REPUBLIC OF SLOVENIA
FISCAL COUNCIL

Public finance and macroeconomic developments

February 2023

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Data available up to and including 2 February 2023 were used.

The present document contains an analysis of fiscal trends in the general government sector in accordance with the European System of Accounts methodology (ESA, 2010), also used for the monitoring of EU fiscal rules. These trends are published quarterly as national accounts statistics by SORS. It also monitors trends in the state budget, local government budgets, the pension insurance fund (ZPIZ) budget and the health insurance fund (ZZZS) budget in accordance with the International Monetary Fund methodology for monitoring government finance statistics (GFS) based on the cash flow principle, which are published on a monthly basis by the Ministry of Finance.

The comments on the state budget implementation (Section 2) refer to the daily data available at:
https://proracun.gov.si/#.

Summary

At the end of last year and at the beginning of this year, the economic situation and especially expectations in Slovenia partially stabilised at slightly less unfavourable levels than previously forecast. This year's economic growth will be much lower than that of the previous year, while many negative risks remain. Price growth remains high and contributes significantly to the strengthening of public revenue, which should be used primarily to reduce the burden of public debt. Last year, the budget deficit totalled 2.4% of GDP and was, as expected, much lower than forecast in the revised budget. The deficit of the Health Insurance Institute of Slovenia was at a record high and municipal spending even exceeded the statutory limit set by the budget drafting framework. The deterioration of the fiscal position has been among the largest in the EU since the onset of the epidemiological crisis, and this year's deficit is expected to be among the highest in the EU. For this reason, and also due to the uncertainty in the financial markets, economic policy should, to the greatest possible extent, avoid measures that would further permanently worsen the state of public finance.

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Slovenia's fiscal situation improved in 2022, but the forecast economic trends and economic policy measures worsen the outlook for this and the upcoming years. As expected, last year's state budget deficit was 1% of GDP lower than projected, which was mainly due to lower than planned state investment activity and labour costs. It was investments that contributed most to the highest deficit of municipalities recorded after 2010, while the high deficit of the Health Insurance Institute of Slovenia was mainly the result of high growth in expenses for sickness benefits and transfers to public institutions for labour costs. Discretionary measures resulted in a nearly EUR 200 million increase in the Pension and Disability Insurance Institute of Slovenia's expenditure last year on pensions, which further increased to EUR 500 million following the last indexation. Average pensions have increased significantly in real terms over the past three years, and pension supplements totalling almost EUR 200 million were also paid out during the epidemic. As warned by the Fiscal Council on the adoption of the 2023 state budget, the adopted budget created relatively ample space for action in view of the lower-than-predicted budget implementation in the previous year. After the end of the epidemic, during which many population groups received supplements to their regular incomes, and in the face of high inflation, which the government is fighting by implementing extensive, but mostly non-targeted measures, this raises the expectations of budget users regarding economic policy incentives in the future as well.

Domestic fiscal policy and monetary policy at the Eurozone level do not follow the same course, which is already reflected in the increased costs of financing of the private sector and the general government sector. This a major change in policy orientations since the end of the epidemic, when both policies were coordinated. At the same time, it is a warning that domestic economic policy decisions in the period of the ECB's withdrawal from the purchases of government bonds will be increasingly exposed to the verification of sustainability by market participants.

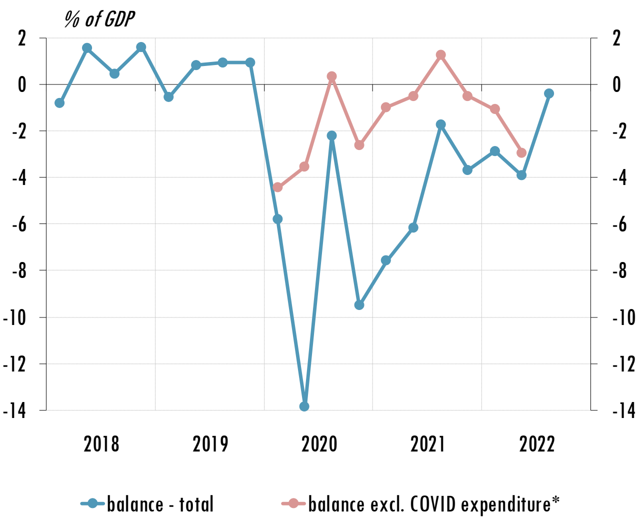
In the Fiscal Council's opinion, the effects of the current agreements regarding public sector wages are still within the scope of the adopted budget documents, but there is no more room for manoeuvre for additional arrangements. It should be borne in mind that some major, inflexible, budget components are underestimated in the 2023 state budget. The Fiscal Council expects that the probable revised budget will be prepared more realistically than last year. However, at the same time, expenditure ceilings should not be raised further. According to the forecasts of the European Commission, Slovenia's general government deficit should be among the highest in the EU this year. At the same time, Slovenian government bond markups have been higher than those for comparable countries in recent months. An increase in public sector wages without adopting measures to neutralise their impact on the fiscal balance worsens, among other things, the structural position of public finance. It is the initial structural balance that will play a key role in determining the sustainable level of public debt and, consequently, in determining the permissible course of government sector expenditures within the framework of the proposed system of economic management in the EU.

Ensuring an efficient and sustainable fiscal policy is therefore extremely important in view of the many uncertainties in the macroeconomic environment, the foreseen changes to the economic governance in the EU and the long-term challenges of economic policy. From this point of view and taking into account the facts, (i) that the real purchasing power of employees in the general government sector will not decrease despite two crises in the last three years, taking into account the agreements adopted in 2022; (ii) that a number of other measures affecting also public employees have been adopted to fight inflation; and (iii) that, according to the government's forecast, the reform of the wage system will be launched in the middle of this year, in the Fiscal Council's opinion, all stakeholders should, before the beginning of this reform, avoid solutions that would lead to an additional labour cost increase compared to the situation before the adoption of the 2023 budget documents. At the same time, during the entire process of adopting all reforms, including the wage system reform in the public sector, their financial impact should also be given due importance and, taking into account the available resources, so should the assessment of the impact of these reforms on the medium-term sustainability of public finance. Transparently determined macroeconomic and fiscal effects of the adopted key reforms that would be included in the medium-term budget plan, would increase the credibility of the updated Stability Programme, which the Government is due to prepare in April.

1. Fiscal trends – general government (ESA 2010 methodology)

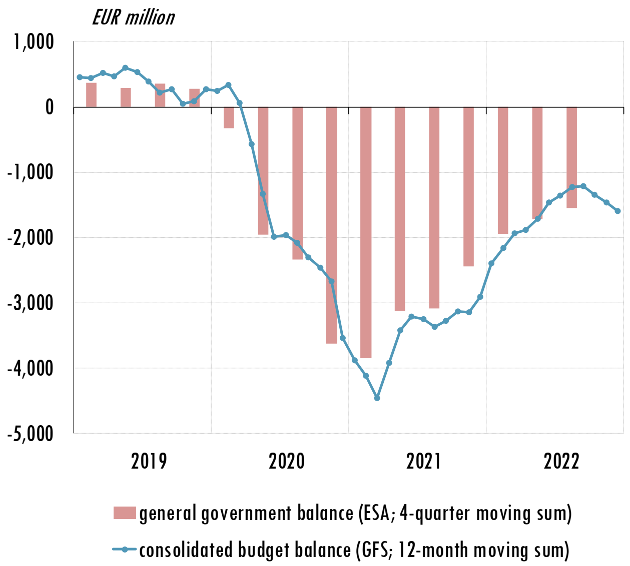
The **general government deficit** in the first three quarters of 2022 (EUR 1,031 million or 2.4% of GDP) was approximately one-half lower than in the same period of 2021 (EUR 1,925 million or 5.0% of GDP).[1] The key reason for this is the much lower impact of spending on mitigating the consequences of the epidemic.[2] In the Fiscal Council's opinion, the deficit for the whole year will be less than the Government's projections in the Draft Budget Plan (3.8% of GDP) from October 2022. This is suggested by the deficit of the four public finance budgetary accounts (-2.8% of projected GDP) and by the fact that, in order for the projections to come true, the general government deficit in the last quarter would have to be approximately 8% of GDP. This confirms the Fiscal Council's assessment of the budget documents last autumn that the Government's estimates regarding the 2022 outturn did not provide an appropriate basis for the preparation of this year's projections. The risk exists that the general government deficit will be much higher than suggested by the implementation of the public finance budgetary accounts, since the method of recording the recapitalisation of energy companies in the amount of EUR 662 million, i.e. 1.1% of GDP, has not yet been determined. In accordance with the methodology, it could be recorded as a capital transfer in the general government sector's balance sheet and thus entail a larger deficit.[3]

Figure 1.1: General government balance



*Source: SORS, FC calculations. Note: *general government balance COVID expenditure data are available only up to second quarter of 2022.*

Figure 1.2: Public finance balances



Source: SORS, MoF, FC calculations

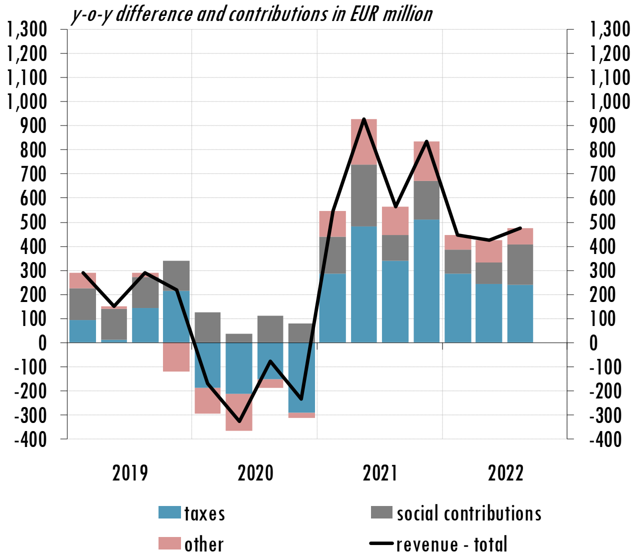
Revenue growth slowed to 7.9% year-on-year in the first three quarters of last year and also lagged behind nominal GDP growth (14.5%). The Draft Budgetary Plan anticipated an annual growth of 8.2% in 2022, while the available data according to the cash flow methodology up to the end of last year suggests that the annual revenue may slightly exceed projections. Growth in the first three quarters of 2022 was largely due to higher VAT revenue and social contributions on a year-on-year basis, particularly in relation to the continued recovery of domestic consumption and favourable labour market conditions. In this period, **total expenditure** was 2.4% higher year-on-year, and growth

[1] Data on the main aggregates of the general government sector for the last quarter of 2022 will be published at the end of March.

[2] Data on epidemic-related expenditure for the general government balance are only available for the first two quarters of last year. This expenditure totalled EUR 388 million and EUR 1,512 million in the same period of 2021. Data on the state budget also show that the volume of measures to mitigate the consequences of the epidemic was considerably smaller year-on-year.

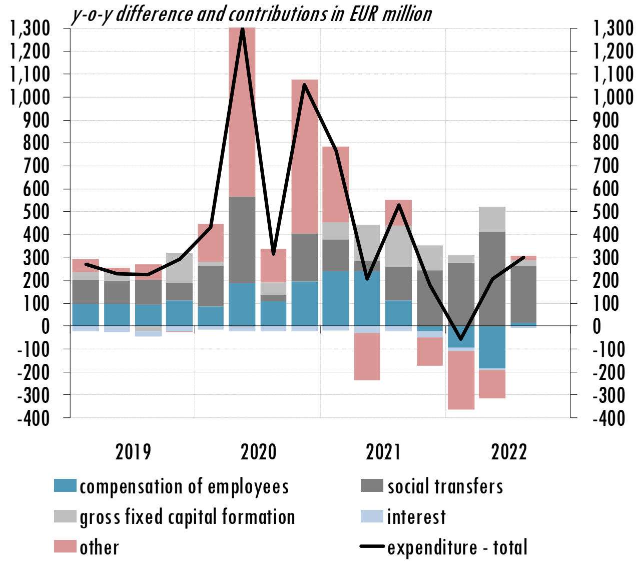
[3] According to the available information, the final decision regarding the accounting method should be made before the publication of data on the main aggregates of the general government sector at the end of March this year.

Figure 1.3: General government revenue (ESA)



Sources: SORS, FC calculations.

Figure 1.4: General government expenditure (ESA)



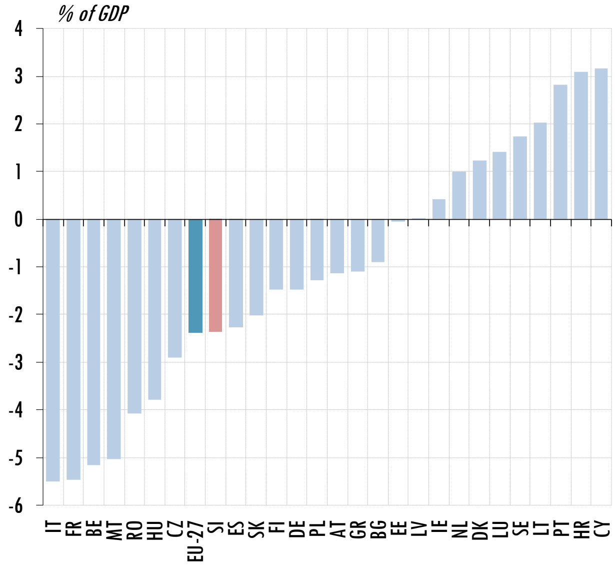
Source: SORS, FC calculations.

