absorption capacity of the administration and the economy. Next year, state budget investment is expected to account for 4.0% of GDP and 7.0% of GDP for the general government. This is double the long-term average, the highest among EU countries and double the EU average according to the European Commission's spring forecasts. A focus on investments is reasonable if they address the risks to which the economy will be exposed in the future and may have an impact on growth in economic potential and on the sustainability of public finances. However, their rapid growth is usually accompanied by inefficiency, which may be also largely due to the high cost of materials in the present case. A high proportion of the planned investments is expected to be financed with EU funds, which reflects the conclusion of the past and the beginning of the new multi-annual financial framework, and the RRF funds, where there are already delays in meeting the milestones as a condition for disbursements. At the same time, the already high level of own resources is increasing further, which is unusual in a context of tightening conditions for state funding in international financial markets and which increases the risks of inefficient project implementation.

The growth in current spending, i.e. expenditure excluding the effect of exceptional measures, investment and interest, is projected to be around 6% per year over the next two years. This is around twice the long-term average and above the estimate of medium-term economic potential growth. This growth in current spending is largely due to the extensive discretionary measures taken after the budget was enacted last autumn. In our estimation, these measures will worsen the position of public finances by about 2% of GDP per year, acting on both the revenue and expenditure sides. The latter are strongly predominant especially due to the proposed amendments to the tax legislation, which partly neutralise the impact of the original changes. The bulk of them relate to public sector salaries and social benefits. Discretionary measures, together with legally guaranteed indexation and inflation mitigation measures, ensure that their real value is preserved. However, the risks of even higher growth in current spending are considerable and are further increased, notably in the area of wages, also as a result of the discretionary measures mentioned above, as evidenced by the recent agreements with individual trade unions.

The draft budgets have taken the above recommendations into account to some extent, but they come with shortcomings and risks. The outturn of the draft budgets would imply a relatively neutral fiscal policy stance on average over the next two years, taking into account high one-off factors, overvalued investment and high inflation. If demand was boosted further, fiscal policy would run counter to the monetary policy efforts to contain the upswing in inflation expectations and also counter to economic policy's own efforts to cushion the blow of the cost of living crisis.

The risks of possible deterioration in the medium-term sustainability of government debt, which is projected at 70% of GDP at the end of 2024 and thus higher than before the COVID-19 crisis, are relatively limited. The short-term deterioration of fiscal position, which otherwise increases the risk of adverse reactions from financial markets, is likely to be smaller than predicted; at the same time, the State has collected ample liquid assets. Nevertheless, the warning about the risks to long-term sustainability of debt, which we assess to be intensifying, is again in place.

Let me conclude by directly addressing the draft budget for 2024. The projected reduction in the overall government deficit will result from the expected end of the epidemiological and inflation mitigation measures. Without these measures, the deficit will be EUR 1.4 billion – or 2 percentage points of GDP – higher than last year, despite the planned reduction in investment spending. This is mainly due to the discretionary measures mentioned above, which to a large extent worsen the public finances on a permanent basis. In addition, the projected expenditure dynamic is unrealistically low, especially in the area of labour costs and social allowances. In the case of labour costs, the projected increase does not even reflect the impact of regular promotions and employment growth, let alone the agreement reached with the trade unions. In the case of social benefits, it does not reflect the statutory adjustment for inflation in the previous year. This is yet another indicator of the continuation of the practice of implausible medium-term budgetary planning.