Table1.1: Main aggregates of the general government

	Q1-Q3				Q4				MoF forecast			
			change				change				change	
	2021	2022	EUR million	%	2021	2022*	EUR million	%	2021	2022**	EUR million	%
REVENUE	**17,069**	**18,414**	**1,345**	**7.9**	**6,227**	**6,781**	**555**	**8.9**	**23,295**	**25,196**	**1,900**	**8.2**
TAXES	8,273	9,045	771	9.3	3,008	3,152	143	4.8	11,282	12,197	915	8.1
Taxes on production and imports	4,955	5,575	619	12.5	1,904	2,013	109	5.7	6,859	7,587	728	10.6
Curr. taxes on income, wealth, etc.	3,308	3,455	146	4.4	1,100	1,133	34	3.1	4,408	4,588	180	4.1
Capital taxes	10	15	5	56.2	5	6	1	17.3	15	21	6	43.1
SOCIAL CONTRIBUTIONS	6,469	6,825	355	5.5	2,277	2,431	154	6.8	8,746	9,256	510	5.8
PROPERTY INCOME	225	255	30	13.5	91	105	14	14.9	316	360	44	13.9
OTHER	2,101	2,290	188	9.0	850	1,094	243	28.6	2,952	3,384	432	14.6
EXPENDITURE	**18,994**	**19,445**	**452**	**2.4**	**6,741**	**7,933**	**1,192**	**17.7**	**25,735**	**27,378**	**1,643**	**6.4**
COMPENSATION OF EMPLOYEES	5,051	4,786	-266	-5.3	1,565	1,685	120	7.7	6,616	6,470	-145	-2.2
INTERMEDIATE CONSUMPTION	2,479	2,775	296	11.9	916	800	-116	-12.7	3,395	3,575	179	5.3
SOCIAL TRANSFERS	7,234	8,173	939	13.0	2,559	2,420	-139	-5.4	9,793	10,593	800	8.2
INTEREST	492	463	-29	-5.8	161	198	37	23.1	652	661	8	1.3
SUBSIDIES	1,007	406	-601	-59.7	137	474	337	244.9	1,144	880	-264	-23.1
GROSS FIXED CAPITAL FORMATION	1,767	1,936	169	9.6	678	1,562	883	130.3	2,445	3,498	1,052	43.0
CAPITAL TRANSFERS	100	101	1	1.5	113	216	103	91.4	212	317	105	49.2
OTHER	864	806	-58	-6.8	613	580	-33	-5.4	1,477	1,385	-91	-6.2
Balance	**-1,925**	**-1,031**	**894**		**-515**	**-1,152**	**-637**		**-2,440**	**-2,182**	**257**	
Primary balance	**-1,433**	**-568**	**865**		**-354**	**-954**	**-600**		**-1,787**	**-1,522**	**266**	
Balance, GDP %	**-5.0**	**-2.4**		**2.7**	**-3.7**	**-8.1**		**-4.5**	**-4.7**	**-3.8**		**0.9**
Primary balance, GDP %	**-3.8**	**-1.3**		**2.5**	**-2.5**	**-6.7**		**-4.2**	**-3.4**	**-2.6**		**0.8**
Nominal GDP, EUR million	**38,199**	**43,749**		**14.5**	**14,009**	**14,172**	**163**	**1.2**	**52,208**	**57,921**	**5,713**	**10.9**

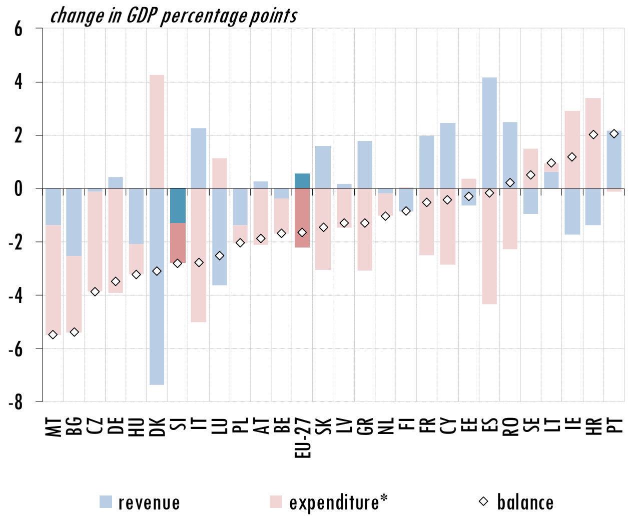
*Source: SORS, IMAD, Ministry of Finance. Notes: **implicitly calculated to match MoF forecast, **MoF forecast: DBP 2023 (October 2022).*

Figure 1.5: General government balance Q1-Q3 2022



Source: Eurostat, FC calculations.

Figure 1.6: Change in general government balance (Q1-Q3 22/Q1-Q3 19)



Source: Eurostat, FC calculations. Note: *Positive sign denotes a decrease in share, negative sign denotes an increase in share.

excluding the impact of anti-COVID-19 measures intensified.[4] We estimate that the growth in expenditure throughout the last year was lower than projected in the Draft Budget Plan (6.4%), since, in order to realise this expenditure, the total expenditure in the last quarter of last year should have increased year-on-year by 17.7%. Social benefits contributed the most to the growth of total expenditure in the first three quarters of last year: they increased even more than in the same period of the previous year. Expenditures for intermediate consumption and investment increased by one tenth, which is much less than in the same period of the previous year. The total expenditures for employee compensation and subsidies were lower year-on-year, mainly due to the reduced amount of allowances or assistance provided in the framework of measures to mitigate the effects of the coronavirus epidemic.

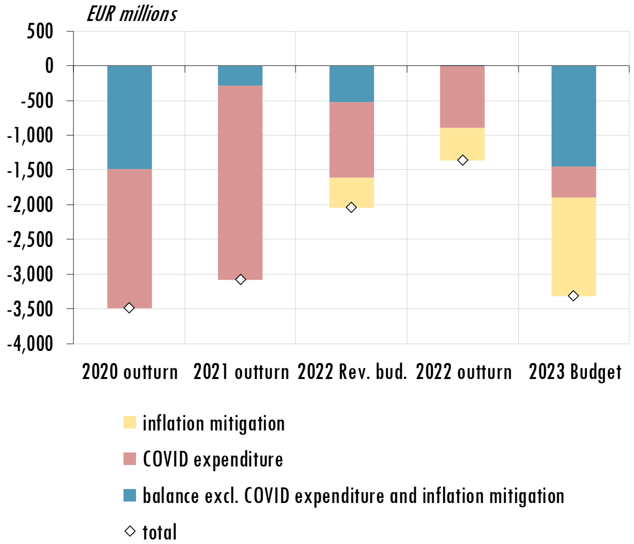
On average, the deficit in the first three quarters was similar to the **EU-27 average** (2.4% of GDP) and was the eighth highest among EU Member States. Compared to the same period of the pre-crisis year 2019, the general government balance in Slovenia deteriorated by 2.8% of GDP in the first three quarters of last year. This was the seventh highest deterioration among EU Member States, exceeding the EU-27 average (1.7% of GDP). The deterioration compared to the pre-crisis year was to a similar extent due to a lower share of revenues in GDP as well as higher share of expenditures. The decrease in the share of revenues (1.3 percentage points of GDP) was largely due to lower revenue from excise duties, as it decreased to the minimum permitted level due to inflation at the beginning of last year. The increase in the share of expenditure (1.5 percentage points of GDP) compared to the same period of the pre-crisis year 2019 was largely due to higher expenditure for social benefits and investment, while the share of interest and employee compensation in GDP was smaller.

2. State budget (GFS cash-flow methodology)

According to the final data, the state budget **deficit** totalled EUR –1,361 million in 2022, which was EUR 33 million less than according to the preliminary data published in the last Fiscal Council Monthly

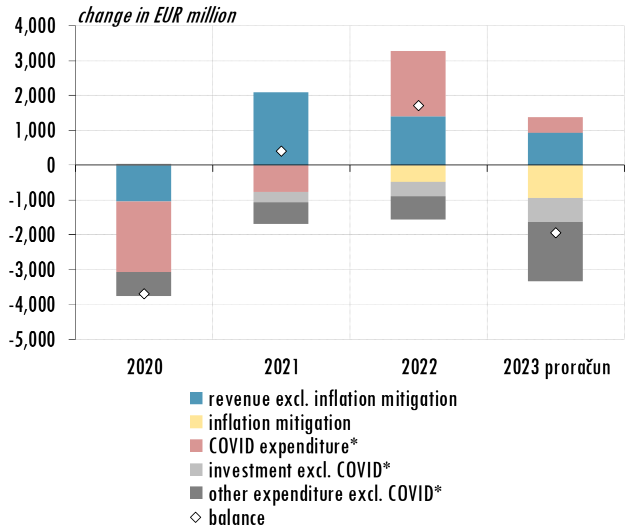
[4] In the first two quarters of last year, for which there is available data on the effect of COVID measures on the general government balance, growth excluding these measures was 11.2%, and 7.1% in the same period of 2021.

Figure 2.1: State budget balance



Source: MoF, FC calculations.

Figure 2.2: Factors of state budget balance change



*Source: MoF, FC calculations. Note: *Positive sign denotes a decrease, negative sign denotes an inrcease.*

Information which took account the daily data on the December budget outturn.[5] A lower deficit than in the previous year was due to lower expenditure on anti-COVID-19 measures. Excluding the direct impact of COVID-related expenditure[6] and measures to ease the cost of living crisis[7], last year's deficit was EUR -27 million (EUR -292 million in 2021).

In line with the Fiscal Council's expectations, the deficit was much lower (by EUR 679 million) than anticipated by the revised 2022 budget, with considerable deviations in individual revenue and expenditure categories. This also impacts the assessment of the realism of this year's budget, which should be properly addressed during the expected preparation of the revised budget for this year. The adopted budget allows for an increase of this year's deficit by almost EUR 2 billion compared to its actual realisation last year.

The key discrepancy on the **revenue** side is again in the revenue from EU funds. This revenue is expected to increase by as much as EUR 821 million this year compared to last year's realisation. Considering the fact that there are delays in meeting milestones, it is estimated that it will be difficult to achieve the planned amount of RRP funds totalling EUR 391 million. At the time of adopting the budgets, we also rated the projection of funds from the new multi-annual perspective amounting to EUR 180 million as optimistic. The key issue is currently related to the ability to spend funds from the previous perspective. The major delays are in the use of cohesion funds, where last year's realisation was even lower than in the previous year and, at the same time, almost half lower than projected in the revised budget.

On the **expenditure** side, last year's lower realisation means that the current budget allows for an almost 22% increase in total expenditure.[8] Labour costs are allowed to increase by almost 17% this year, which otherwise mostly enables the offset of obligations under the agreements adopted so far and other factors impacting labour costs (for more information see Box 1). Given the fact that last

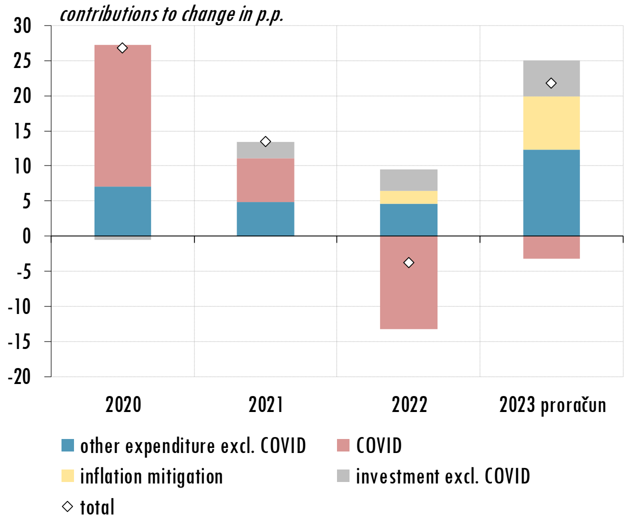
[5] For a more detailed breakdown of last year's state budget revenue and expenditure trends, despite a slight discrepancy in the final data, see Monthly Information, January 2023, which is available at https://www.fs-rs.si/wp-content/uploads/2023/01/MI_2023_01.pdf.

[6] The state budget expenditure for COVID-related measures totalled EUR 2,788 million in 2021 and EUR 892 million in 2022.

[7] The impact of measures to ease the cost of living crisis on the state budget totalled EUR 470 million in 2022.

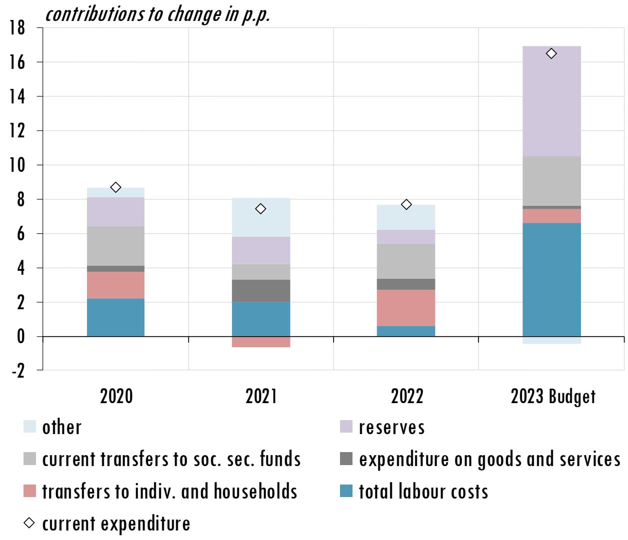
[8] According to last year's revised budget, a 14.5% total expenditure growth was projected for this year.

Figure 2.3: Structure of state budget expenditure growth



Source: MoF, FC calculations.

Figure 2.4: Factors of current expenditure change (excl. COVID and inflation mitigation)



Source: MoF, FC calculations

Table 2.1: State budget

	EUR million						change in %			
	Revised budget 22		outturn 22		Budget 23		total		excl. COVID and infl. mitigation	
	total	excl. COVID and infl. mitigation	total	excl. COVID and infl. mitigation	total	excl. COVID and infl. mitigation	Bud..23/ Rev. 22	Bud. 23/ outt. 22	Bud..23/ Rev. 22	Bud. 23/ outt. 22
Revenue	**12,540**	**12,757**	**12,346**	**12,563**	**13,377**	**13,497**	**6.7**	**8.4**	**5.8**	**7.4**
VAT	4,744	4,802	4,747	4,805	5,038	5,110	6.2	6.1	6.4	6.3
Excise duties	1,516	1,615	1,446	1,545	1,452	1,500	-4.2	0.4	-7.1	-2.9
Personal income tax	1,558	1,558	1,586	1,586	1,719	1,719	10.3	8.4	10.3	8.4
Corporate income tax	1,555	1,555	1,553	1,553	1,516	1,516	-2.5	-2.4	-2.5	-2.4
EU funds	1,195	1,195	957	957	1,778	1,778	48.7	85.7	48.7	85.7
Non-tax	689	689	776	776	542	542	-21.3	-30.1	-21.3	-30.1
Other revenue	1,283	1,343	1,280	1,340	1,332	1,332	3.8	4.1	-0.8	-0.6
Expenditure	**14,580**	**13,281**	**13,707**	**12,562**	**16,691**	**14,947**	**14.5**	**21.8**	**12.5**	**19.0**
Total labour costs	3,860	3,711	3,669	3,569	4,180	4,170	8.3	13.9	12.4	16.8
Transfers to individ. and hou.	1,827	1,630	1,965	1,727	1,864	1,806	2.0	-5.1	10.8	4.6
Exp. on goods and services	1,518	1,358	1,525	1,321	1,411	1,342	-7.0	-7.5	-1.2	1.6
Investment	1,923	1,862	1,669	1,614	2,452	2,309	27.5	46.9	24.0	43.1
Curr. transf. to soc. sec. funds	1,694	1,537	1,612	1,455	1,844	1,844	8.8	14.4	20.0	26.7
Subsidies	656	435	632	422	502	399	-23.4	-20.6	-8.2	-5.4
Interest	674	674	655	655	646	646	-4.1	-1.4	-4.1	-1.4
Payments to the EU budget	714	714	730	730	654	654	-8.4	-10.4	-8.4	-10.4
Reserve	985	805	561	561	2,494	1,224	153.2	344.5	52.0	118.2
Other expenditure	729	555	690	509	645	554	-11.6	-6.5	-0.2	8.8
Expenditure excl. investment	*12,657*	*11,419*	*12,038*	*10,948*	*14,239*	*12,638*	*12.5*	*18.3*	*10.7*	*15.4*
Balance*	**-2,040**	**-524**	**-1,361**	**-27**	**-3,314**	**-1,450**	**-1,274**	**-1,953**	**-926**	**-1,423**

*Source: MoF, FC calculations. Note: *change in balance in EUR million.*

year's realisation of expenditure, particularly on transfers to individuals and households, and, to a lesser extent, on goods and services, was higher than foreseen in the revised budget, the planned amount of funds for this year is considered to be insufficient for these purposes. According to the law, the majority of transfers are adjusted in March to last year's inflation, which was 10.3% in December, and this year's budget envisages a less than 5.0% increase in this expenditure (without taking into account anti-COVID and anti-inflationary measures; compared to the revised budget, the increase in this expenditure in the adopted budget was approximately 11%). Underestimating this expenditure category is customary in the budget planning process, which is also problematic from the viewpoint of aggregate fiscal results, as this important category does not allow flexibility. However, last year's investment expenditure was, as expected, much lower than projected. As a result, a more than 40% increase can be achieved this year[9], which the Fiscal Council considers to be unrealistic. Based on past experiences, the expenditure projected for this year will decrease with the revised budget, but they will probably still be too high with regard to the realistic possibilities given the limited absorptive capacity of the administration and the economy. From the viewpoint of realistic assessment, a special case is represented by expenditure for transfers to the social security fund. This expenditure is expected to increase by more than one-fourth compared to the expenditure realised in the previous year (excluding anti-COVID and anti-inflationary measures). At the same time, this kind of projected budget expenditure was EUR 200 million higher than the total budget revenue planned by both funds in their adopted financial plans. However, according to the data provided by the Health Insurance Institute, the financial plan does not include the impact of the separate agreement reached with healthcare unions in December last year and the impact of the Decree on compulsory health insurance service programmes, the resources required for its implementation, and the amount of funds for 2023 (see also the paragraph on the Health Insurance Institute as part of the fiscal budgets analysis in Chapter 3, p. 11).

In **January**, the state budget had a surplus of EUR 149 million according to preliminary data. Excluding the direct impact of expenditure on anti-COVID measures (EUR 24 million) and anti-inflationary measures (EUR 56 million), the surplus was EUR 229 million. The "core"[10] revenue was year-on-year lower by 6.4% due to lower revenue from EU funds. A part of the RRP advance payment was made into the state budget in January last year. Income tax revenue was lower year-on-year due to a further reduction of the tax burden in accordance with the changes in legislation adopted last year. The modest growth in VAT revenue continues due to a slowdown in domestic demand, while the growth in excise revenue has slightly increased.[11] Expenditure was 14.3% lower year-on-year, and without taking into account the direct impact of anti-COVID-19 measures (EUR 24 million) and anti-inflationary measures (EUR 20 million) by 7.4%. The high growth in labour cost expenditure continued due to the impact of the agreement reached last autumn, and so did the high growth in investment expenditure, while growth of interest payments was also high. On the other hand, expenditure on subsidies and especially on the other expenditure category[12] was lower year-on-year.

[9] According to last year's revised budget, an approximately one-fourth increase in total expenditure was projected for this year.

[10] Excluding the effect of measures to mitigate the cost of living crisis (lower VAT rate on energy products, lower excise duties and freezing of payment of the CO2 tax).

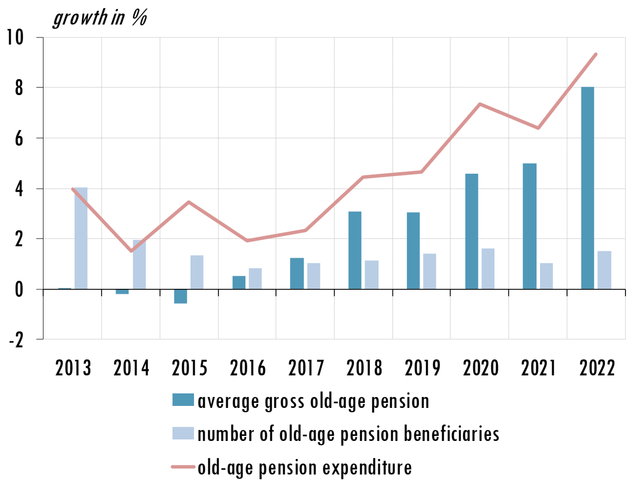
[11] Excise duties on tobacco products were raised in January, and so were excise duties on automotive and heating gas oil on 17 January.

[12] The advance payment of RRP funds was transferred to the budget fund in January of last year and posted to the reserves. No such transaction was carried out in January this year, which, in our opinion, was the main reason for the high year-on-year decline in other expenditure category. The exact structure of other expenditure will be known at the end of February, when more detailed data on the implementation of the state budget for January will be published.

3. Public finance budgetary accounts (GFS cash-flow methodology)

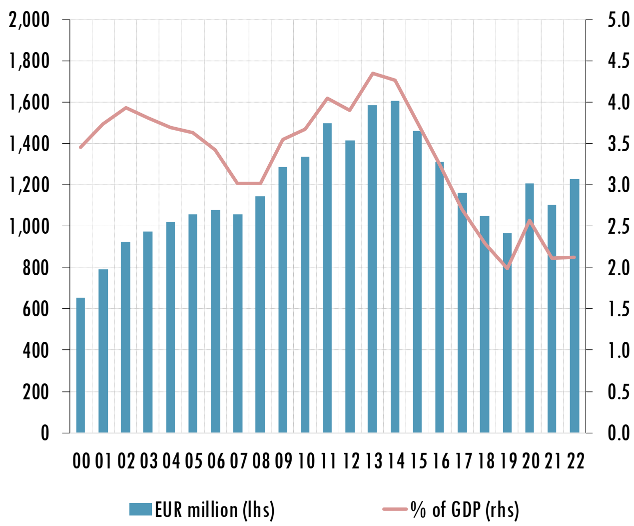
The growth rate of expenditure of the **Pension and Disability Insurance Institute of Slovenia** increased last year to 8.2% (5.2% in 2021) as a result of higher pensions paid, while the number of beneficiaries remained practically unchanged. Pensions were higher due to the extraordinary indexation under the ZPIZ-2L (EUR 145 million expenditure impact on an annual basis), the ordinary indexation carried out in January (4.4% or approximately EUR 270 million expenditure impact on an annual basis), and the 4.5% extraordinary pension increase (EUR 43 million) in November and December last year.[13] In the past three years, the total pension expenditure increased by EUR 1 billion or 22%. However, this increase is only slightly higher than the cumulative increase in nominal GDP in the same period, so that the share of pension expenditure increased by 0.1 percentage points to 9.7% of projected GDP. The real purchasing power of pensions (excluding supplements) has increased over the past three years, as the increase in all types of pensions[14] was higher than cumulative inflation, which stood at 10.9%. The relatively high increase in pensions will continue this year as a result of the relatively high regular indexation (an estimated 4.8%). Given the slowdown in wage growth (which is largely due to lower COVID-related allowances), the growth in social contribution revenue (7.3%) slowed down last year, and the total transfer from the state budget to the Pension and Disability Insurance Institute of Slovenia increased by EUR 127 million to EUR 1.2 billion.

Figure 3.1: Old-age pensions*



*Source: Pension and Disability Insurance Fund of Slovenia (ZPIZ), MoF, FC calculations. Note: *Old-age pension beneficiaries represented 75 % of all beneficiaries last year, while volume of old-age pension expenditure represented 81% of all ZPIZ pension expenditure.*

Figure 3.2: Pension and Disability Insurance Fund of Slovenia (ZPIZ) - state budget funding



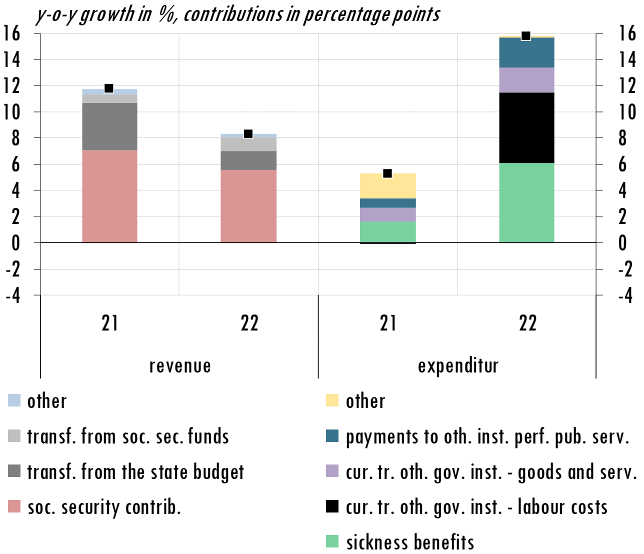
Source: MoF, SORS, IMAD, FC calculations

The **Health Insurance Institute of Slovenia** ended 2022 with the highest deficit ever (EUR -133 million) due to increased expenditure growth (from 5.3% in 2021 to 15.8% in 2022) and the concurrent slowdown in revenue growth (from 11.8% to 8.3%). The increase in expenditure growth was to a similar extent the result of higher transfers for labour costs to public institutions and a notable increase in sickness benefits. The latter is the result of the implementation of the Act Amending the

[13] Two additional amendments to the Pension and Disability Insurance Act (ZPIZ-2) were adopted, which, according to the Pension and Disability Insurance Institute of Slovenia, had an annual effect of EUR 16 million.

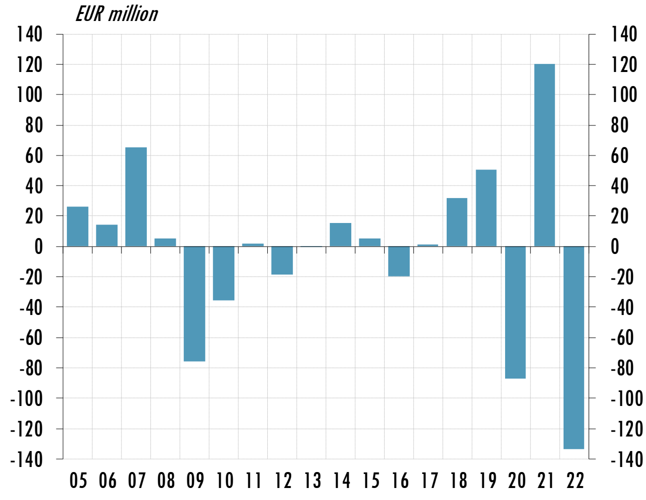
[14] The average old-age pension, which represents the largest share of expenditure, was on average 18.6% higher last year than in 2019. During this period, the average disability pension increased by 19.3%, while survivor's and widow's pensions increased by 16.3%, respectively.

Figure 3.3: ZZZS revenue and expenditure



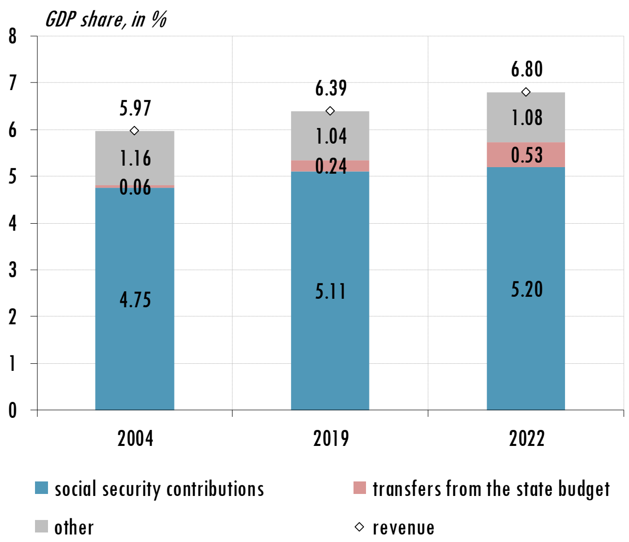
Source: MoF, FC calculations.

Figure 3.4: Health Insurance Institute of the Republic of Slovenia (ZZZS) budget balance



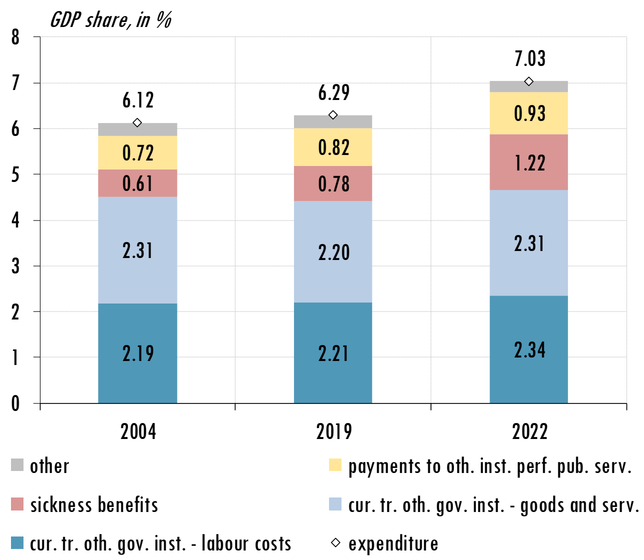
Source: MoF.

Figure 3.5: ZZZS revenue



Source: ZZZS, SORS, IMAD, FC calculations.

Figure 3.6: ZZZS expenditure



Source: ZZZS, SORS, IMAD, FC calculations.

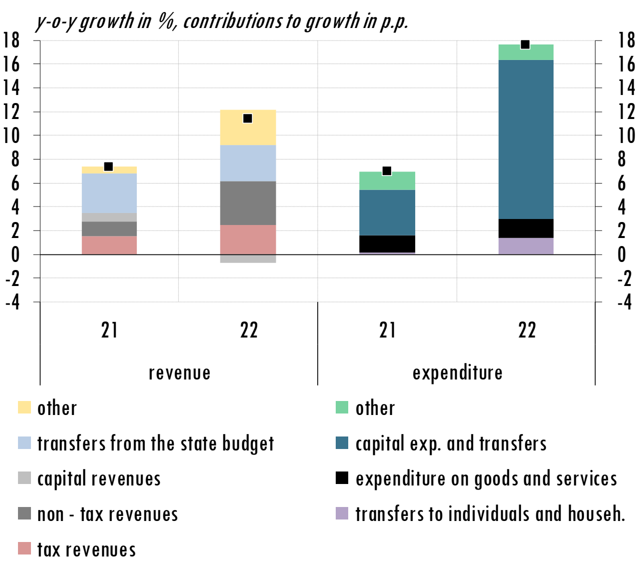
Health Care and Health Insurance Act (ZZVZZ-R), which shortened the period for the payment of sickness benefits by employers from 30 to 20 days.[15] There was a substantial increase in sickness benefit expenditure already before the aforementioned amendment and last year represented as much as 17.4% of total expenses of the Health Insurance Institute of Slovenia, which is almost 8 percentage points above the 2014 level, i.e. before the onset of the rapid growth. The growth in expenditure on transfers to entities other than budget users also increased considerably last year. In addition to sickness benefits, this part of the Health Insurance Institute's expenditure experienced the highest increase over an extended period of time. Last year's lower revenue growth was largely due to the slower growth of social contribution payments (including due to lower allowances paid in the public sector). Last year, the growth of transfers from the state budget was also lower than the year

[15] According to the Health Insurance Institute of Slovenia, the impact of this measure in 2022 is estimated at approximately EUR 50 million, as it entered into force in March of that year, and at approximately EUR 90 million at an annual level.

before. The state budget has become an increasingly important source of the health insurance fund's financing, and its share in the revenue more than doubled last year compared to the year before the onset of the epidemic. According to the financial plan, the deficit should be cut to EUR 48 million, and according to the data provided by the Health Insurance Institute, the financial plan does not include the impact of the agreement reached with healthcare unions in December last year[16] and the impact of the Decree on compulsory health insurance service programmes, the resources required for its implementation and the amount of funds for 2023.[17]

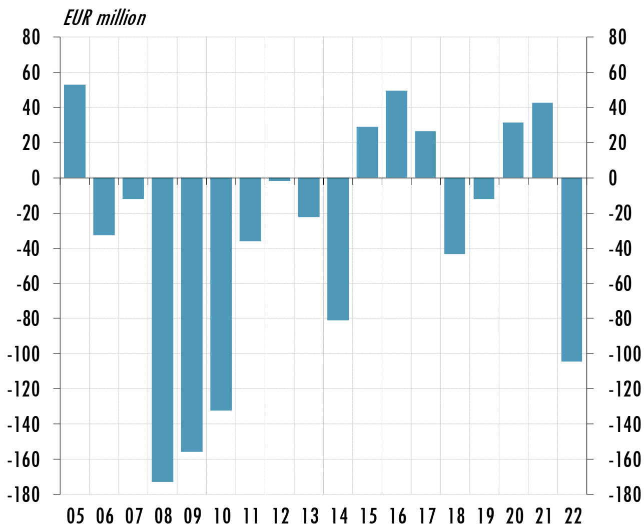
Last year, **municipal budget balances** recorded the highest deficit (EUR 104 million) after 2010. The revenue growth increased (from 7.3% in 2021 to 11.4%), but much less than expenditure growth (from 6.9% to 17.6%). The increase in the lump sum funding resulted in the increase of the growth in income tax revenue as the primary source of municipal budget revenue. Higher growth in total revenue than the year before was again also due to developments in the property market. Revenue from real property transaction tax, real estate transfer tax and public utilities charges increased by almost 17%, again contributing to around a quarter of total revenue growth. Other factors contributing to increased income growth were much higher income from capital gains and received donations. The growth of transfers from the state budget stabilised somewhat compared to the previous year, but remained high and to the greatest extent the result of higher transfers for investments and funds pursuant to the Municipal Costs Reduction Act adopted in 2020. This provides additional resources for rebalancing the development of municipalities in the amount of 6% of the total appropriate spending of municipalities. Three quarters of the growth in expenditure, which was the highest since 2008, were mainly due to stronger investment activity, which increased by more than a third. Transfers to individuals and households increased more than in the previous year, mainly payments of the difference between nursery school programme prices and the parents' payments and home-to-school transport subsidies.[18]

Figure 3.7: Revenue and expenditure of local government



Source: MoF, FC calculations.

Figure 3.8: Local government budget balance



Source: MoF.

[16] According to the data provided by the Ministry of Public Administration, the impact of this arrangement should be approximately EUR 50 million in 2023.

[17] According to the Government's estimates, the impact of the Decree on Compulsory Health Insurance is this year expected to be EUR 105 million.

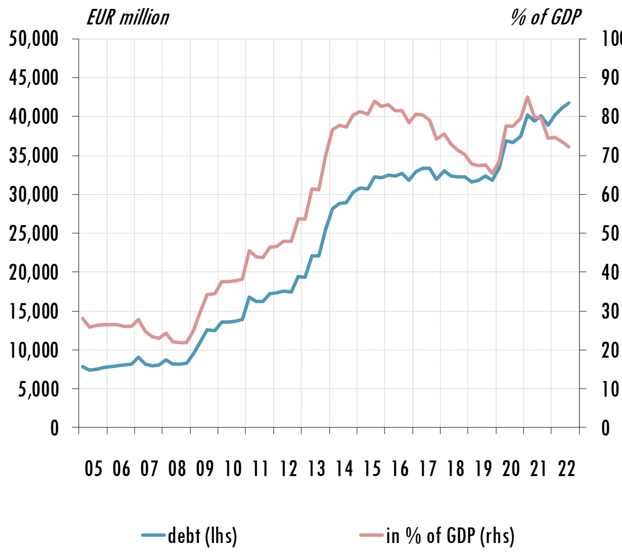
[18] Schools were closed for a part of 2021, which resulted in lower revenue.

4. General government debt

At the end of the third quarter of 2022, **the gross general government debt** stood at EUR 41.8 billion, which is EUR 2.9 billion more than at the end of 2021 and EUR 10 billion more than before the pandemic crisis at the end of 2019. The debt represented 72.3% of GDP, increasing by slightly less than 7 percentage points of GDP from 2019, but declining in respect of the highest value achieved so far, i.e. 85% of GDP in the first quarter of 2021. In addition to the lower primary balance deficit, the bulk of the decline in the debt ratio in the past two years was due to the high nominal GDP growth in the post-crisis period. The contribution of inflation to the shrinking debt share, which was amounted to approximately 7 percentage points in a year to the third quarter of 2022, was similar to the contribution of real economic growth.

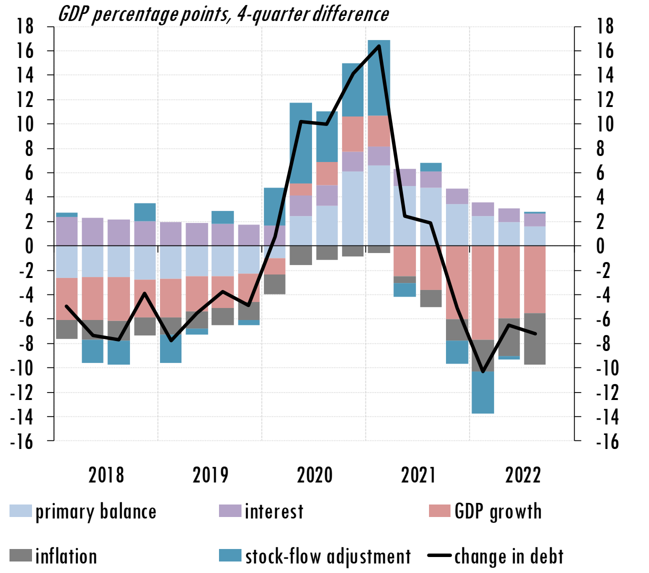
Most of the borrowing in 2022 was not carried out by issuing new bonds, but by additional issues of existing bonds. At the beginning of the year, two new bonds were issued with a total value of EUR

Figure 4.1: General government debt (ESA)



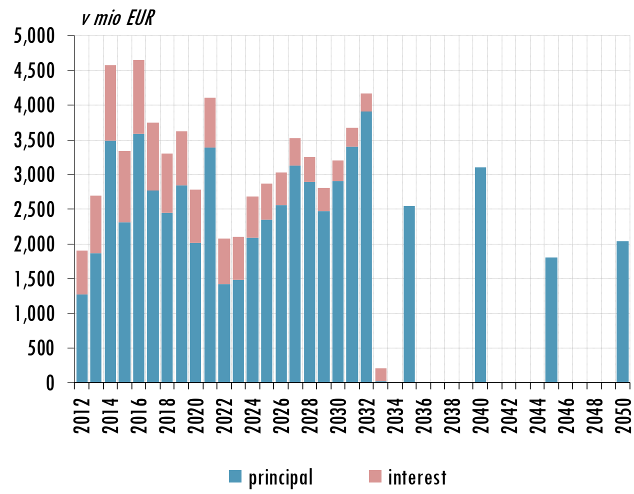
Source: SORS, FC calculations.

Figure 4.2: Change in general government debt



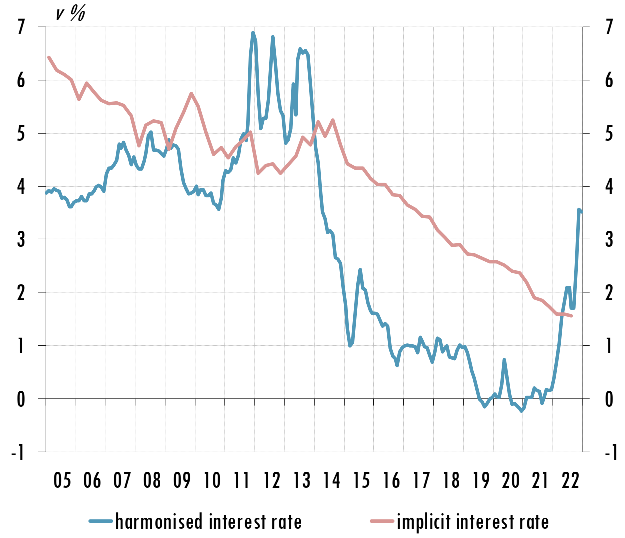
Source: SORS, FC calculations.

Figure 4.3: State budget debt repayment schedule until 2050



Source MoF: State Budget Debt, 1/2023 (as of 31.12.2022). After 2033: Financing Programme of the Republic of Slovenia Central Government Budget for 2023- no information on interest payments.

Figure 4.4: Harmonised long-term interest rate and implicit public debt interest rate



Source: ECB, SORS, FC calculations.

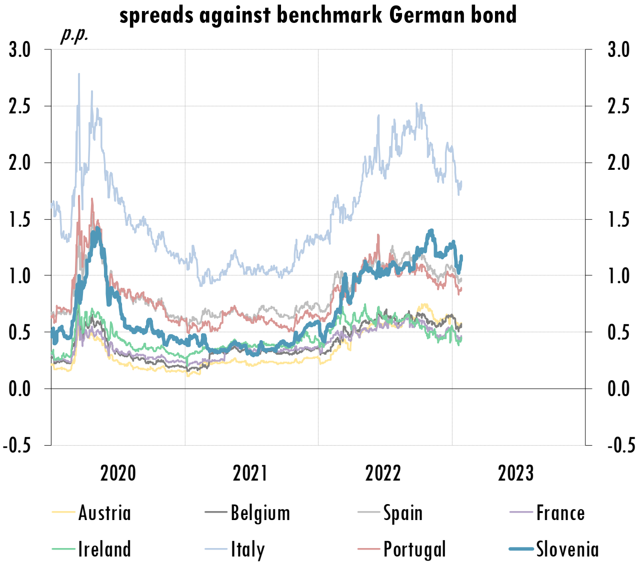
1.75 billion, a 4-year bond with a zero-coupon rate and a 40-year bond with a coupon rate of 1.175%. Later in the year, 24 additional issues of nine already existing bonds were floated in a total amount of approximately EUR 2.9 billion, and, at the beginning of 2023, there was another additional issue of RS76 bonds in the amount of EUR 250 million, maturing in 2045. In 2022, the Treasury also exercised ten partial early redemptions of three existing bonds in a total of just under EUR 1.1 billion, the majority of which relates to the bond maturing this year. At regular auctions in 2022, the Treasury issued treasury bonds in a total of approximately EUR 1 billion, of which approximately EUR 750 million matured last year. At the beginning of 2023, with demand exceeding EUR 10 billion, it issued ten-year sustainability bond for a total of EUR 1.25 billion with a coupon rate of 3.625%.

The maturity volume of the currently issued bonds in 2023 is similar to that in 2022. Thus, at the end of March this year, approximately EUR 1.1 billion worth of RS83 bond fall due for payment, which is almost three quarters of the debt maturing this year. According to the data on the currently issued treasury bills, approximately EUR 220 million fall due this year. According to current data, the largest amount of debt securities in the coming years will mature in 2027 (approximately EUR 3 billion).

Treasury single account balances increased in the first half of the year and peaked at the end of June, totalling EUR 9.1 billion (approximately 16% of the projected GDP), exceeding the highest level reached in March 2021. A similar level was maintained until October, while at the end of January 2023, the balance decreased to approximately EUR 8.0 billion. This treasury single account balance, which provides state budget liquidity, is about EUR 2.8 billion higher than the long-term average.

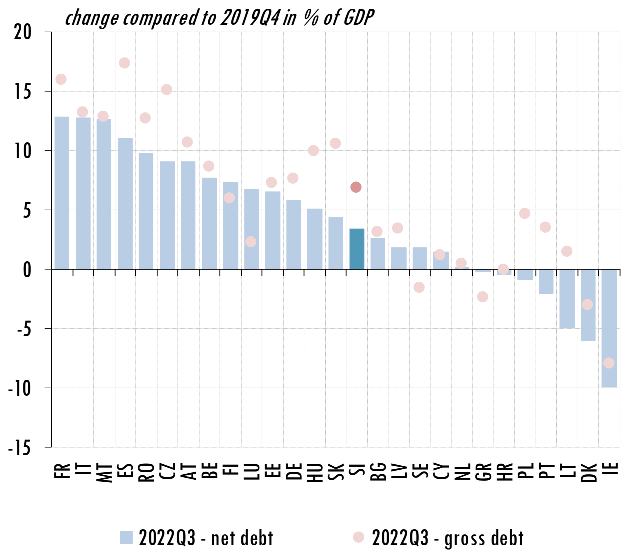
The yields on long-term bonds of euro area countries, including Slovenia, have risen for almost a year, mainly due to changes in the ECB's policy towards tightening financing conditions, higher inflation expectations and the required inflation risk premiums. From the lowest values reached in mid-2021, the required yields on bonds of euro area countries increased by 2.5-3.5 percentage points by the end of January this year (Slovenia: slightly over 3 percentage points). The required yield on Slovenian government bonds has exceeded the implicit interest rate on total government debt for more than the past six months. If this ratio persists and the debt level remains unchanged, this will entail higher budget expenditure on interest payments when refinancing outstanding debt. The pressure to increase

Figure 4.5: Reference 10-year government bond spreads against benchmark German bond



Source: Bloomberg, FC calculations.

Figure 4.6: General government net and gross debt



Source: Eurostat, ECB, FC calculations.

interest costs will be relatively gradual. The maturity distribution of debt-related obligations remains favourable, as the weighted average time to maturity of the debt exceeded 10 years at the end of 2022. At the same time, the Treasury has been limiting the impact of interest rate increases on debt interest costs totalling approximately EUR 4.6 billion (data available for the end of 2021) by means of a hedging instrument since 2018. In 2022, Markups over German benchmark bond increased for some countries, including Slovenia. In the last quarter of the year, Slovenian government bond markups were approximately 0.2 percentage points higher than markups on, for example, Portuguese and Spanish government bonds, which previously exceeded those on Slovenian government bonds. Interest rates on treasury bills, issued in the first half of 2022 were negative, but became positive in the second half of the year for bills with all maturities. For the one-year treasury bills issued in January this year, the interest rate was 2.75%, which is still negative in real terms given current inflation expectations. Sovereign debt ratings have not changed in the last year, and all three leading agencies — Moody's, Standard&Poor's, and Fitch — confirmed stable debt outlook for the Republic of Slovenia. According to the latest available data, the value of government guarantees decreased by approximately EUR 200 million from end-2021 to the third quarter of 2022, to reach EUR 4.5 billion, representing 7.8% of GDP. This excludes government guarantees totalling EUR 1.3 billion which were granted to three energy companies in September last year.

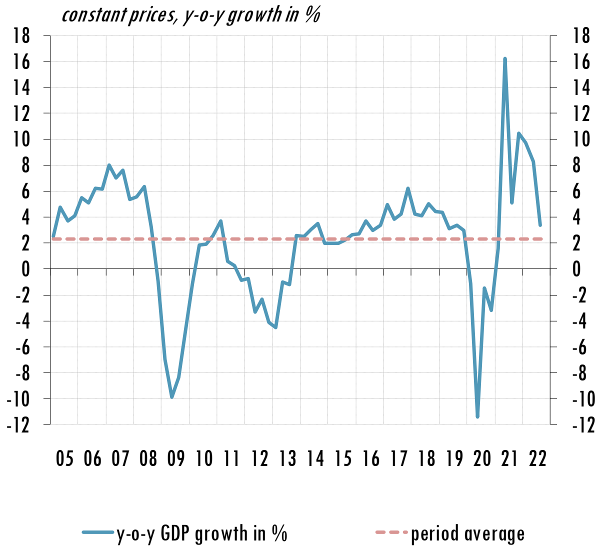
The Slovenian general government's gross debt-to-GDP ratio **is below the EU average**, although the backlog (-12.8 percentage points of GDP) is at a half of the long-term average backlog.[19] The increase in debt-to GDP ratio in the third quarter of 2022 was 0.8 percentage points less than the increase in the EU average compared to the period before the onset of the pandemic crisis, making Slovenia 13th out of the 27 EU Member States. Excluding general government assets, which resulted mainly from pre-financing, in the third quarter of 2022 the net general government debt stood at 46% of GDP, placing Slovenia 15th among the EU Member States in terms of its increase over the same period.

5. Macroeconomic trends and risks

The currently available data point to stagnation, i.e. to a decline in the quarterly GDP dynamics in the first three quarters of last year. The average year-on-year growth of economic activity in 2022 was nevertheless significantly positive due to the carry-over of the high level achieved at the end of 2021, and the annual growth of real GDP is expected to be close to 5%. Following the decline in exports at the beginning of the year, domestic consumption in particular contributed to stagnation and subsequently to the fall in GDP. General government spending also shrank in 2022 up to the third quarter as a result of the reduced economic support in relation to the pandemic. Despite stronger inflationary pressures and the rapidly declining rate of savings, which was the fastest year-on-year so far in the third quarter of 2022, the volume of household consumption remained almost unchanged. The government's price and income incentives probably also contributed to maintaining household consumption at a stable level. In domestic consumption, a significant increase was only recorded in gross fixed capital formation, which was mainly the result of investment in the private sector and to a greater extent related to investment in construction than to investment in machinery and equipment. Despite the above, the volume of all components of domestic consumption is relatively high and was at

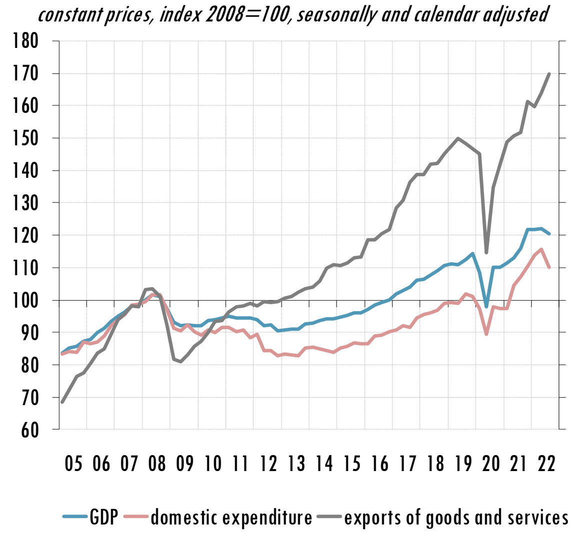
[19] Comparable data have been available since 2000. The largest difference between the share of the government sector's debt in GDP between Slovenia and the EU on average for the year was achieved in 2000 (42.9% of GDP), and the smallest in 2016 (4.2% of GDP).

Figure 5.1: GDP



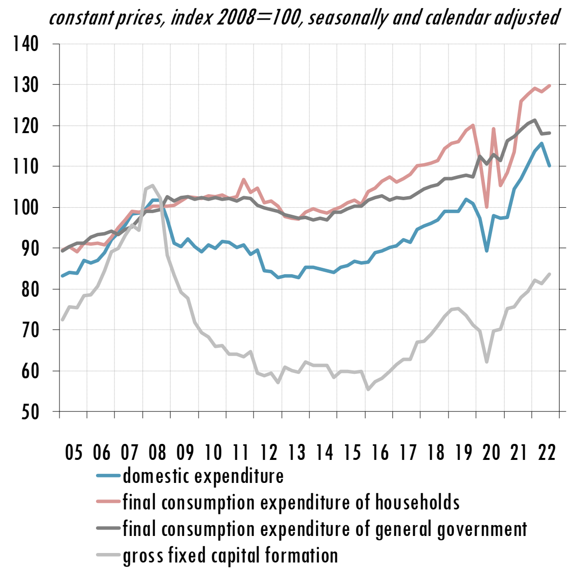
Source: SORS, FC calculations.

Figure 5.2: GDP, domestic expenditure and exports



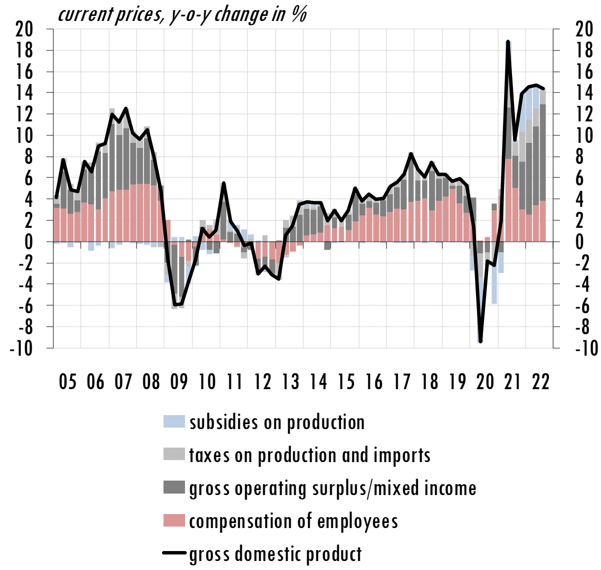
Soure: SORS, FC calculations.

Figure 5.3: Domestic expenditure



Source: SORS, FC calculations.

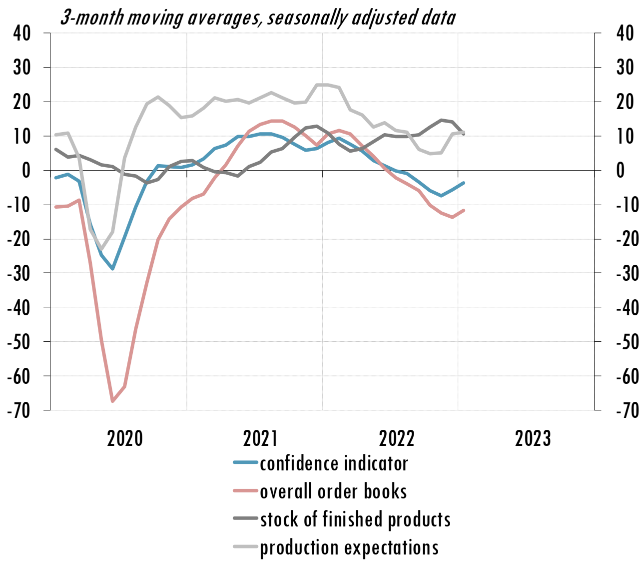
Figure 5.4: GDP by income structure



Source: SORS, FC calculations.

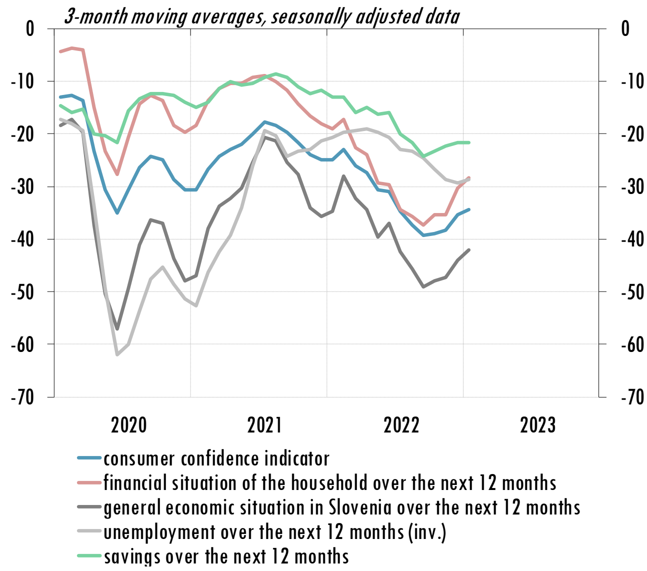
least 10% in real and at least 20% in nominal terms above the pre-crisis level at the end of 2019. In addition to an approximately 15% higher wage bill and an approximately 30% increase in gross operating surplus and miscellaneous income, this is also reflected in higher tax bases. High domestic consumption after the lifting of epidemiological restrictions and the resulting rapid recovery of the economy, together with high prices of raw materials, also caused a decrease in the balance of payments current account surplus by around 7% of GDP in just over a year up to the last quarter of 2022. In this period, the deterioration of terms of trade can be compared to major deteriorations in the last two decades, despite the high prices of raw materials and the resulting high import prices (17.5%), as at the same time the prices of exports of goods and services also increased significantly (13.8%).

Figure 5.5: Business tendency in manufacturing



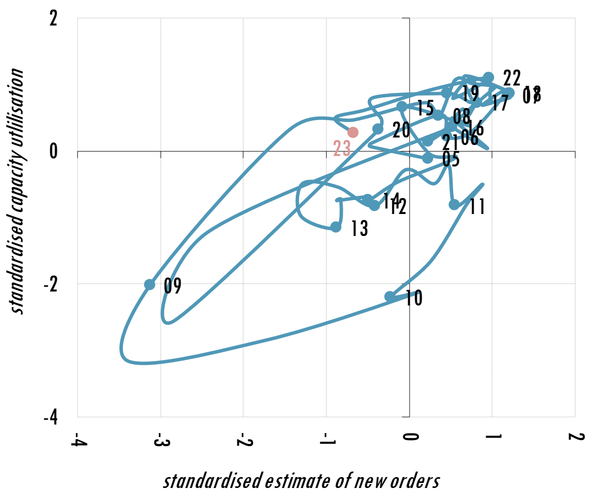
Source: SORS, FC calculations.

Figure 5.6: Consumer survey



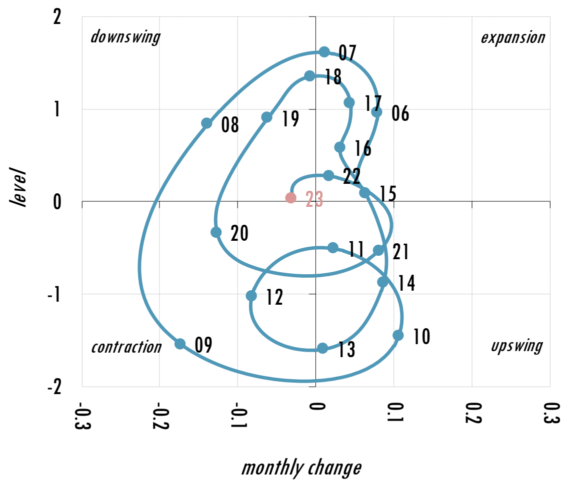
Source: SORS, FC calculations.

Figure 5.7: New orders and capacity utilisation



Source: SORS; FC calculations. Numbers denote first quarter data.

Figure 5.8: Economic climate tracer for Slovenia

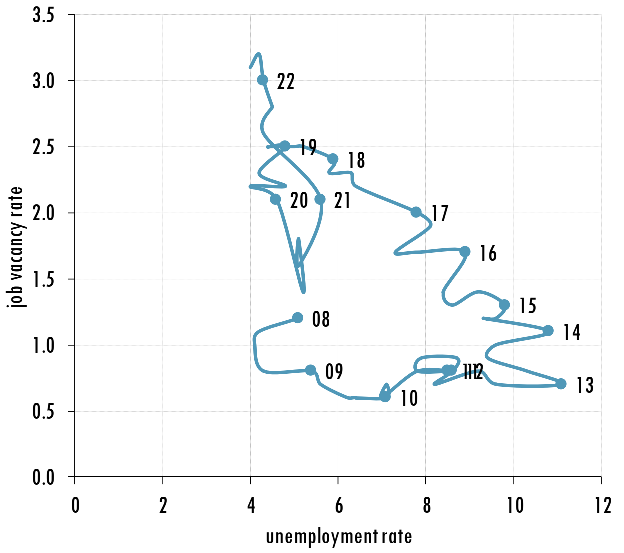


Source: SORS; FC calculation. Numbers denote Janaury data.

At the turn of the year, the level of economic activity remained relatively high. Despite the fact that the majority of indicators point to a somewhat more optimistic picture than in the autumn, the prospects for the dynamics of economic activity this year are fairly moderate. Due to a relatively mild winter, the risks of restricting the business activity of companies, which could arise from limited access to energy sources, have been reduced, while the pessimism of business and of the general population is probably also limited due to the stabilisation of energy prices and fairly broad-based direct and indirect government measures to fight inflation. Since the beginning of autumn, when the majority of confidence indicators were at their lowest level last year, the least improvement in optimism could be found in manufacturing activities, facing a relatively low level of orders, while the improvement in sentiment in the construction and service sectors stands out. While businesses also indicate financial constraints as the limiting factors of their operations, the main factor in increasing the optimism of households is the future financial situation. Businesses quote higher financing costs as a principal financial constraint, although the volume of loans, especially short-term, has increased relatively quickly in the past year, which probably also points to the need to finance the costs of high raw material prices.

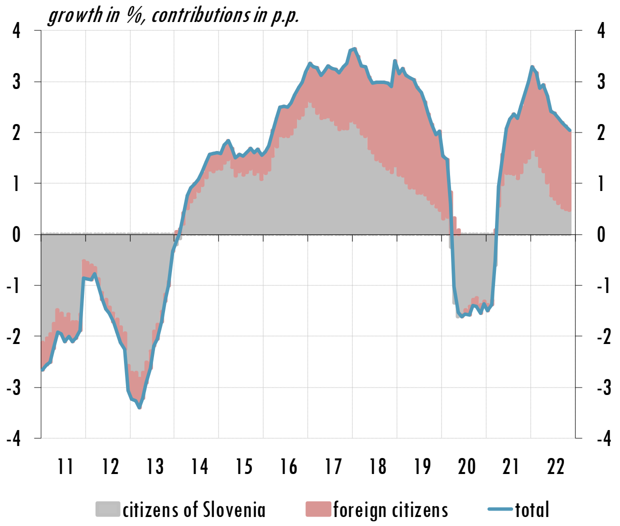
The slowdown in economic activity is reflected in the stagnation of improvement in labour market conditions, which, however, remain solid and at the same time increasingly point to the restrictions that may also result from demographic changes. The increase in employment in the third quarter of last year was only one third of that recorded the year before, but, standing at 0.3%, remained above the long-term average. The number of unemployed and the unemployment rate also decreased last year and reached record low values, but at the end of the year, a stagnation in their dynamics could also be observed, which is probably due more to structural labour market restrictions than to cyclical conditions. The number of persons who have been out of work for less than a year as well as the number of long-term unemployed reached historically low values. At the same time, the vacancy rate[20] twice exceeds the long-term average; this surplus is greatest in the hospitality industry. Businesses have been reporting increasing difficulties in recruiting an adequately qualified workforce for two consecutive years. This problem is the most severe in the construction industry, where, like in service activities, the aforementioned trend slowed down in the second half of last year. The labour shortage is also reflected in the fact that about a three-quarter increase in the active working population at the end of last year was due to the influx of foreign workers. Businesses are less optimistic about employment than a year ago, while the aforementioned mismatches in the labour market and high inflation are encouraging nominal wage growth, which in autumn still lagged behind productivity growth and inflation.

Figure 5.9: Job vacancy rate and unemployment



Source: SORS, FC calculations. Numbers denote first quarter data.

Figure 5.10: Contributions to y-o-y growth rate of the number of persons in employment (excluding farmers)

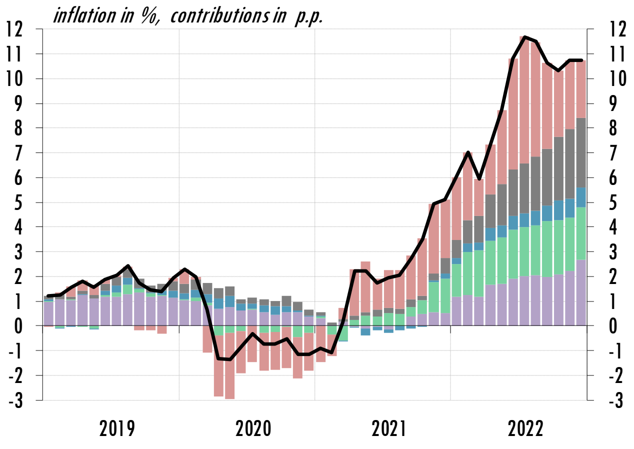


Source: SORS, FC calculations.

Energy price pressures are easing, but overall price growth remains high at over 10%. While the difference between total inflation in Slovenia and inflation in the Eurozone was shrinking last year, the difference in core inflation was increasing. Import prices have been decreasing since the middle of the year, and manufacturing prices, which grew faster on the domestic market than on the foreign market last year, have also stagnated since autumn. This, among other things, points to relatively greater

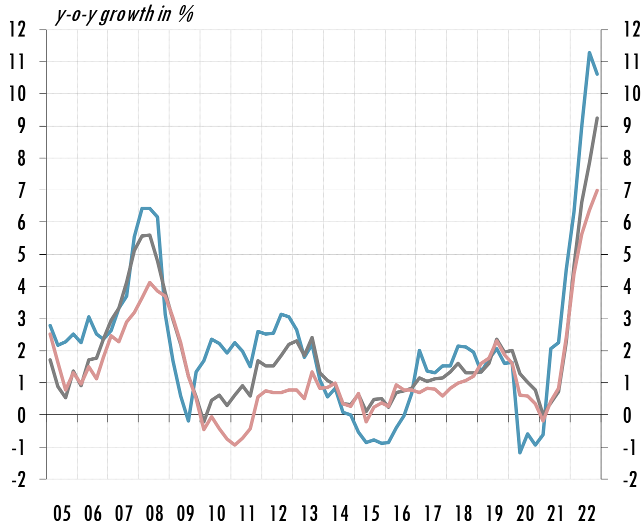
[20] The share of vacancies in total number of (vacant and occupied) jobs.

Figure 5.11: HICP inflation



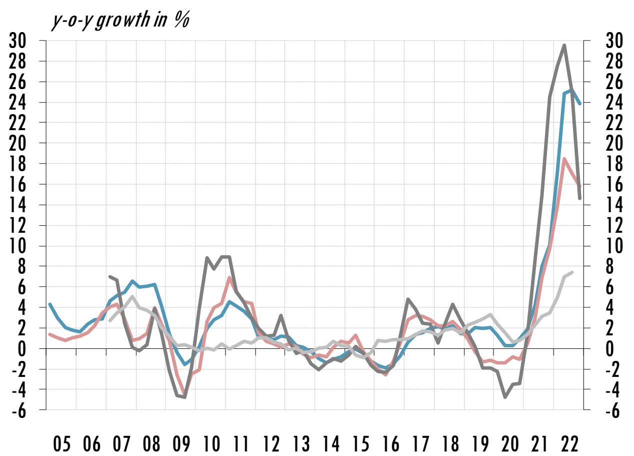
Source: Eurostat, FC calculations.

Figure 5.12: HICP and core inflation indicators



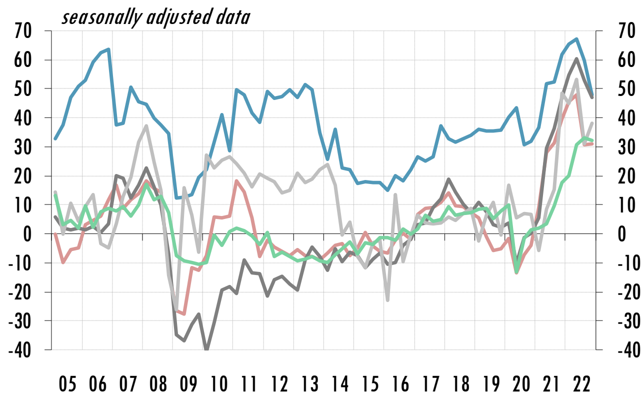
Source: Eurostat, FC calculations.

Figure 5.13: Industrial and services producer price indices and import price index



Source: SORS, FC calculations.

Figure 5.14: Business tendency and consumer surveys - price developments

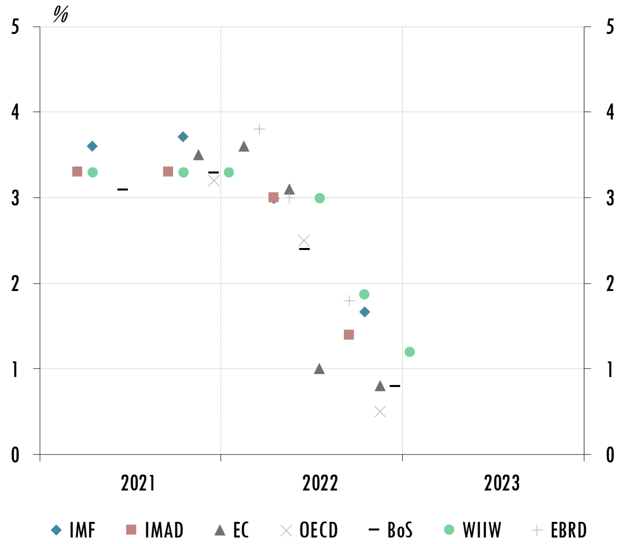


Source: SORS, FC calculations.

pressures of domestic demand and also less competition, although the supply factors and the changed structure of consumption remain the main reason for high inflation. This results in an increased ability of businesses to pass the costs to customers and, at the same time, in their increased profitability. Despite all of the above, future price growth expectations have been decreasing both among consumers and among companies since the middle of last year, with the exception of service industry companies, which expect prices to remain at the current levels.

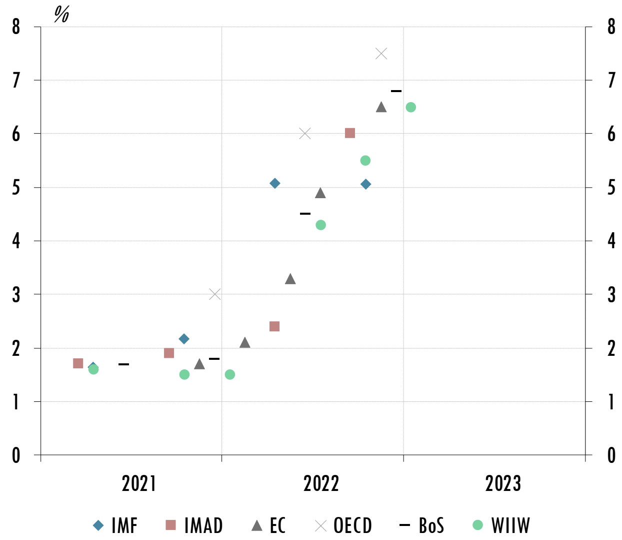
At the end of the year, the economic indicators in Slovenia's most important trading partners were more favourable than previously expected, and the current forecasts show that the Eurozone is likely to avoid recession in 2023. Quarterly GDP growth dynamics halved in the third quarter to 0.3% compared to the dynamics in the first half of the year, while in the last quarter the quarterly growth was only 0.1%. The slowdown was mainly the result of high prices of raw materials or consumer

Figure 5.15: Real GDP growth forecasts for 2023 - Slovenia



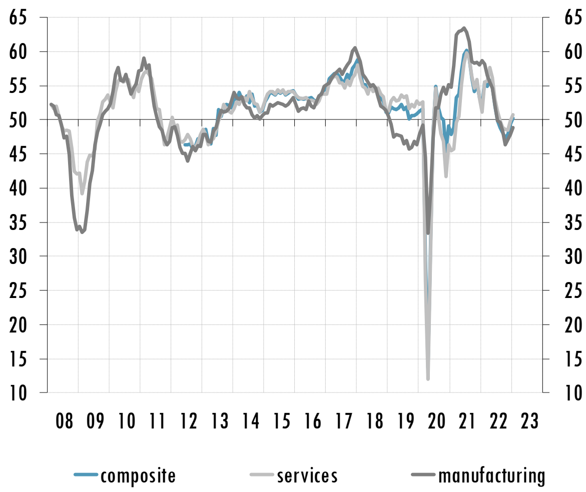
Source: IMF, IMAD, European Commission (EC), OECD, Bank of Slovenia (BoS), WIIW, EBRD.

Figure 5.16: Inflation forecasts for 2023 - Slovenia



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

Figure 5.17: PMI - euro area



Source: S&P Global.

Figure 5.18: Real GDP growth forecasts for 2023 - euro area

Source: IMF, European Commission (EC), OECD, ECB.

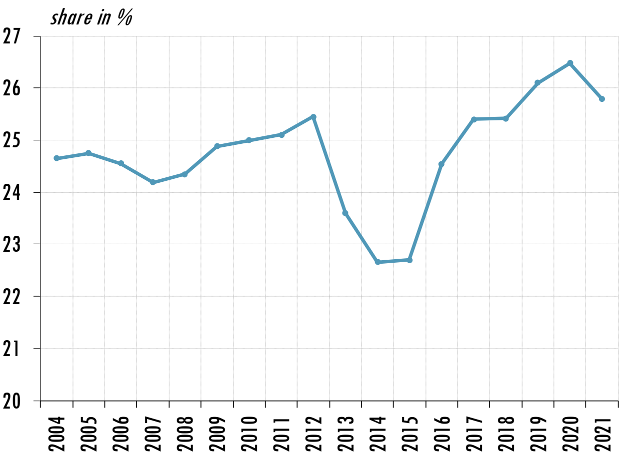
goods, uncertainty, tight financing conditions and low global economic growth. Data for the end of 2022, as a reflection of a tighter monetary policy and an increase in financing costs, confirm a relatively strong slowdown in the volume of loans to the private, especially the corporate, sector. Although economic growth in the Eurozone is expected to be significantly lower in 2023 than in 2022, the rapid decline in the growth forecasts, which persisted throughout the past year, has at least partially come to a halt. This is also consistent with the latest data on aggregate confidence indicators, which, after a prolonged decline, have offered a more favourable outlook at the beginning of this year.

Recent macroeconomic projections for Slovenia for this year are less favourable than projected in the middle of last year. At that time, most projections of real GDP growth in 2023 were set at around 3%, and were then, by the end of the year, lowered to around 1% due to lower expectations regarding final and investment spending by the private sector, which were supposed to be partly compensated by the government spending. In circumstances of the current expected inflation at the level of around 6.5%, this still means a relatively high nominal economic growth, which will be about 2 percentage points above the long-term average, but at the same time much lower than in 2022, when it amounted to around 11%. Inflation forecasts for 2023 averaged around 2% at the beginning of last year, but increased significantly by the end of the year, and the slowdown in inflation in 2024 is expected to be more gradual than anticipated one year ago due to the persisting cost pressures and aggregate demand. The risks to economic activity in 2023 remain high and predominantly negative. Both the Institute of Macroeconomic Analysis and Development and the Bank of Slovenia have prepared alternative scenarios in addition to the latest forecasts, which point to a possible recession in Slovenia in 2023 in the event of negative foreign demand and an additional energy price shock, where deteriorated macroeconomic conditions could lead to more stringent financing conditions. Inflation forecasts are also governed predominantly by risks that could bring about inflation that would be higher than currently expected. The outstanding risks are associated, in particular, with energy prices and additional cost pressures potentially stemming from higher inflation expectations. Existing labour market discrepancies, state interventions in determining wages, energy prices and aggregate consumption, and corporate decisions related to the aforementioned factors regarding the formation of their selling prices could also contribute to such risks.

Box 1: Labour costs in the general government sector[1]

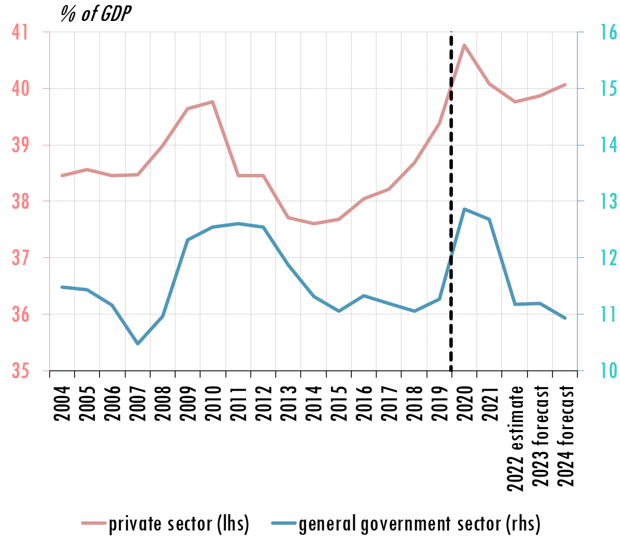
Efficient management of funds for employee compensation in the general government sector is important in terms of both their impact on the sustainability of public finances and ensuring an adequate quality of public services.[2] Employee compensation accounts for approximately one-fourth of total general government expenditure and thus significantly impacts the sustainability of the fiscal situation. With the exception of the 2013-2015 period, which saw a decline in the share of employee compensation in total expenditure as a result of austerity measures, it was fairly constant between 2004 and 2018 (see Figure 1). A general agreement on an increase in wages was adopted at the end of 2018,[3] and work performance payments were freed up in mid-2020 after several years of being frozen, which together contributed to the increase of the share of employee compensation in total expenditure. The share of employee compensation in GDP fluctuated more due to economic crises in the period after 2004, and before the start of the epidemic was only slightly higher than its lowest level in 2007 and 2008 before the introduction of the single wage system (see Figure 2). With the decline in economic activity at the beginning of the epidemic, the share of employee compensation

Figure 1: Compensation of employees share in total general government expenditure



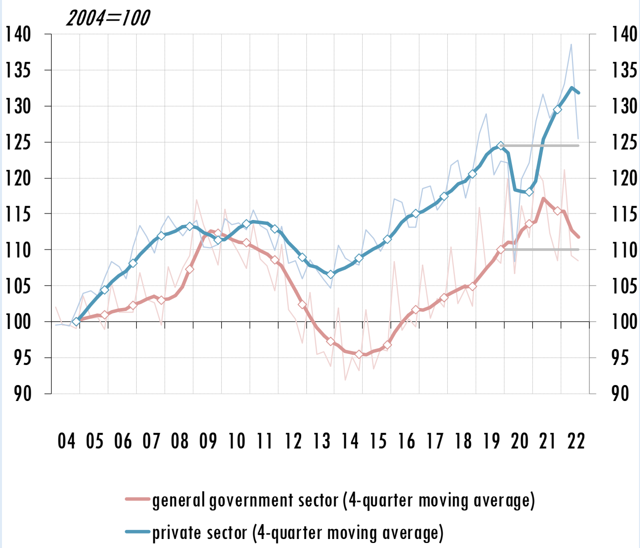
Source: SORS. Note: total expenditure excluding capital transfers to banks 2011-2014 and excluding COVID expenditure 2020-2021; compensation of employees excluding COVID allowances 2020-2021.

Figure 2: Compensation of employees by sector



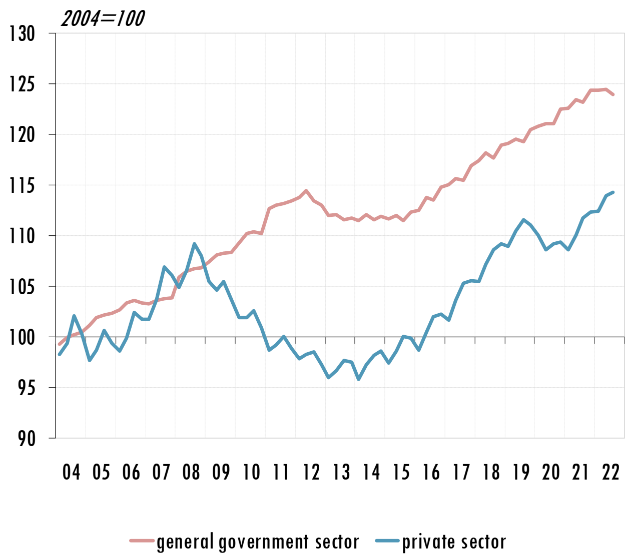
Source: SORS, MoF, IMAD, FC calculations. Note: including COVID allowances.

Figure 3: Real compensation per employee indices by sector (excluding COVID allowances)



Source: SORS, FC calculations.

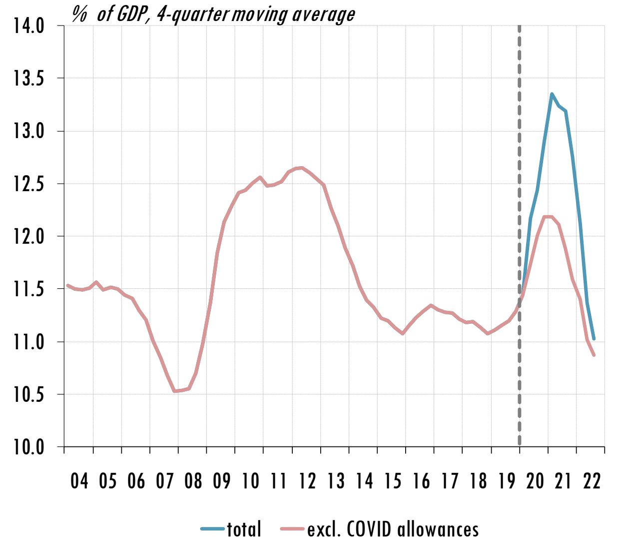
Figure 4: Employment by sector



Source: SORS, FC calculations.

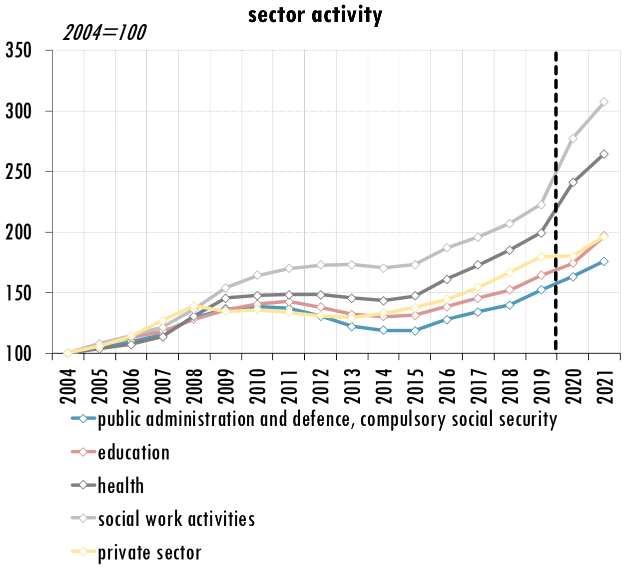
increased significantly, additionally due to the large-scale supplements under anti-COVID measures (see Figure 5), which were paid in a non-transparent manner.[4] Numerous partial agreements from previous years also contributed significantly to increased expectations regarding higher wages.[5] The large number of stakeholders[6] restricts the effectiveness of the negotiation process and, in the light of the preservation of a centralised system for wage determination, allows the possibility of general wage increases even when they are not justified in terms of employee performance or fiscal sustainability. Due to fragmented negotiations, the transparency of the wage system is also reduced.[7] This, together with the regular practice, when, contrary to the Public Sector Wage System Act,[8] wage agreements are mainly reached only after the adoption of budget documents, reduces the credibility of the adopted budget and therefore also the quality of budget planning.[9] At the same time, agreements on wage increases do not include measures that would lead to improving the efficiency and accessibility of public services. On the other hand, during the financial crisis ten years ago, wage incentive payments were frozen for a number of years, which reduced the motivation of employees and further increased the already high proportion of employees with very good and excellent work performance rating.[10] We therefore reiterate our finding from 2019[11] that the public employee

Figure 5: Compensation of employees - general government sector



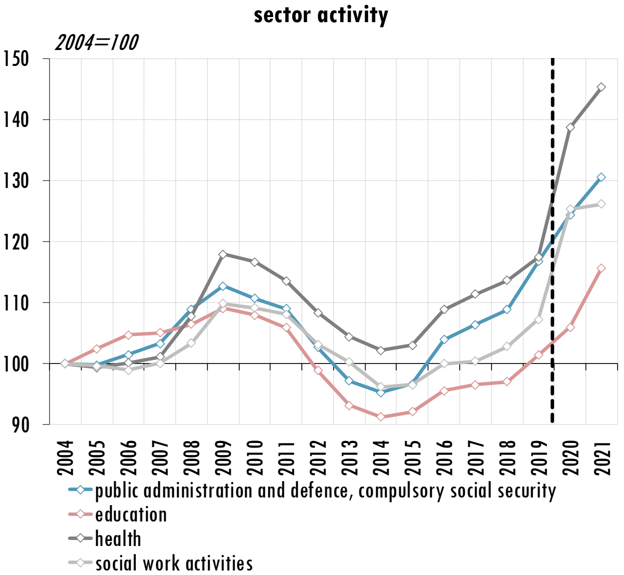
Source: SORS, FC calculations.

Figure 6: Compensation of employees by public sector activity



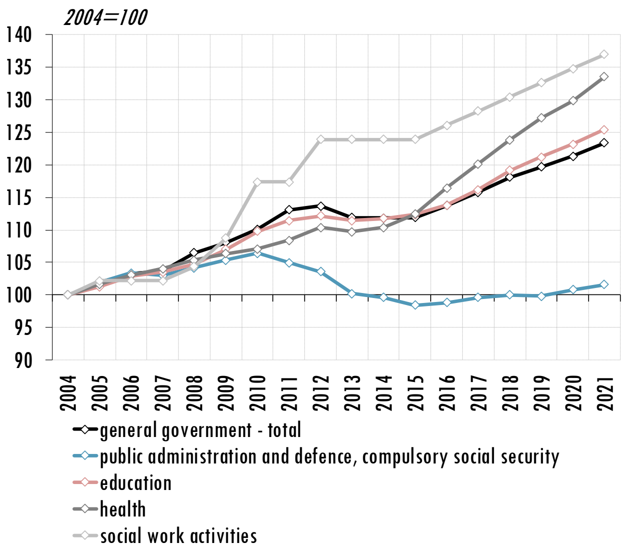
Source: SORS, FC calculations. Note: including COVID allowances as data on COVID allowances are not available by SKD activity.

Figure 7: Real compensation per employee by public sector activity



Source: SORS, FC calculations. Note: including COVID allowances as data on COVID allowances are not available by SKD activity.

Figure 8: General government employment

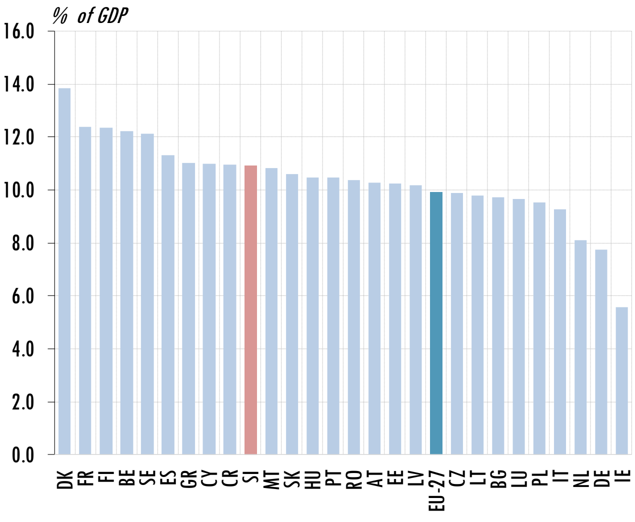


Soure: SORS, FC calculations.

compensation management system is ineffective and we note that the aforementioned problems have been aggravated in the last three years. In terms of its impact on the sustainability of public finances, one of the major shortcomings of the system for managing funds for employee compensation is the lack of emphasis on planning and active management of the number of employees (see Figure 4), considering an otherwise partial and excessively short-term oriented wage adjustment.

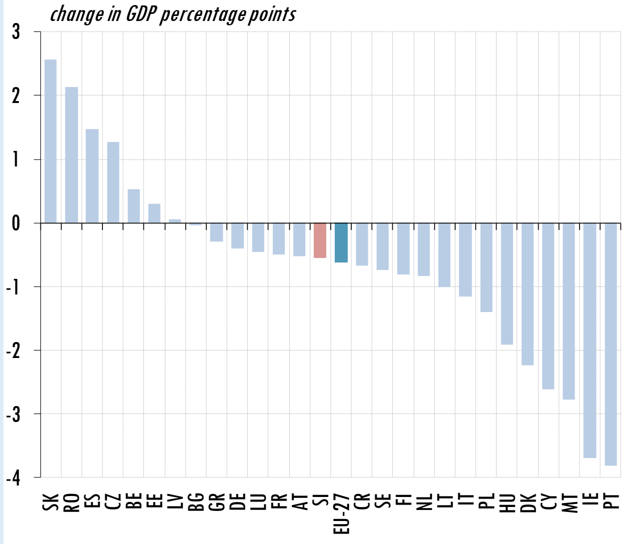
In the scope of public sector activities, trends have been quite diverse in the long term, but after the increase in funds for employee compensation, social care stands out and, due to the relatively larger amount of funds, especially healthcare (see Figure 6).[12] The increase in the amount of employee compensation in social care in the period between 2004[13] and 2019 was mainly the result of an increase in employment, while in healthcare, along with the increase in employment, also the result of an increase in real wages. In the period up to and including 2019, the highest increase in real compensation per employee was in healthcare, administration, defence and compulsory social security services (activity under section O of the Standard Classification of Activities; see Figure 7). At the same time, the largest increase in the number of employees was recorded over a longer period in social care and healthcare activities (see Figure 8), which is partly understandable given demographic changes. In the activity under section O of the Standard Classification of Activities the lowest increase in the volume of funds was recorded in the fifteen years before 2019 in public sector activities despite the second largest increase in real compensation per employee, as there had been no change in the number of employees since 2004. In education, where the increase in the volume of funds was greater than in activity O of the Standard Classification of Activities, it was, to a great extent, the result of growth in employment, as the increase in real compensation per employee was the lowest among public sector activities. The trend in 2020 and 2021, for which data on individual public sector activities is available, was significantly impacted by epidemic-related allowances, which, particularly in healthcare, contributed to an even greater, almost one-fourth, increase in wages in 2020 and 2021. A closer look at the marked increase in employee compensation during the epidemic further confirms our assessment that, due to the changed perceptions of employees regarding the level of income and the rigidity of income down the scale, it was the allowances that significantly contributed to the increase in expectations during the period after the end of the epidemic and, at the same time, to the creation of disparities within the public sector. This particularly applies to healthcare where the highest allowances were recorded. In this regard, it should be noted that the share of the general government sector in total employment in education and healthcare has gradually been decreasing and was approximately 2 percentage points lower in 2021 than in 2004.

Figure 9: Compensation of employees - general government (Q1-Q3 22 average)



Source: Eurostat.

Figure 10: Compensation of employees - general government (Q1-Q3 22/04)



Source: Eurostat.

In relative terms, total employee compensation in Slovenia does not differ significantly from the EU-27 average, but at the same time, the growth in employment in the general government sector in Slovenia is much higher than in the EU average for the last twenty years. The relative amount of funds for employee compensation in the general government sector varies significantly by country. According to the latest available data, the share of funds for employee compensation in Slovenia's GDP was 10.9% on average for the first three quarters of last year, when allowances no longer had a significant impact on these funds. This is the tenth largest share in the EU-27 and 1 percentage point above the average, but it varies considerably from one country to another (see Figure 9). Since 2004, it decreased by 0.6 percentage points of GDP, which equals the EU-27 average (see Figure 10).[14] The changes in the volume of funds for employee compensation varies with regard to the number of employees and the amount of compensation per employee. Data on employment in the general government sector are available for 22 EU[15] Member States, in which employment in the general government sector increased by 5.2% in the period 2004-2019, which is about one fourth of the growth rate in Slovenia (19.6%). At the same time, compensation per employee in the general government sector in Slovenia and in the average of the 22 Member States for which data are available increased by approximately 8% during this period.[16]

In the Fiscal Council's opinion, the projected increase in funds for labour costs[17] for 2023 is included in the habitually unharmonised budget documents and already consistent with the impact of all factors, especially the various arrangements adopted so far (see the table below). According to the Draft budgetary plan from October last year, the increase in funds for employee compensation in the general government sector this year should be around EUR 160 million less than the total increase based on the plans for the each of the four public finance budgetary accounts. The difference may be partly the result of the applied methodology[18] and the different coverage of institutional units[19], partly the result of the still unknown actual implementation in the general government sector in 2022,[20] and partly also the result of inconsistency of budget documents, to which the Fiscal Council regularly calls attention. However, it is estimated that the effect of the various arrangements, measures and other factors adopted so far with an impact on labour costs is within the scope of the projected increase in labour cost expenditure in all four public finance budgetary accounts together. Thus, labour costs in the light of the anticipated state budget revision should not be the cause for any increase in the expenditure ceiling due to the current arrangements. There is a considerable risk of an even higher increase in labour cost expenditure due to trade union demands. It should also be noted that, according to the latest available data, average compensation per employee in the general government sector in the third quarter of last year was in real terms at a similar level to that before the start of the epidemic (see Figure 3). Moreover, the nominal increase in the average wage, as per the general public sector wage agreement concluded last October, will be higher than the expected inflation up until the end of this year.[21] Due to the need to reduce inflationary pressures, wage growth should lag slightly behind inflation. In the light of the forecast of one of the largest deficits sustained at the EU level, the realisation of the risk posed by any additional arrangement could lead to a worsening perception of Slovenia in the financial markets.

Ensuring an efficient and sustainable public sector wage policy is also extremely important for fiscal sustainability in view of the many uncertainties in the macroeconomic environment, the foreseen changes in the EU economic governance system and the long-term challenges of economic policy. From the viewpoint of pursuing a sustainable fiscal policy and taking into account (i) that the real purchasing power of employees in the general government sector will not decrease despite two crises in the last three years, taking into account the arrangements adopted in 2022; (ii) that a number of other anti-inflationary measures affecting also public employees have been adopted; and (iii) the Government's announcements that the wage system reform will be launched in the middle of this year, the Fiscal Council believes that, before the start of the reform, all stakeholders should avoid taking steps that would lead to an additional labour cost increase compared to the situation before the adoption of the 2023 budget documents. The Council therefore appeals for the entire wage reform process to give due weight to its financial impact and, taking into account available resources, to their impact on medium-term fiscal sustainability.

Table: Labour costs (excluding COVID-related allowances)

	2022	2023	23/22 (change in EUR million)
General government sector (DBP Oct. 22)	**6,119**	**6,840**	**721**
Public finance budgets	**5,201**	**6,083**	**882**
National budget[1]	3,569	4,170	601
Municipalities[2]	327	382	55
ZZZS[3]	1,279	1,503	224
ZPIZ[3]	25	28	3
Growth factors			**819**
General agreement for 2023 and 2024 (Oct. 22)[4]	90	451	361
Point 5 of the general agreement (healthcare, nursery school assistants, young researchers)[4]		71	71
Arrangement for healthcare and social assistance (Nov. 21)[5]		123	123
Arrangement for judicial officials (Jan. 23)[4]		8	8
Emergency act for healthcare (Jul. 22)[6]	13	49	37
Funding of clinics for patients without chosen personal doctor (Jan. 23)[6]		9	9
Decree on compulsory health insurance service programmes for 2023 (Jan. 23)[6]		52	52
Effect of regular promotions[7]			79
Effect of increase in employment (assumption 1.0%)[8]			53
Increase of the minimum wage[9]			27

Source: National Assembly, Ministry of Public Administration, Pension and Disability Insurance Institute, Ministry of Labour, Family and Social Affairs, calculations by the Fiscal Council.

Notes:

[1] The current amendment to the state budget for 2023; it includes labour costs and transfers for labour costs to public institutions.

[2] The Fiscal Council's estimate for 2023 based on the assumption of an increase equal to that in the state budget; it includes labour costs and transfers for labour costs to public institutions.

[3] The financial plan adopted for 2023.

[4] Data and estimates provided by the Ministry of Public Administration.

[5] In 2022, the impact of the agreement was financed in the framework of COVID-related expenditure; for 2023 it is assumed that it will be within the limits of regular expenditure.

[6] The Health Insurance Institute's estimate with regard to labour costs.

[7] The impact of regular promotions is estimated at 1.5% of the wage bill.

[8] The assumption of 1% employment growth in 2023; in the five-year period 2017-2021 it was 1.6%, and 1% in the average of the first three quarters of 2022.

[9] The Ministry of Labour, Family and Social Affairs, calculations by the Fiscal Council.

[1] The analysis only deals with the presentation of labour costs and not with their possible feedback impact on other items of the budget or sector, or with their impact on other macroeconomic variables, the estimates of which are necessarily subjective.

[2] The Fiscal Council published a more detailed analysis of long-term trends in employee compensation with an international comparison and an assessment of the effectiveness of the management of funds for employee compensation in the Report on the Fiscal Council's operation in 2018, May 2019 (pages 20-32). Available at: https://www.fs-rs.si/wp-content/uploads/2019/05/Poro%C4%8Dilo-o-delovanju-FS-v-letu2018.pdf.

[3] The agreement also included a salary increase of one salary grade for all public employees in January 2019 (with certain exceptions); additional increases of one salary grade for all public employees in salary grades above 26 was carried out in November 2019 and in September 2020. There was also an increase in the number of supplementary payments and an additional salary increase of one salary grade for some occupational groups. The Agreement on salaries and other payments of labour costs in the public sector is available at: https://www.uradni-list.si/glasilo-uradni-list-rs/vsebina/2018-01-3862?sop=2018-01-3862.

[4] For more information, see Assessments of budget documents for 2022 and 2023, October 2021 (pages 31-34). Available at: https://www.fs-rs.si/wp-content/uploads/2021/10/Ocena-Fiskalnega-sveta_oktober-2021.pdf. See also the audit of the payment of COVID-19-related allowances by public healthcare institutions in 2021 carried out by the Court of Auditors, available at: https://www.rs-rs.si/fileadmin/user_upload/Datoteke/Revizije/2022/Covid-19/Covid-19_ZbirnoP_P.pdf.

[5] Only in 2021, special agreements were concluded with the Police, the armed forces, nurses and social assistance workers.

[6] For example, the number of trade unions in the public sector increased from 27 in 2008 to 46 last year.

[7] See the Ministry of Public Administration's website at https://www.gov.si/teme/placni-sistem/.

[8] Article 5 of the Public Sector Salary System Act determines that negotiations should start no later than 1 May each year and end 30 days before the deadline set for the submission of the draft national budget to the National Assembly.

[9] Reliable medium-term budget planning is one of the foundations of the proposed renewed system of economic management in the EU. See point 3.2 of the Commission Communication available at https://economy-finance.ec.europa.eu/system/files/2022-11/com_2022_583_1_en.pdf.

[10] Regular promotions based on annual work performance evaluation were long one of the few ways of increasing employee wages. The share of employees in state administration bodies with the annual work performance rating "outstanding" and "very good" stood at 78.9% in 2008, rising to 97.4% by 2019.

[11] See footnote No. 2.

[12] In 2019, employee compensation in social care represented only slightly more than 5% of the total volume of public sector activities. At the same time, the share of the general government sector in the total employment in social care was less than 30%.

[13] The choice of base year for comparisons is always subjective. The year 2004 was chosen in order to show data over as long a period as possible, but at the same time it is also a period of relatively stable economic conditions. In most cases, the presented data enable comparison with other base years.

[14] In the same period, the share of employee compensation in the private sector increased (by 0.4 percentage points to 38.9% of GDP).

[15] There are no data available for Bulgaria, Cyprus, Croatia, Malta and Romania.

[16] Deflated by the internationally comparable Harmonised Index of Consumer Prices (HICP). If the National Consumer Price Index (CPI) is used as the deflator, the cumulative real increase in per capital employee compensation in Slovenia was approximately 10%.

[17] Excluding COVID-related allowances, where projections for the general government sector differ considerably from those for the state budget.

[18] The balance sheets of the general government sector are prepared in accordance with the accrual method, where expenditure is recorded as an accrual, and the public finance budgetary accounts are based on the cash flow, where the expenditure is recorded when it was paid.

[19] The amount of employee compensation in the general government sector is about EUR 1 billion greater than total labour costs in the four public financing budgets due to a number of institutional units of the general government sector that are not financed from the aforementioned budgets. As a result, the projected smaller increase in the general government sector than in the public financing budgets implies that the amount of employee compensation outside the aforementioned budgets should be reduced significantly, which is, in our opinion, not realistic.

[20] The Statistical Office will publish data on the general government sector's budget outturn in the last quarter of 2022 on 31 March 2023. The state budget outturn and data on the balance sheet realisation of the general government sector in the first three quarters of last year show that, as expressed by the Fiscal Council in its opinion on the adoption of budget documents in autumn last year, the projections of employee compensation for 2022 were too high.

[21] The cumulative increase in the average public sector salary based on the agreement of October last year following two general increases (October 2022 and April 2023) was 8.7%. Consumer prices increased by 1.8% between September and December last year, and IMAD predicts 3.9% year-on-year inflation for December this year. The general price level is expected to rise by 5.7% in the period between the adoption of the arrangement and the end of this year.